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TAXING FOR SUSTAINABILITY:

Assessing the competition
implications of ESG-driven
tax incentives

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Introduction

Decarbonisation is no longer driven by environmental policy alone; it is increasingly shaped by tax systems and state support measures.

▶ **A**cross jurisdictions, governments are using tax incentives, targeted rebates, and subsidies to accelerate the transition to greener economies. Yet, while these instruments are designed to correct market failures and incentivise sustainable practices, they do not operate in a vacuum. The uneven allocation of tax burdens and benefits can subtly, but materially, reshape competitive dynamics.

This article explores the tension at the intersection of ESG-driven tax policy and competition law. It considers how well-intentioned measures may distort markets by conferring selective advantages, raising barriers to entry, and entrenching incumbents' market position.

Potential negative competition effects of ESG taxes

ESG-related taxes are often Pigouvian taxes, being primarily premised on changing behaviours and ensuring that the price of an activity reflects its full social cost. A key example of this type of tax is the South African Carbon Tax, which relies on the 'polluter-pays-principle' as its design cornerstone. Another example is the plastic bag levy. However, these types of taxes are effectively imposed on certain market participants but not others, with the result being an asymmetric cost burden that may distort the competitive playing field.

In South Africa, the Carbon Tax Act, 15 of 2019 ("Carbon Tax Act") incorporates sector-specific phase-in allowances and trade-exposure rebates that can effectively reduce the tax burden for certain firms, while others remain fully exposed. This effectively results in a 'punishing' effect for some non-green market participants who may, from a competition perspective, be efficient firms who promote product innovation and drive overall prices down across a sector, but who are now subject to additional costs in an arbitrary policy attempt to address environmental impact generally.

Apart from the immediate tax consequences that might disadvantage such a firm in the short term, this may also ultimately lead to increased fixed costs to upgrade to greener technologies that may not necessarily be more efficient or cost-effective from an output perspective when compared to current non-green technologies. This could, in turn, give rise to uneven cost increases across competitors within a sector and, ultimately, to wholesale price increases that are driven not by competitive market dynamics but by distorting regulatory and policy considerations.

These types of wholesale price increases are contrary to the purpose of the Competition Act, 89 of 1998 ("Competition Act"), which seeks to ensure that markets are competitive, prices are low, and consumers have freedom of choice.

Selective exemptions may also entrench incumbents that benefit from preferential treatment and a larger balance sheet to accommodate green technology conversions, while newer or smaller entrants are left to bear the full cost burden of entry, along with added tax cost hurdles. This may have the inadvertent effect of deterring entry into a market, raising entry barriers, reducing consumer choice and entrenching market concentration. This may also go against the Competition Act's public interest mandate, as it may stifle entry by small and medium-sized enterprises and those owned by historically disadvantaged persons.

An EU competition perspective—State aid

Although not a feature in the South African Competition Act, European Union (EU) legislation prevents governments or public authorities of member states from providing 'state aid' to certain industries/companies that would result in distortions of competition in the European market. For example, the Spanish government cannot give financial support to assist citrus farmers, which would place them on an uneven playing field when compared to other citrus farmers in the EU. If this were to occur, it would undermine the very objective of the EU's various treaties, which is to form a single, common market where companies across the EU can freely trade with one another on equal terms.

As seen in the above example, market distortions arise where certain companies receive state support while others do not, conferring a relative competitive advantage on the beneficiaries. In turn, supported companies may face reduced pressure to operate efficiently and maintain competitiveness. On the other hand, state support can also revitalise less efficient companies that might otherwise have exited the market but for the aid. Although this support may benefit the public interest by saving jobs, it may undermine competition overall by keeping inefficient competitors active in markets where market forces suggest that they should exit.

Subsidies represent a specific form of state aid assistance and may include mechanisms such as direct grants, tax incentives, or preferential loans. Although these measures are typically designed to stimulate growth or support underperforming sectors, they can also lead to distortions in competition if they are not carefully structured and applied.



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► Should a member state wish to provide state aid to certain companies or industries, an application needs to be made to the EU Commission before the aid can be provided. Article 107 of the Treaty on the Functioning of the EU (TFEU) prohibits any form of selective advantage granted by national public authorities to companies, unless such treatment can be justified on exceptional grounds. One exception is provided under Article 107(3)(b) and (c) of the TFEU, which considers aid compatible with the internal market where it is intended to remedy a serious disturbance in the economy of a Member State (or across the EU economy) or in order to facilitate the development of certain economic activities. Support for green initiatives has been found to fall within these categories and to warrant state aid.

In 2025, the EU released its Framework for State Aid Measures to Support the Clean Industrial Deal ("EU Framework"). The EU Framework reflects a policy shift towards accelerating the deployment of renewable and low-carbon energy in a cost-efficient manner, allowing governments and public bodies the ability to cover the costs associated with making the green transition while ensuring that competition across the EU is carefully considered. The EU Framework has relaxed and simplified the conditions under which state aid is granted for green initiatives and caters for a range of state instruments, including direct grants, tax advantages (such as tax credits), as well as loans or guarantees, subject to specified caps and limitations. ►

- ▶ However, these initiatives need to be applied with caution, especially when it comes to the intersection of tax and competition. This intersection is no more prevalent than in the famous case involving the tech giant Apple, in which the European Court of Justice (ECJ) held in September 2024 that certain tax rulings and tax treatment of Apple's activities in Ireland amounted to illegal state aid.

Towards a unified policy approach

State aid, such as tax incentives, can influence the behaviour and incentives of companies, particularly in circumstances where market failures, such as adverse effects on the environment, would naturally occur but for the aid. Put differently, without various policy incentives (be it tax or otherwise), many companies would not ordinarily move towards green alternatives because of the additional costs attached to the transition, coupled with the fear that competitors may not do so and reap the commercial rewards from doing so. Sector-specific regulation, together with incentives such as ESG tax breaks, is a noble attempt to level this playing field to ensure that companies across a sector play by the same rules to achieve a sustainable future.

In crafting these multi-pronged solutions, however, legislatures do not necessarily consider the impact that these incentives may have on competition generally, or, at the very least, across various sectors.

Unlike the EU, these considerations are not mandatory in the South African context, potentially resulting in negative externalities (such as harm to the environment) being favoured over efficient market outcomes, potentially resulting in consumers themselves or non-green competitors footing the bill for noble green initiatives. Non-subsidised firms, despite potentially being more efficient or innovative, may be deterred from entering, lose market share, or be forced to exit altogether.

Such legal subsidies also raise a jurisdictional question where the South African competition authorities may be less inclined to prosecute companies under the Competition Act that are complying/benefitting from other laws or policy outcomes. The South African competition authorities also do not, as a general rule, bring legal challenges, such as reviews, against legislation that falls outside of the Competition Act. Although these competition authorities, like any other stakeholder, have the right to provide comments on new legislation that may impact competition, it remains unclear whether the legislature actively engages with the competition authorities during the legislative process or examines their views (if they provide any) with the necessary vigour when passing such legislation.

In order to ensure that competition issues are more actively considered when determining potentially discriminatory subsidies in the form of tax incentives, exemptions or exclusions, it would, as a first step, be beneficial if the South African competition authorities were more actively involved in the policy-making process to help ensure that adverse market outcomes are avoided while still pursuing the noble objective of incentivising sustainable business practices.

