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# ENERGY **ALERT**

## IN THIS ISSUE >

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### Energy boom on the cards for 2021 and beyond

On 15 October 2020, government released the reconstruction and recovery plan of the economy of the country following the adverse impact of COVID-19 to the country's economy. One of government's immediate challenges is to reduce and ultimately solve load shedding. Government identified the creation of jobs through aggressive infrastructure investment, and in order to achieve this objective, it has identified key interventions with one of them being the procurement of secure and reliable energy supply within two years.

### The pursuit of de-carbonisation – proposed changes to the carbon tax regime announced in the 2021 National Budget

In 2020, South African businesses had to pay carbon tax for the very first time. Considering the relative novelty of the Carbon Tax Act 15 of 2019 (Carbon Tax Act), it is understandable that there would be some interpretive challenges and that amendments would need to be made to the legislation to ensure it is implemented as intended. In the 2021 Budget, it was proposed that the Carbon Tax Act be amended in a number of instances.



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# Energy boom on the cards for 2021 and beyond

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Government's plan to rapidly expand energy generation capacity was set out to include, *inter alia,* the following:

- accelerating the implementation of the Integrated Resource Plan to provide substantial increase in the contribution of renewable energy sources, battery storage and gas technology;
- by bringing about 11,813 MW of new generation capacity into the system by 2022. 6,800 MW of this energy will be generated from renewable sources;
- in the immediate term, agreements will be finalised with Independent Power Producers to connect 2,000 MW of additional capacity from existing projects by June 2021;
- the launch of the Risk Mitigation Independent Power Producer Procurement Programme (RMIPPPP), which will unlock a further 2,000 MW of emergency supply within twelve months; and
- the launch and implementation of bid window 5 of the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP).

As an update to the reconstruction and recovery plan, and announced as part of the 2021 National Budget on 24 February 2021, it was stated that three energy projects have been gazetted: the RMIPPPP, the Small Independent Power Producer Programme (Small IPP Programme) and the Embedded Generation Investment Programme. These projects are estimated to create 2569 MW of electricity generating capacity. It is anticipated that the total investments to be funded by private sector to these programmes amount to R52,4 billion.

In respect of the RMIPPPP, the IPP office accepted 28 bid submissions for evaluation on 22 December 2020. According to the IPP Office website, the announcement of preferred bidders is expected to be made by the Department of Mineral Resources and Energy on 31 March 2021. The programme is expected to be operational by the second half of 2022, at an estimated capital cost of R40 billion.

The Small IPP Programme involves the development, installation and operation of a total of 100 MW of generating capacity at an estimated cost of R2,7 billion. The Programme offers opportunities for small and medium sized enterprises and new developers in the renewable energy sector. The target capacity for these projects is to generate and provide



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# Energy boom on the cards for 2021 and beyond*...continued*

The 2021 National Budget also announced that the IPP office will soon initiate bid window 5 of REIPPPP to secure 2,600 MW of wind and solar PV from renewable energy IPPs.

between 1 MW and 5 MW of energy from solar photovoltaic (PV), wind and biomass power. The programme is expected to be operational towards the end of 2022.

The Embedded Generation Investment Programme involves the development, installation and operation of up to 469 MW of solar PV and wind generation projects. The Development Bank of Southern Africa (DBSA) and the Green Climate Fund will administer and manage this programme. According to the DBSA and Green Climate Fund, the programme will be implemented through two components. The first component will provide credit support to private sector solar and wind IPPs established as special purpose vehicles that are backed by non-sovereign offtakers. The second component will provide credit support to special purpose vehicles, which are established and owned by local community trusts (LCTs) and/or SMMEs to support such LCTs and SMMEs in obtaining and managing an equity ownership in local renewable energy projects. This programme has an estimated lifespan of 20 years.

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It should be further noted that on 11 February 2021, in the President's State of the Nation speech, it was announced that Schedule 2 of the Electricity Regulation Act 4 of 2006 will be amended within three months in order to raise the threshold to obtain an exemption to hold a generation licence which is currently 1 MW.

This is certainly the impetus the private sector has been waiting for after years of a lull in the conclusion of utility scale new power generation projects. In order to reinstate some of the investor confidence that may have diluted in the periods of delay in the conclusion of the round 4 REIPPPP projects and the commencement of these next round of programmes, it will be critical for the momentum for development to be maintained in line with government's expedited plan.

*Jay Govender and Ndzalama Dumisa*



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# The upside and downside of the 2021 National Budget for energy companies

In the OECD Paper, it is recognised that statutory corporate income tax rates have been decreasing on average over the last two decades.

**The tax revenue system funds government expenditure in a similar way that the income of a household funds personal and living expenses. In this manner, where a household's personal living expenses continue increasing without the concomitant growth in income, the ultimate result is unsustainable and could result in (for example) defaults on debt and similar consequences. Likewise, National Treasury recognises that Government spending remains too high for the tax base, which has been exacerbated by the recent COVID-19 global pandemic. Government is therefore increasingly focused on a combination of inclusive growth, fiscal consolidation, and a widening of the tax base for purposes of stabilising public finances.**

Interestingly, as per the SARS Annual Report for the 2019/20 financial year, the contribution of corporate income tax revenue as a percentage of overall tax revenue (i.e. also including for example personal income tax and value-added tax) has decreased from 18.9% in 2014/15 to 15.9% in 2019/20. In the Corporate Tax Statistics (Second Edition) published by the OECD (OECD Paper), one of the key insights highlighted was that in 2017, the share of corporate tax revenues as a percentage of total tax revenues is on average 14.6% across the 93 jurisdictions that formed part of the OECD study. South Africa therefore sits a little above the average.

National Treasury, in the 2021 Budget Review Documents (specifically Chapter 4), reference a research study, namely Southern Africa – Towards Inclusive Economic Development (Kemp, 2020) which shows that tax increases have a greater negative effect on growth than reduction of expenditure, and these effects are more noticeable during an economic recession. It is in this context, that it was announced in the 2021 National Budget Speech (Budget) that previously announced tax increases of approximately R40 billion over the medium term have been withdrawn to support the economy. While it was unclear what these increases would exactly be at the time that they were originally announced, this fresh announcement regarding the withdrawal of such increases can be welcomed by companies, as they may have been in the firing line in some way or another.

In the OECD Paper, it is recognised that statutory corporate income tax rates have been decreasing on average over the last two decades. In 2020, the global average combined (i.e. central and other government) statutory corporate income tax rate was 20.6%. The average global statutory tax rate fell by 7.4% from 28% in 2000 to 20.6% in 2020. South Africa sits just above New Zealand on the table, and its rates are higher than some of its key trading partners, including the United Kingdom and the United States. Furthermore, Mauritius has a corporate income tax rate of 15% and Botswana 22%. Compared to some of its immediate

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# The upside and downside of the 2021 National Budget for energy companies*...continued*

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competitors, its key trading partners and the global average, South Africa's corporate income tax rate is relatively high. This makes it less attractive for investment, which ultimately negatively impacts on growth.

Against this background, the Minister of Finance (Minister) announced in the Budget that Government would be reducing the corporate income tax rate over the medium term. This would commence with a reduction from 28% to 27% in years of assessment commencing on or after 1 April 2022. In this way, Government recognises that tax policy must also take into account tax regimes in neighbouring and competitor countries and that the current corporate income tax rate is not conducive to investment and growth.

However, the restructuring of the corporate income tax system is, according to Government, to be undertaken in a revenue neutral manner. Government thus intends on widening the corporate income tax base through various means, including limiting the limitation of assessed losses as well as interest expense deductions. The Minister did, however, announce in the Budget that these two previously announced limitations on the limitation of assessed loss as well as interest expense deductions would be postponed until 2022. This is welcome relief, given the ongoing uncertainty and negative impact of the global COVID-19 pandemic on business profitability.

In addition to the two aforementioned proposals, Government intends on reducing the number of tax incentives available to companies. It is recognised by Government that while the corporate tax rate is being reduced, there needs to be a widening of the corporate tax base by, amongst others, limiting the number of tax incentives available to companies. It was thus announced that those tax incentives that either erode the equity of the tax system or do not meet National Treasury's objectives will be limited or Government will allow them to lapse.

Given the various incentives available in the energy sector (and more broadly), it will be interesting to monitor which incentives National Treasury intends on limiting and/or letting lapse. Some practical examples of the various approaches are discussed below – i.e., relevant incentives that may be limited or allowed to lapse and incentives that will be extended. As a start, some provisions in the Income Tax Act, 58 of 1962 (the ITA), including for example the accelerated depreciation allowances for renewable energy plant and machinery in section 12B of the ITA, do not have sunset dates.

Other incentives, such as the section 12L energy efficiency savings allowance, can currently only be claimed in years of assessment ending before 1 January 2023. Furthermore, it was announced in the Budget that the sunset date for the venture capital regime contained in section 12J of the ITA would not be



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# The upside and downside of the 2021 National Budget for energy companies*...continued*

Energy companies would thus be well advised to keep apprised of developments insofar as the limitation of assessed losses and deduction of interest is concerned as well as the ongoing review of the efficacy of various tax incentives.

extended beyond 30 June 2021. In relation to other tax incentives dealing with airport and port assets, rolling stock, and loans for residential units, a sunset date of 28 February 2022 has been introduced.

On the other hand, the urban development zones and learnership tax incentives will be extended for two years pending completion of their reviews. Furthermore, the tax incentives in relation to Special Economic Zones (SEZs) were extended in the most recent round of tax amendment bills from an initial sunset date of years of assessment commencing on or after 1 January 2024 to years of assessment commencing on or after 1 January 2031.

While the intention of Government to reduce the corporate income tax rate over the medium term to attract investment and increase growth should certainly be welcomed, energy companies should nevertheless keep in mind that the intention of Government is to simultaneously widen the corporate tax base through various means. Energy companies would thus be well advised to keep apprised of developments insofar as the limitation of assessed losses and deduction of interest is concerned as well as the ongoing review of the efficacy of various tax incentives.

*Jerome Brink*

# The pursuit of de-carbonisation – proposed changes to the carbon tax regime announced in the 2021 National Budget

Concerns have been raised that the Carbon Tax Act is unclear as to who is eligible for the renewable energy premium tax deduction.

**In 2020, South African businesses had to pay carbon tax for the very first time. Considering the relative novelty of the Carbon Tax Act 15 of 2019 (Carbon Tax Act), it is understandable that there would be some interpretive challenges and that amendments would need to be made to the legislation to ensure it is implemented as intended. In the 2021 Budget Speech (Budget), it was proposed that the Carbon Tax Act be amended in a number of instances.**

We briefly discuss these proposed amendments here:

### Clarifying renewable energy premium beneficiaries

Concerns have been raised that the Carbon Tax Act is unclear as to who is eligible for the renewable energy premium tax deduction. To address this concern, it is proposed that section 6(2)(c) of the Carbon Tax Act is amended to clarify that only entities that conduct electricity generation activities and purchase additional renewable energy directly under the REIPPP programme or from private independent power producers with a power purchase agreement are eligible to claim the tax deduction for their renewable energy purchases. A formula for calculating the amount of the renewable energy premium, which will be deducted as follows:

*Renewable energy deduction = quantity of renewable energy purchased (kilowatt hour) × rate (rand) for technology, as per the renewable energy notice gazetted in June 2020.*

It is proposed that the amendment is effective from 1 January 2021. Carbon taxpayers should note that as the current carbon tax year runs from 1 January 2021 to 31 December 2021, they would be able to benefit from this amendment, if it is eventually passed and confirmed to apply retrospectively. Based on the wording used in the Budget, it is unclear whether only the purchaser of the renewable energy or both the purchaser and generator of the renewable energy will be able to claim the premium. Currently, section 6(2) states that the renewable energy premium is available to *"a taxpayer in respect of the generation of electricity from fossil fuels in respect of a tax period."*

### Aligning fugitive emissions activities under the Carbon Tax Act

The Carbon Tax Act defines the tax base in terms of:

- section 4(1), where companies use company specific emission methodologies to calculate their greenhouse gas emissions; and
- section 4(2), where country - specific emission factors or default emissions factors prescribed by the Intergovernmental Panel on Climate Change (IPCC) in its 2006 guidelines can be used to calculate emissions. Section 4(2) also sets out formulae for the calculation of, amongst others, carbon tax payable as a result of fugitive emissions.

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# The pursuit of de-carbonisation – proposed changes to the carbon tax regime announced in the 2021 National Budget*...continued*

To address any ambiguity due to the new voluntary carbon budget system, it is proposed that reference to "before the tax period" be replaced with the specific timeframe for the carbon budget (that is, 1 January 2021 to 31 December 2022), as determined by the department.

When the Carbon Tax Act was amended in 2019, IPCC Activity code 1B3 for other emissions from energy production was unintentionally excluded from section 4(2) of the Carbon Tax Act. To ensure alignment between sections 4(1) and 4(2) of the Carbon Tax Act, it is proposed that an additional category be included under the Carbon Tax Act to cover the IPCC code 1B3 activities for other emissions from energy production.

### Clarifying the definition of carbon capture and sequestration

The Carbon Tax Act allows taxpayers to deduct sequestered emissions as verified and certified by the Department of Environment, Forestry and Fisheries (DEFF) from their fuel combustion-related greenhouse gas emissions for a tax period. This covers carbon capture and storage in geological reservoirs and biological sequestration. Government has clarified that for combustion activities where carbon capture and storage technologies are used, the net greenhouse emissions should be reported to the DEFF. Amendments are proposed to:

- prevent double benefits for the same sequestered emissions, by amending the definition of greenhouse gas emissions sequestration to remove carbon capture and storage in geological reservoirs from the scope of the sequestered emissions deduction;
- to address concerns about the permanence of sequestered emissions in harvested wood products and the robustness of the available emissions calculation methodologies. To address this issue, it is proposed that only actual forestry plantation sequestered emissions should be eligible for the deduction under the Carbon Tax Act.

### Progress on waste tyre greenhouse gas (GHG) emissions

Currently, schedule 1 of the Carbon Tax Act is aligned with the technical guidelines of the Department of Environment, Forestry and Fisheries (DEFF), which do not include emission factors for waste tyres. The DEFF will develop appropriate emission factors for waste tyres for possible inclusion in the 2022 Budget.

### Clarifying the carbon budget allowance

Currently, section 12(1) of the Carbon Tax Act permits a taxpayer to claim a carbon budget allowance of 5% if they participate in the carbon budget system during or before the tax period. The DEFF has gazetted the extension of the voluntary carbon budget system, which became effective from 1 January 2021 and ends on 22 December 2022, and the piloting of new methodologies for determining company-level carbon budgets. To address any ambiguity due to the new voluntary carbon budget system, it is proposed that reference to "before the tax period" be replaced with the specific timeframe for the carbon budget (that is, 1 January 2021 to 31 December 2022), as determined by the department.

### Aligning schedule 2 emissions activities and thresholds with the GHG regulations of the DEFF

In September 2020, the DEFF gazetted the amended National Greenhouse Gas Emission Reporting Regulations, including new activities required to report emissions and changes to emissions reporting thresholds.



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# The pursuit of de-carbonisation – proposed changes to the carbon tax regime announced in the 2021 National Budget*...continued*

The proposed amendments will likely be included in the 2021 draft Taxation Laws Amendment Bill, which will likely be published in the second half of this year.

To ensure alignment between the activities covered under the Carbon Tax Act and the amended regulations, certain changes are proposed to schedule 2 of the Carbon Tax Act, with effect from 1 January 2021.

| Changes in regulations | IPCC activities |
|---|---|
| Change to the threshold | • 1A2m - brick manufacturing: threshold change from 4 million to 1 million bricks/month.<br>*Emissions now reportable:*<br>• 2A4a - ceramics, 2A4b - soda ash, and 2A4d - other (production capacity ≥ 50 tonnes/month);<br>• 2B10 chemicals industry other (production capacity ≥ 20 tonnes/month);<br>• 2C7 metal industry other (production capacity ≥ 50 tonnes/month); and<br>• 2G1B electrical equipment (production capacity ≥ 50 kilograms/year). |
| Inclusion of new activities | • 1A2n - manufacture of ceramic products by firing, in particular roofing tiles, tiles, stoneware or porcelain (production capacity ≥ 5 tonnes/day). |
| Exempted activities now reportable to the DEFF | • 3A2 - manure management (threshold: 40,000 places for poultry);<br>• 3C1a - biomass burning in forest lands, 3C4 direct nitrous oxide emissions from managed soils, and 3C5 indirect nitrous oxide emissions from managed soils (owning ≥ 100 hectares of plantation);<br>• 3D1 harvest wood products (harvest wood products produced from timber harvested from forest owner registered for reporting [see threshold defined in 3B1a and 3B1b]); and<br>• 5B other (none). |

The proposed amendments will likely be included in the 2021 draft Taxation Laws Amendment Bill, which will likely be published in the second half of this year. Stakeholders and parties potentially affected by the amendments should keep an eye on the release of the draft legislation, as they will be given an opportunity to comment on the draft legislation and raise any concerns they may have.

*(Note: A shorter version of this article was originally published in* [CDH's 2021 Special Budget Speech Alert]*)*

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**BBBEE STATUS:** LEVEL TWO CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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