Press release. Will tax incentives encourage a future of sustainable energy for South Africa? South Africa has the good fortune of possessing many renewable energy sources that remain largely untapped, wind and solar energy being among them. In the longer term, these two leading renewable technologies have the greatest potential with little or no negative impact on the environment as, once they are built, they draw on a free source of energy. However, despite abundant renewable energy sources, developing sustainable markets for renewable energy technologies presents complex challenges as financial, institutional and informational obstacles often hinder advancement.

A 2003 White Paper on Renewable Energy estimated that the upper limit of wind energy available to be captured in South Africa is 3 GW. Wind power is generally good along the entire coast when it comes to solar resources and South Africa experiences some of the highest levels of solar radiation in the World. The average daily solar radiation in South Africa varies between 4.5 and 6.5 kWh/m^2, compared to about 3.6 kWh/m^2 for parts of the United States and about 2.5 kWh/m^2 for Europe and the United Kingdom, and the areas with the most solar potential are mainly in the north of the country including portions of provinces in the Northern Cape and North West.

Mansoor Parker, a tax executive at Edward Nathan Sonnenbergs, says, “The key question facing developers of renewable energy projects, is whether their cost of capital will be low enough to allow them to generate electricity for less than R1.25 a kilowatt hour or R2.10 a kilowatt hour, for wind and solar energy respectively, as per the current feed-in tariffs that were approved by South Africa’s National Electricity Regulator in March this year.”

“However,” Parker continued, “tax incentives, if properly structured, can play a valuable role and taxpayers wanting to generate electricity of not more than 30 megawatts, from wind, sunlight, biomass and gravitational water forces, qualify for an accelerated depreciation allowance.” This allowance cannot be claimed on any equipment that is used for transmitting or distributing electricity and is only to be used for equipment that actually *generates* electricity. Biofuel production is subsidised through a similar accelerated depreciation allowance. South Africa’s Income Tax Act distinguishes between two types of biofuels, bio-ethanol and bio-diesel and Biomass is defined as comprising organic waste, landfill gas or plants.

The allowance tries to encourage entry into the market by targeting technologies where the initial cost is the biggest deterrent. Parker says that, “In renewable energy projects, especially wind, the biggest cost is the turbines as sometimes developers are required to make down-payments well ahead of the start of the project. However, the payment obligations for these developers is eased somewhat as the Income Tax Act allows them to purchase ‘machinery, plant, implements, utensils or articles’ or more simply “equipment” for commercial use”. Taxpayers that generate electricity or biofuel, qualify for an immediate tax deduction of half the cost of the equipment in the year that it is used, with the balance of the cost being depreciated over the next two years and the allowance is then an offset against taxes the taxpayer would otherwise have to pay. The cost of the equipment also includes the installation or erection costs.

There is flexibility in terms of who receives the allowance and there is also no phasing-out time period for using the allowance, unlike in the United States where the 'on-again, off-again' status of certain tax credits hindered renewable energy project development.

Legislation allows the allowance to be claimed against the 'cost' of the machinery which is usually the actual cost to the taxpayer. However, the revenue authority is allowed to substitute an arm's length price if the cost price is less than the actual cost to the taxpayer. In addition, there is no need for the parties to be related or connected for this to happen.

"However," Parker cautions, "A downside with claiming the allowance, is that it will be recaptured if the equipment has been bought to replace equipment that has been damaged or destroyed. Other than an exception made for assets that were bought on an instalment credit agreement, there is no leeway for taxpayers claiming accelerated depreciation if they are not, in fact, the owners of the assets".

This particular allowance is part of a mix of policy initiatives that complement other implemented strategies to create an encouraging environment for South Africa's renewable energy targets. end

ENS (Edward Nathan Sonnenbergs) is based in South Africa and is the largest full-service law firm in Africa.

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