

# Joining the Greenies tax wagon

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**S**outh Africa has joined recent world wide efforts to reduce harmful greenhouse gas emissions. The Taxation Laws Amendment Act (17 of 2009) inserts s12K into the Income Tax Act (58 of 1962), which provides an incentive for companies that reduce their greenhouse gas emissions by exempting the sale of Certified Emissions Reductions from tax.

SA's greenhouse gas emissions rank in the top 20, contribute 1,8% to global emissions and are responsible for 42% of Africa's emissions. The green approach adopted by government is in line with the Kyoto Protocol, an international treaty which came into force in February 2005 and which aims to achieve a certain level of reduction of greenhouse gas emissions by 2012. This is in the hope of delaying the effects of global warming. The Kyoto Protocol provides mechanisms to ensure that developed countries, which are signatories to the protocol, meet their emission reduction targets. One such is the Clean Development Mechanism (CDM) which ensures the participation of developing countries in the global carbon reduction market.

CDM projects are available only in developing countries and are focused on ways to achieve emissions reductions. A project is eligible for these benefits if it will result in a net decrease in greenhouse gas emissions. This is called additionality (that is, a CDM project is additional if emissions are reduced below those that would have occurred in its absence).

The Kyoto Protocol allows approved CDM projects to yield Certified Emission Reduction Credits (CERs) which are awarded by the CDM Executive Board in the form of certificates. CDM projects in developing countries may then sell these CERs to developed countries which may use them to meet their emission reduction obligations. Income earned from the sale of the CERs may then be used to top up the funds for the CDM project.

The legislation exempts from normal tax 'any amount received by or accrued to or in favour of any person in respect of the disposal by that person of any CER derived in the furtherance of a qualifying CDM project carried on by that person.' Both the terms 'CERs' and 'qualifying CDM projects' are defined in the Act.

To be a qualifying CDM project under SA law, the project requires both registration with the United Nations Framework Convention on Climate Change (UNFCCC) and South African approval in the form of a letter issued by our Designated National Authority; the South African Department of Energy.

s12K is deemed to have come into operation on February 11 2009. The provision provides an incentive to disposals of CERs occurring on or after that date and in respect of CDM projects registered on or before December 31 2012.

When the Draft Taxation Laws Amendment Bill of 2009 was first made public, many concerns were raised as to the tax treatment associated with the disposal of CERs. Among the concerns were the cross-border tax implications arising from the sale of CERs to other developed countries, the value-added tax (VAT) implications for buyers and sellers as well as the tax treatment of expenditure incurred in the implementation of a CDM project.

It appears that SARS' approach to the income tax treatment resulting from trade in CERs is that amounts received on disposal (or anticipated disposal) of the CERs are exempt from normal tax and capital gains tax. The exemption is also said to



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apply to distributions in specie. Furthermore, as there is no receipt of taxable income on the disposal of the CERs, the value of the CERs held by a CDM project will not be taken into account as opening or closing trading stock. Since income earned from the sale of CERs will be “exempt” income, there are concerns that expenditure incurred in developing a CDM project will not be deductible based on the reasoning that it is expenditure incurred in the production of exempt income.

The view taken by SARS with regard to the VAT treatment of CERs is in line with the approach adopted

by countries such as the United Kingdom, namely that the supply of CERs is a supply of ‘services.’ In line with normal VAT principles, the supply of CERs will be zero-rated because the supply to industrialised countries will constitute an exportation of services.

The introduction of mechanisms to curb the output of carbon emissions has arisen from the need to address climate change and global warming. The fixed rate of allowable emissions and the resultant trade in emissions serves as a benefit to the environment in that companies have to pay for the right to pollute thus ensuring a certain predictable environmental outcome. Emissions’ trading has also proved considerably appealing to private industries in that by decreasing emissions, firms stand to profit by selling their excess greenhouse gas allowances. This directly benefits the environment as creating such a market for pollution could potentially drive emissions reductions below expected targets.

Some 190 countries will be meeting at the United Nations climate change conference in Copenhagen in December to discuss a new climate treaty set to replace the Kyoto Protocol which will expire in 2012. This conference will provide much needed clarity on how carbon emissions will be handled in future. SA’s Environmental Affairs Minister, Buyelwa Sonjica,

announced that, while SA is in favour of reduction initiatives, it will not commit to a target for the reduction of carbon emissions as it would be unrealistic for developing countries to commit to these.

Current legislation already allows for an accelerated depreciation allowance of 50:30:20% for investments in renewable energy, such as wind-farms, and biofuels production. More simply put, the legislation allows taxpayers generating electricity to qualify for an immediate tax deduction for half the cost of the ‘equipment’ in the year that it is put into use. The balance of the cost is depreciated over the next two years. In addition to this existing incentive and the carbon emissions incentive discussed, SARS has further acknowledged its support for the environment and SA’s need to become more energy efficient in the interest of the sustainability of its resources, by introducing an incentive which provides an allowance for energy efficiency savings and so too, investments in energy efficient technologies.

s12L, introduced by the Act, will entitle taxpayers to claim a notional allowance for income tax purposes for all forms of energy efficiency savings resulting from activities in the production of income. One of the primary requirements for companies to benefit from this tax incentive is that they need to use independent and registered Measurement and Verification (M&V) professionals.

An energy efficiency savings certificate is a prerequisite to claim the allowance and can only be attained following the M&V process. Energy efficiency savings will be determined by the professionals using standardised baseline methodology. This process measures the energy use of a consumer before the implementation of an energy efficiency project, and again after its implementation. These two measurements, the actual and the baseline, are then compared to determine the savings achieved.

A proper analysis of s12L cannot be undertaken at this point as many of the requirements are dependent on the Regulations which have yet to be issued by the Minister of Energy in terms of the National Energy Act (34 of 2008). Furthermore, s12L will only come into operation on a date determined by the Minister of Finance by notice in the Gazette. ♦

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