

# **FIRST DRAFT CARBON TAX BILL 2015**

## **RESPONSE DOCUMENT**

**December 2017**

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## DRAFT CARBON TAX BILL 2015

### THEMATIC SUMMARY OF COMMENTS AND DRAFT RESPONSES

#### 1. BACKGROUND

##### 1.1 Process

The National Treasury published the first Draft Carbon Tax Bill and Explanatory Memorandum for public comment and further consultation on the 2<sup>nd</sup> of November 2015. The Draft Carbon Tax Bill is the culmination of stakeholder consultations and revisions to the policy, since the publication of the Carbon Tax Discussion Paper in 2010, the Carbon Tax Policy Paper in 2013, the Carbon Offsets Paper in 2014, the Draft Carbon Tax Bill in 2015 and draft Regulation on the Carbon Offset in 2016.

##### 1.2 Public comments

The closing date for public comments was 15 December 2015. Several respondents requested extensions and comments were considered until March 2016. Ninety-one (91) written submissions were received from a wide range of stakeholders including companies, industry associations, non-governmental organisations, government departments, state-owned entities, academia, individuals, international organisations and consultants. The second Draft Carbon Tax Bill takes into account written comments and inputs received during consultations held with affected stakeholders since 2016.

#### 2 POLICY ISSUES AND RESPONSES

The comments received were analysed and divided into two main categories:

- Carbon tax policy and design issues; and
- Technical comments on the legal and administration aspects of the bill.

The comments on the carbon tax policy and design are summarised according to the following themes:

- Revenue recycling
- Electricity price and electricity levy
- Pass through of the carbon tax for the liquid fuel sector, non-stationary transport emissions and taxation of aviation fuels
- Allowances focusing on the trade exposure, offsets and performance allowance

- Alignment of the carbon tax with the carbon budget
- Carbon tax modelling and the socio-economic impacts of the carbon tax
- Carbon pricing, emissions trading, and timing of the introduction of the tax
- Carbon tax rates and thresholds for phases 1 and 2

### 2.1 Revenue recycling

#### 2.1.1 Earmarking of revenues

##### COMMENTS:

The carbon tax policy provides for the recycling of the carbon tax revenues through mechanisms such as a reduction in the electricity generation levy, credit rebate for the Renewable Energy Premium, and energy efficiency savings tax incentive. Respondents noted that the first draft Bill does not include a commitment for revenue recycling and there are concerns that this concession may be excluded in the future.

- It is requested that the Bill confirms that the carbon tax will be revenue-neutral and that clear guidelines be developed to inform how the revenue will be allocated to ensure transparency, improved energy management and environmental quality.
- Several respondents support the explicit earmarking of the carbon tax revenues and that there should be annual reporting on the use of the funds.
- Additional revenue recycling measures were also proposed including: Funding the electrification of currently un-electrified households in support of meeting South Africa's developmental goals; financial support for the rollout of smart metering (required to enable return flows of rooftop solar to the grid); that the modal shift of freight from road to rail and pipeline to be included in the revenue pool from revenue recycling, and in the absence of guidelines, rewarding of tax credits of each tonne of carbon abated by shifting freight from road to rail and pipeline is recommended.

##### RESPONSE:

In general, the rigid earmarking of specific tax revenue streams are not in line with sound fiscal management practices. However, based on the economic modeling analysis undertaken, the efficient and effective recycling of revenue will be vital for the required structural adjustment to support the transition to a low carbon, climate resilient economy. The three categories of revenue recycling mechanisms proposed are:

- *tax shifting*: reducing or not increasing other taxes (credit for the electricity generation levy)
- *tax incentives*: including the Energy efficiency savings tax allowance
- *“soft” earmarking (on budget allocations)*: enhanced free basic energy / electricity programme, improved public transport

The energy efficiency savings tax incentive was implemented in November 2013 and is encoded in legislation as section 12L of the Income Tax Act. The credit for the renewable energy premium is already incorporated in the Draft Carbon Tax Bill. In the absence of a carbon tax, the electricity levy is currently fulfilling the twin objectives of promoting energy efficiency and indirectly pricing greenhouse gas (GHG) emissions. To ensure the effective pricing of carbon without double taxation, upon the introduction of the carbon tax, a credit or reduction of the electricity generation levy is proposed for the first phase (up to 2022). Currently, some of the revenues from the electricity levy are also used

for energy savings measures such as the rollout of solar water heaters / geysers previously included in the electricity tariff; and rehabilitation of some of the roads that are damaged due to hauling large volumes of coal using trucks in one of the Provinces.

Other revenue recycling measures will be done through on budget allocations in the usual transparent way such allocations are done. Additional suggested revenue recycling measures proposed are noted and will be considered, should there be surplus revenue from the carbon tax after the fore-mentioned revenue recycling measures, as part of the on budget support mechanisms.

### 2.1.2 Electricity price and electricity levy

#### COMMENTS:

The proposed reduction of the electricity generation levy which applies to non-renewable, fossil based electricity generation at the rate of 3.5c/kWh is supported. However, clarity is requested on the amount by which the electricity levy will be reduced to help companies determine their actual tax liability. The following concerns were raised on whether electricity price neutrality can actually be achieved through reductions in the electricity levy:

- It is argued that the current electricity levy charged by Eskom amounts to 4.1 c/kWh whilst the carbon tax that will be applied to Eskom will be 4.8c/kWh assuming only a 60 per cent tax free allowance.
- It is recommended that the electricity sector should be granted a higher tax free threshold in order to achieve the desired neutrality. The removal of the electricity levy only will not result in electricity price neutrality.

The issue of double taxation has also been raised and it is argued that the electricity generation levy and the Renewable Energy Independent Power Producer Procurement Programme are comparable to carbon taxes. Thus, there are requests to either remove both these components or implement only the carbon tax.

#### RESPONSE:

It is important to note that the real electricity tariffs in South Africa have been stagnant or declining for most of the period between the late 1980s and 2007 due partly to the excess generation capacity. This promoted the inefficient use of electricity due to very low electricity prices, provided little or no incentive for improving the efficiency of energy use and therefore placing the economy on a more energy and carbon intensive growth path. Besides the relatively low electricity prices from a 'pure' financial perspective, no consideration was given to take into account the full economic costs of generating electricity including the environmental damage costs associated with local air pollution and GHG emissions.

Since the beginning of 2008, it became clear that the demand and supply balance has shifted and that the need for additional and cleaner electricity generation capacity is required. Significant increases in electricity prices since 2008 has been noted as a concern, although electricity prices in South Africa are still relatively modest, and the intermittent load-shedding has impacted negatively on economic growth. The electricity generation levy was introduced as one of a range of demand side management tools to deal with some of the supply challenges facing the electricity sector as well as a proxy carbon tax. Some of the revenues from this levy are used to fund the solar water heater programme and rehabilitation of roads damaged due to coal haulage.

It is clear that the transition to a period of more cost reflective tariffs, including environmental costs is necessary, but will have to be carefully managed.

It should be noted that the electricity levy is currently 3.5 c/kWh. NERSA allows Eskom an effective higher pass through due to losses in transmission and distribution.

As per the explanatory memorandum:

Section 6 (2) of the Draft Carbon Tax Bill deals with the calculation of the tax liability by entities that generate electricity taking into account the generation of electricity from renewable energy source as guided by the Integrated Resource Plan (IRP). This section outlines a formula that will be used to calculate the tax liability of electricity generation plants and at the same time providing a credit for the actual (calculated) implicit carbon price in any given year that is based on the actual renewable energy “premium” (e.g. wind, solar and small-scale hydro) in the electricity prices.

This credit will reduce the impact of the carbon tax on electricity prices and will avoid the so-called “double taxation”. The credit will be calculated annually and an estimate of this premium will be consulted on and agreed with the DoE Renewable Energy IPP Office and NERSA. The methodology for determining the premium will be published by way of a notice.

Assuming a 70 per cent tax free allowance, i.e. the basic tax free allowance plus the offset allowance of 10 per cent, would translate into an additional 3.77 cent per kWh. Hence electricity price neutrality during the first phase could be achieved through a combination of a lower electricity levy and a credit for the renewable energy premium.

Section 6(2) of the bill has been amended to allow a credit for the electricity generation levy payable against the carbon tax liability of a particular taxpayer that is, all electricity generators. These two measures, plus the energy efficiency savings tax incentive, would leave very little if any additional revenue for further recycling during the first phase, up to 2022. It is important to note that both the electricity generation levy and the renewable energy premium seek to implicitly price GHG emissions but does not aim to explicitly price externalities into the final price of electricity. This is the intention of the carbon tax. The combined effect of the implicit and explicit carbon price will however need to be considered, but this is unlikely to reflect the full marginal external costs of climate change in the near future. The commitment to ensure that the carbon tax does not impact the electricity price holds for the first phase up to 2022, primarily to provide relief for sectors currently in distress such as mining and steel.

## **2.2 Liquid fuel – Transportation**

### **2.2.1 Carbon tax pass through**

#### **COMMENTS:**

It is argued that a cost pass-through mechanism for the petroleum sector responsible for scope 1 emissions should be explored. Fuel prices are regulated in South Africa and refineries are unable to recover the costs of a carbon tax, to the extent that they might have been able in a competitive price setting environment.

- It is proposed that a mechanism to allow for the cost pass-through of the carbon tax is developed as part of the tax design to provide certainty to the sector.

### RESPONSE:

Given the regulated nature of fuel prices in South Africa, and that refineries are unable to recover these costs; a limited transparent and equitable pass through mechanism could be considered. Such a possibility will be explored with the industry. This will include the establishment of a benchmark – based on the technologies for the oil refinery industries – and the company's performance against the benchmark will determine the quantum of the carbon tax that could potentially be allowed as a pass through. This possibility was raised with the industry following the consultation process on the 2013 Carbon tax Policy Paper and the 2015 draft bill. An initial proposal for an average cost pass through was provided by the industry during consultations on the first draft bill in 2016. Industry was advised to develop a benchmark which could form the basis for determining the level of the pass through. A revised proposal has been developed by the industry and engagements will continue in early 2018.

### 2.2.2 Taxation of non-stationary emissions

#### COMMENTS:

Further *clarity is requested on the taxation of non-stationary, mobile GHG emissions* from the transport sector and how the carbon tax will be applied. According to the IMF estimates, petrol is currently under taxed by about 50 per cent and diesel by about 40 per cent from the perspective of charging for non-carbon environmental costs from use of these fuels (local air pollution, congestion, accidents). It is therefore argued that applying carbon charges to these fuels could therefore produce net economic benefits to the domestic economy, rather than costs. This view is supported by the Energy Research Centre.

#### RESPONSE:

The current suite of fuel taxes serve as both revenue raising instruments (for general revenue and compensation for vehicle fatalities) and as a means to address negative externalities associated with vehicle use on public roads. The general fuel levy applies to petrol, diesel and biodiesel to raise revenue for specific expenditure, internalise negative environmental externalities associated with fuel combustion by vehicles like greenhouse gas (GHG) emissions leading to climate change, local air pollution and other social costs associated with road use including congestion, accidents, road wear (infrastructure costs) and noise.

Transport sector non-stationary GHG emissions arising from liquid fuels will be covered by the carbon tax regime and incorporated into the current fuel tax regime as an add-on. This will result in a higher effective tax on diesel than on petrol due to the higher carbon intensity of diesel fuel relative to petrol. Assuming a 60 per cent tax free threshold (only 40 per cent of emissions taxed at R120 per ton) the estimated carbon tax will amount to a maximum of 11 c/litre for petrol and 13 c/litre for diesel. This does not take into account the potential use of carbon offsets by a taxpayer which could further reduce the amount of carbon tax applied on transport fuels.

### 2.2.3 Aviation fuels

#### COMMENTS:

The aviation industry supports the goal of GHG mitigation however; it does not support the imposition of a carbon tax for aviation, both international and domestic. The reasons for this are:

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- The global aviation industry through the International Civil Aviation Organisation (ICAO) and supported by IATA are currently working on the development of global market-based measures (MBMs) which will be presented at the 39th ICAO Assembly in September and October 2016. It is the view of the aviation industry that the solution for domestic aviation should be aligned with that of international aviation.
- Concerns about the competitiveness of domestic airlines have been raised especially if carbon taxes apply to domestic operators only. Currently, there are increased operations directly to the three main airports in SA by international operators.
- 30 per cent of airline operating costs are attributable to fuel spend. The estimated percentage increase in the cost of tickets attributable to a carbon tax will be significantly higher on low fare end of the market (tourism) than on higher priced tickets (business travel) hence this is likely to have a significant effect on domestic tourism. The industry argues that the most effective way to reduce carbon emissions from the airline industry is through government setting standards for minimum aircraft efficiency to prevent importation of old, inefficient aircraft. It is argued that South Africa as an important member of the ICAO Council should be fully supporting ICAO positions and not deviating from them.

IATA believes that the decision to subject aviation to the carbon tax should therefore be deferred until after the 39th Assembly of the International Civil Aviation Organization (ICAO) in order to allow the South African Government to take into account the outcome of the ICAO Assembly. The South African Government should commit to review the inclusion of aviation in the carbon tax bill after the 39<sup>th</sup> Assembly (in September and October 2016), but before the entry into force of the tax on 1 January 2017.

**Carbon offsets** is argued to be more cost effective for the aviation industry and these are preferred to taxes and other forms of levies or charges. IATA believes that an international carbon reduction scheme should be used by airlines to avoid a proliferation of incompatible regional and national measures that will be less effective and more costly to airlines.

- In IATA's view, carbon offsetting guarantees a high environmental integrity. Provided adequate quality criteria are implemented, each carbon offset surrendered will deliver an equivalent reduction in CO<sub>2</sub> emissions. Given the high cost of reducing aviation's emissions, carbon offsetting is a cost- and environmental-effective mechanism.
- IATA is of the view that limiting the proportion of offsets that can be used by civil aviation to 10 per cent not justified by cost-effective perspective or by environmental considerations. Accordingly, IATA requests that the cap on the proportion of offsets that can be used to reduce the carbon liability in relation to aviation activities be removed.

### RESPONSE:

South Africa supports a global approach to address GHG emissions from the international aviation sector, which might include the use of an appropriate carbon pricing measure, such as an internationally agreed carbon tax. Enforcing regional carbon pricing measures on the international aviation sector (for example, by including the aviation sector in the EU ETS) could be disruptive and distortionary. Emissions from domestic flights will be subject to the domestic carbon tax regime. It is proposed that the carbon tax be applied according to the carbon content of fuels used for domestic flights. The proposed domestic policy regime for aviation could be incorporated within an international approach for this sector at a later stage.



The global aviation industry at the tri-annual Assembly of the ICAO in October 2016 agreed to the use of global market-based measures (MBMs) to deal with emissions in the sector. The MBM will be implemented in the form of a Carbon offsetting and Reduction Scheme for International Aviation (CORSIA). The CORSIA is designed to offset carbon dioxide (CO<sub>2</sub>) emissions generated by international aviation activities above 2020 levels and contribute to the carbon neutral growth of the sector from 2020 onwards.

Following consultations with industry in November 2016, National Treasury is still of the view that emissions from domestic flights should be subject to the domestic carbon tax regime. It is proposed that the carbon tax be applied according to the carbon content of fuels used for domestic flights. The proposed domestic policy regime for aviation will be developed in a way that would allow its seamless incorporation within the CORSIA approach for the sector. Discussions are underway with the Department of Transport and the aviation industry to consider the options that have been developed by National Treasury for integration of the CORSIA mechanism for domestic aviation within the carbon tax.

### 2.3 Trade exposure allowance

#### COMMENTS:

Several respondents support the implementation of a special allowance which takes into account the nature and the energy intensity of industry.

It is proposed that the trade exposure allowance (of up to 10 per cent) should be reviewed and restructured in a manner that allows for seasonal fluctuations in production and demand as companies might qualify for higher allowances at certain times of the year. An assessment of vulnerable sectors should be undertaken at sector level and should include both qualitative, such as proportion of imports and exports as a proportion of total market size as well as quantitative factors such as:

- Homogeneity of goods traded
- Market share of domestic industry in global trade
- Exposure of competitors carbon pricing
- Magnitude of transport costs from competitors

Specific proposals include:

- Applying tax rates evenly across the economy but recycling tax revenue to compensate EITE sectors at a level necessary to prevent CO<sub>2</sub> leakage that is, so that these sectors are revenue neutral. The tax exemptions are provided to the extent that EITI sectors experience CO<sub>2</sub> leakage. Exports to countries in the SACU region should be considered within the trade exposure allowance.

Several respondents support the original formula for the trade exposure allowance which includes both imports and exports. Additional recommendations include:

- To the extent that imports are not included, it was recommended that *border carbon adjustments* (effectively an import duty, equivalent to the domestic carbon tax on imports from countries without a carbon price) be considered to address some of the concerns regarding imports. It is argued that the competitiveness impacts will likely outweigh the administration complexity reasons for not considering border carbon adjustments. This includes the chemicals, glass, and cement sectors.

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- It is also proposed that all companies should be eligible for support and the thresholds for trade exposed sectors should be removed.
- The current allowance of 10 per cent caps out when the exports reach 25 per cent of total sales. It is recommended that this cap be reconsidered.

During consultations held with industry in April 2016, concerns were raised on the structure of this allowance. Some have expressed the view that the allowance provides an incentive for companies that are not significantly trade exposed to unnecessarily benefit. In addition, certain sectors are facing increased competition from imports for example, the cement sector, and the focus on exports only was viewed as an inappropriate measure of trade exposure of a sector. Consultations with sectors and specific companies revealed a preference for sector rather than company based tax free threshold for trade exposure.

### RESPONSE:

The 2013 Carbon Tax Policy Paper provided two options to determine trade exposure – either: (a) a combination of exports plus imports or (b) exports only. Following initial consultations with industry, this allowance was reviewed and adjusted to include exports only. The carbon tax policy provides a special trade exposure allowance up to a maximum of 10 per cent for those sectors subject to the carbon tax. The formula used provided graduated relief for companies using exports as the key factor.

Following consultations on the carbon tax bill, the design of the allowance has been adjusted from a company to a sector-based trade exposed allowance and has been amended to include imports in the formula. Trade intensity will be used as a proxy for trade exposure which will be determined at a sector or subsector level based on the World Customs Organisation: Harmonised System Convention (HS Code) classification for final products only. The revised formula will be used to calculate the trade intensity of a particular sector / subsector / industrial activity based on the ratio of the sum of the value of imports and exports to production. The trade intensity of a product/s for a particular sector / subsector will be based on the sum of the value of imports and exports divided by production. The trade intensity will be calculated for the sector or subsector, using the formula below:

$$\text{Trade Intensity} = (X + M) / P$$

Where: X = Exports (“final” products only)

M = Imports (“final” products only)

P = Production

The tax-free allowance will be structured as graduated relief with sectors qualifying for the allowance depending on the magnitude of their deemed trade exposure. The trade exposure allowance will be determined according to the trade intensity category (high, medium or low) of a sector. For the medium trade intensity category, trade intensity will be multiplied by 0.33 in order to determine the associated trade exposure allowance for sectors in this band.

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	Trade intensity	Trade exposure allowance
Low trade intensity	< 10 %	0 per cent
Medium trade intensity	≥ 10 % to < 30 %	3 to 9 per cent
High trade intensity	≥ 30 %	10 per cent

An intensity threshold of 30 per cent will ensure that sectors with a trade intensity of 30 per cent and more will automatically qualify for the full maximum 10 per cent allowance (high trade intensity). Those with a trade intensity of less than 30 but equal or greater than 10 per cent will receive a progressive allowance of between 3 and 9 per cent (medium trade intensity). Sectors with a trade intensity of less than 10 per cent will not qualify for the allowance (low trade intensity).

For companies with activities in different sectors with varying HS code categories, and that potentially face different trade intensity risk levels simultaneously, a weighted average of the different tax-free allowance levels will be calculated. This will be based on the total sales of a company. The final level of the trade exposure allowance that the company is eligible for will be determined in line with the proportion of sales of specific final goods to total sales of the company.

The qualifying activities and their respective trade exposure allowance will be published in a regulation to the carbon tax act.

Initial analysis indicates that distressed sectors such as mining and iron and steel are likely to qualify for the full 10 per cent trade exposure allowance. Although carbon pricing is likely to affect the competitiveness of certain carbon intensive activities, it will also provide opportunities for new, low carbon activities over the medium to long term. Also concerns about the competitiveness implications of the carbon tax will recede as more and more jurisdictions begin to phase in carbon pricing. Emerging economies that are already implementing carbon pricing are China, Mexico, Chile, Colombia and India; an emission trading scheme in the case of China, a carbon tax in Mexico, Colombia and Chile and a tax on coal in India. Brazil and Singapore are also exploring the implementation of a carbon price.

### 2.4 Carbon offset allowance

#### COMMENTS:

Companies generally support the inclusion of the offset mechanism as a means to drive least cost mitigation. Specific suggestions include that:

- The offset allowance not be limited and request the removal of the cap on the allowance.
- The eligible projects under the offset scheme are expanded to include projects that reduce indirect (scope 2) emissions e.g. energy efficiency, fuel switch, cogeneration projects.
- Renewable energy projects, developed under the renewable energy independent power producers procurement programme (REIPPPP) and other renewable energy projects, should also be allowed to participate in the offset scheme.
- The geographical scope is expanded to include the SADC region.
- A positive or negative list should be prescribed to make it easier to identify eligibility criteria.

On the other hand, the NGO sector is of the view that the offset allowance should not be permitted as it undermines the efficacy of the carbon tax as a disincentive to emit GHG emissions and hence GHG emissions reduction policy and should thus be scrapped.

### **RESPONSE:**

The Draft Carbon Tax Bill makes provision for the carbon offset allowance in terms of Section 13. This provides for firms to reduce their carbon tax liability by using offset credits of up to a maximum of 5 or 10 per cent of their process or combustion GHG emissions respectively, as specified in Schedule 2 of the draft Carbon Tax Bill.

The proposal to use carbon offsets in conjunction with the carbon tax has been widely supported by stakeholders as a cost-effective measure to incentivise GHG emission reductions. A carbon offset is an external investment that allows a firm to access GHG mitigation options at a lower cost than investment in its current operations. Carbon offsets involve specific projects or activities that reduce, avoid, or sequester emissions, and are developed and evaluated under specific methodologies and standards, which enable the issuance of carbon credits.

The carbon offset system seeks to encourage GHG emission reductions in sectors or activities that are not directly covered by the tax and/or benefiting from other government incentives. It also serves as a flexibility mechanism that will enable industry to deliver least cost mitigation, i.e., mitigation at a lower cost to what would be achieved in their own operations, and thereby lower their tax liability.

The draft Carbon Offset Regulations and explanatory note were published for public comment and further consultation on 20<sup>th</sup> June 2016. The Carbon Offset Regulation was developed jointly by the National Treasury, the Department of Energy and the Department of Environmental Affairs in terms of Sections 13 and 20 (b) of the Draft Carbon Tax Bill and sets out the procedure for the use of carbon offsets by taxpayers to reduce their carbon tax liability.

The carbon offset scheme will rely primarily on existing international carbon offset standards namely, the Clean Development Mechanism (CDM), Verified Carbon Standard (VCS) and the Gold Standard (GS) and their associated institutional and market infrastructure. However, scope is also provided for the use of local standards/ methodologies where appropriate and independently verifiable.

The offset tax-free allowance will remain limited to 10 per cent of combustion and 5 per cent of process emissions so as to ensure that firms make real efforts to mitigate emissions in their own operations. Limitations on offsets are common in most carbon pricing schemes e.g. China, California, South Korea etc. for this very reason. Most projects that reduce indirect (scope 2) emissions are already incentivised through other mechanisms e.g. the energy efficiency savings tax incentive (12L) that rewards act as an intervention to help companies to reduce both their energy (electricity and fuel) consumption and their Scope 2 (indirect) greenhouse gas emissions.

The Draft Regulation on the Carbon Offset has been revised to allow for certain types of renewable energy projects including some projects under REIPPPP, and small and medium scale renewable energy projects. For the first phase of the carbon tax up to 2022, the geographic scope will be strictly South African projects and specific criteria of ineligible projects have been incorporated into the revised Regulation. The revised regulations will be published in early 2018 for public comments and further consultation.

## **2.5 Performance allowance (Z-factor)**

### **COMMENTS:**

In general, the performance based allowance is supported. Some suggestions on the design of the allowance are provided:

- Emissions thresholds be based on product benchmarks rather than at installation level to promote best available technology and this could be based on the z-factor.
- A grandfathering approach, similar to the percentage-based thresholds.
- Provide more clarity to the taxpayer on how this allowance will be calculated. There were some concerns raised on the inclusion of scope 2 emissions in the determination of carbon intensity as it introduces a significant aspect over which consumers of electricity have little control of in the South African context.

### RESPONSE:

The benchmark report entitled “Emissions Intensity Benchmarks for the South African Carbon Tax”<sup>1</sup> was published in 2014 followed by a workshop in May 2015. At this workshop National Treasury proposed that it be the responsibility of industry to initiate a process to calculate appropriate and acceptable benchmarks using a methodology that is, in line with the guidelines in the report. During the consultations held in April 2016, the performance allowance was widely supported and several sectors such as petroleum refining, cement, ferrochrome, iron and steel, nitric acid, pulp and paper, clay brick making, ilmenite, platinum and gold have initiated processes for developing benchmarks to ensure that these industries / sectors / firms can qualify for the performance allowance. These submissions are being assessed by the National Treasury according to the criteria outlined in the Emissions Intensity benchmark study and will be considered for inclusion into the Regulations as provided for in the draft Carbon Tax Bill.

## 2.6 Tax deductibility of the carbon tax

### COMMENTS:

Several commentators requested clarity on the whether the carbon tax will be tax deductible for income tax purposes. Concerns were raised that the Bill does not directly address this issue and it is argued by stakeholders that in the absence of any specific legislation stating otherwise, general tax principles would have to be applied. Similarities were drawn with the current treatment of the mineral royalties.

### RESPONSE:

Section 11A of the Income Tax Act provides for any expense deemed to be in the production of income, to be deductible for income tax purposes. In line with the Income Tax Act, to the extent that the carbon tax forms part of a company's business expense it may therefore be deductible for income tax purposes.

## 2.7 GHG Emissions Trajectory

### COMMENTS:

According to a study undertaken by business, which is quoted in several submissions, the GHG emissions as currently reflected for SA has been overestimated. It is argued that SA's current GHG emissions trajectory is below that envisaged by the peak-plateau and decline approach of the DEA

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<sup>1</sup>Available from: [http://ntintranet/publications/other/GHG\\_Emissions\\_Intensity\\_Benchmarks\\_for\\_SA\\_Carbon\\_Tax.pdf](http://ntintranet/publications/other/GHG_Emissions_Intensity_Benchmarks_for_SA_Carbon_Tax.pdf)

and that further reduction in emissions is not required at this time if the PPD model is used as the reference.

### RESPONSE:

South Africa submitted its Intended Nationally Determined Contribution (INDC) on Adaptation, Mitigation as well as finance and investment requirements for both. For the INDC, South Africa transitioned its international mitigation commitment from a relative deviation from business as usual to an absolute peak, plateau and decline GHG emissions trajectory. This means that emissions by 2025 and 2030 will be in the range between 398 and 614 MT CO<sub>2-eq</sub> as defined in national policy.

South Africa ratified the Paris Agreement in November 2016 and endorsed its Nationally Determined Contribution (NDC), which requires that our greenhouse gas (GHG) emissions peak in 2020 to 2025, plateau for a ten-year period from 2025 to 2035 and decline from 2036 onwards. The Carbon Tax Bill gives effect to the polluter-pays-principle. The carbon tax will assist, in a least cost manner, in reducing GHG emissions and ensuring that South Africa will meet its NDC commitments as part of its ratification of the 2015 Paris Agreement. The carbon tax is an essential element of South Africa's commitment to the Paris Agreement, as part of a package of measures to mitigate climate change. The carbon tax is intended as an instrument to help drive down emissions in a cost effective and dynamic way over the medium to long term.

As noted in the various policy documents and stated again in the 2016 Budget Review: "The main aim of the carbon tax is to put a price on the environmental and economic damages caused by excessive emissions of greenhouse gases. A secondary aim is to change the behaviour of firms and consumers, encouraging them to use cleaner technology". The fact that the level of emissions might be below the target during a specific period does not mean the carbon tax should be zero or negate the need for a carbon tax. This merely indicates that the level of the tax need not to be increased further, or by too much, to achieve and or maintain a longer term emissions trajectory.

## 2.8 Carbon tax modelling and socio economic impact

### COMMENTS:

There were questions raised on the carbon tax modelling undertaken to date and the need for more detailed analysis on the impacts of the carbon tax on electricity prices, emissions intensive trade-exposed sectors and revenue recycling measures. The DTC view on the need for further modelling to be undertaken to determine the potentially impacts and recycling options as well as implications for employment was also raised.

### RESPONSE:

Several carbon tax modelling studies have been undertaken to date, by the National Treasury (Economic Policy Unit), local academics and international institutions such as the World Bank. The broad findings from these Computable General Equilibrium models show that a carbon tax will make a significant contribution to the reduction of GHG emissions and that the economic impact of the carbon tax will depends on how the revenues are used, that is the revenue recycling measures. These modelling studies are publicly available.

The results of these studies provide a reasonable understanding of environmental and economic impacts of a carbon tax and helped with the decision making process.

The National Treasury published a carbon tax modelling report entitled: **“Modelling the Impact on South Africa’s Economy of Introducing a Carbon Tax” in November 2016**. This report provides an assessment of the impacts of the proposed carbon tax policy on reducing greenhouse gases (GHG) emissions, economic growth, employment, and industry competitiveness. The study was conducted on behalf of the National Treasury under the Partnership for Market Readiness initiative administered by the World Bank, which is aimed at supporting countries in strengthening their policy analysis and technical capacity to implement carbon pricing measures.

Overall, the economic modelling conducted based on the current policy design shows that the carbon tax will have a significant impact on reducing South Africa’s GHG emissions and would lead to an estimated decrease in emissions of 13 to 14.5 per cent by 2025 and 26 to 33 per cent by 2035 compared with business-as-usual. The carbon tax will have a marginal impact on the economy’s average annual growth rate which will be 0.05–0.15 percentage points below business as usual. The carbon tax would make an important contribution towards reaching South Africa’s NDC commitments.

The National Treasury has engaged the Department of Planning, Monitoring and Evaluation (DPME) on the Socioeconomic Impact Assessment (SEIAS) of the carbon tax bill. A final SEIAS report of the Draft Carbon Tax Bill was completed and SEIAS certificate was issued by the DPME in August 2017.

### 2.9 Policy alignment with the carbon budgets

#### COMMENTS:

Although efforts to ensure alignment with the carbon budget is appreciated by respondents, there are concerns regarding the nature of carbon budgets and how the carbon budgets will be applied, especially in phase 2 of the carbon tax. It is argued that an overlapping policy will result in additional costs and administrative burden on industry especially if the phasing-in period of both the carbon tax and carbon budget are not aligned.

- The current alignment is viewed as insufficient. The NGO sector is of the view that what is proposed is alignment is more a harmonisation of the two instruments rather than a proper integration of their intent and design to achieve the overarching mitigation goal of government.

#### RESPONSE:

The carbon tax is envisaged as a broad-based carbon pricing mechanism to provide the least-cost option to incentivise GHG emissions reduction and to address climate change. It will be phased in gradually and will provide clear signals for investment decision-making. Additional measures include regulations, standards, the carbon budgets, tax incentives and budget allocations.

A study on the options for alignment and integration of the carbon tax and carbon budget policy instruments post 2020 has been completed by the Department of Environmental Affairs and the National Treasury. The mandatory carbon budgets regime will be introduced in a way that is fully-aligned with the carbon tax, and designed to ensure no double penalty. An integrated review process to assess both instruments will be done after three years of implementation of the carbon tax, and will inform any significant changes in the tax rate and the implementation of the carbon budgets.



### 2.10 Carbon pricing, emissions trading and timing of the introduction of the tax

A few general comments include the following:

- Carbon tax rates
- Support for an emissions trading scheme
- The timing of the introduction of the tax
- Request for clarity on the tax rates and tax free thresholds for phase 1 and phase 2 of the proposed carbon tax

#### 2.10.1 Carbon tax rates

##### COMMENTS:

Academia, NGOs and some individuals strongly supported carbon pricing through the carbon tax. They argue that a carbon tax is the most effective policy for emissions mitigation as higher prices for carbon-intensive fuels such as electricity will encourage shifting to cleaner fuels and adoption of energy-saving technologies across all sectors of the economy. Carbon taxation, if designed properly, is viewed as an appropriate way to implement carbon pricing as it provides more certainty over emissions prices and also a source of revenue for government to support cleaner, low carbon programmes.

Some companies, academia, international organisations, NGOs, individuals and government entities are of the view that the proposed carbon tax rate is relatively low taking cognisance of the high level of tax free allowances hence insufficient to provide the necessary strong price signals to encourage/incentivise behaviour change. According to analysis undertaken by the IMF, a carbon tax is likely to produce domestic environmental benefits (primarily health benefits from less local air pollution) equivalent to about R150 or \$10 per ton of reduced CO<sub>2</sub>. If a carbon tax is the main instrument for reducing CO<sub>2</sub> emissions, the IMF suggests that the rate will need to be ramped up quite substantially by 2030 to meet the NDC target.

This view is supported by the Energy Research Centre who also recommend that *the tax rate starts as low as proposed, and it should increase every year as previously proposed*. It is further suggested that this increase should be stipulated in law.

##### RESPONSE:

To ensure a smooth transition to a low carbon economy and at the same time encourage significant reductions in GHG emissions over the medium to longer term, the effective carbon tax will be phased in gradually and increased during the second phase. This approach takes cognisance of the developmental changes that South Africa has to deal with and is fully in line with the internationally acceptable principle of common but differentiated responsibilities and respective capabilities (CBDR – RC). South Africa's NDC commitment to contribute to the global effort of reducing GHG emissions, by limiting emissions in 2025 and 2030 to between 398 and 614 Mt CO<sub>2e</sub>, implies that the country will need to submit progressively more ambitious goals to guarantee a low-carbon future, so South Africa is obliged to develop and implement measures and systems that will enable the achievement of its commitment. The carbon tax is one of the measures being developed to reduce GHG emissions in the country.



Section 5 of the carbon tax bill has been amended to include the headline, marginal tax rate of R120/tCO<sub>2e</sub> and specifies the annual increase to the nominal carbon tax rate by the rate of inflation plus 2 per cent for the first phase of the tax up to 2022, and inflationary adjustments thereafter. This will help to provide more certainty to firms.

### 2.10.2 An emissions trading scheme

#### COMMENTS:

It is suggested that the alternative pricing instrument that is, a cap and trade scheme be explored. It is argued that this will guarantee the environmental outcome in contrast with the carbon tax which provides certainty on the price but not the level of emissions reductions.

In light of international developments, it was also recommended that the proposal to consider an emission trading scheme over the next 10 to 15 years and discussions on the transition from a carbon tax to an emissions trading scheme should be brought forward. It is argued that there could be benefits from SA establishing linkages with these carbon markets early.

#### RESPONSE:

The government proposes a gradual phasing in of the carbon tax, with significant relief measures during an initial five-year transition period. Analysis shows that due to the oligopolistic nature of South Africa's emissions profile, a domestic ETS would not deliver as an efficient and effective carbon pricing measure. About four companies account for between 55 and 60 per cent of South Africa's GHG emissions. This line of argument was extensively discussed in the 2010 Carbon Tax Discussion Paper and the 2013 Carbon Tax Policy Paper.

The possibility of a domestic ETS, to complement the carbon tax, would however be considered only in the context of an effective linkage with carbon pricing systems in other jurisdictions. As countries work towards achieving their Paris Agreement commitments, cooperation across borders will be key for many jurisdictions' strategies as this helps ensure that the goals of the Paris Agreement are met in a cost effective manner. Through the carbon offset scheme being developed under the carbon tax, elements of Article 6.2 of the Paris Agreement on "cooperative approaches" through use of 'internationally transferred mitigation outcomes (ITMOs) as these represent future bi-lateral or multilateral crediting mechanisms should be investigated. The domestic carbon offset system could be viewed as a first step towards implementing a carbon market mechanism that could be linked with other international carbon market schemes.

It should be noted that only about 45 per cent of European GHG emissions are currently covered by the EU ETS and most of the remaining GHG emissions are subject to national carbon and / or energy taxes introduced at member state level.

### 2.10.3 Regulations – the electricity sector

#### COMMENTS:

South Africa's electricity sector, accounts for about 45 per cent of the country's GHG emissions, is a state regulated sector with technology choices a function of regulation and policy and not market

incentives. Thus imposition of carbon price is unlikely to influence the choice of energy technology or feedstock beyond what is mandated in the IRP 2010.

The IRP 2010 and carbon budget process is seen by some as sufficient to drive down GHG emissions in this sector.

### RESPONSE:

This line of argument does not take into account the polluter pays principle that is, the need for all polluters to be held accountable for the damaged cause as a result of the negative externalities they are responsible for. The IRP is a plan which is revised periodically and therefore faces challenges in being fully implemented. Under the carbon tax, a credit will be introduced to cater for the implicit carbon price associated with renewable energy. It is important to look at the 'actual' implicit carbon price of the current electricity supply and not at the simulated 'implicit' price of an energy mix not yet implemented. An explicit, economy wide carbon price that includes the electricity sector is therefore necessary.

#### 2.10.4 Timing of the introduction of the tax and long term policy certainty

### COMMENTS:

Concerns were raised on the timing of the introduction of the tax taking into account the current economic climate and in particular, the state of the mining and steel sectors.

- It is proposed that consideration is given to introducing the carbon tax when the challenges of regulatory policy alignment are addressed that is, post 2020. It is argued that the consideration of implementation of a carbon tax post 2020 will provide industry the period required to adjust to the slow economic growth and high electricity prices. The carbon tax will increase the cost of doing business in South Africa which is not in the best interests of the country.
- NGOs argue that given the NDC commitments, the carbon tax should have been already implemented.
- There is support for the recommendation of the Davis Tax Committee that the carbon tax be implemented in 2017 with the rebate threshold set to 100 per cent for the first year. That is, firms with scope 1 emissions comply and submit tax returns with no tax liability for the first tax year.

The EM indicates the introduction of the carbon tax from 1 January 2017 and that the first phase of the tax will run from this date to 31 December 2019. Clarity is requested on the timeframe for the first phase:

- It is proposed that the first phase of the carbon tax be for 5 years as per the 2013 Carbon Tax Policy Paper, which indicated the period 2015 to 2019 as the first phase. Given the delay in the implementation date the first phase should now be from 2017 to 2022.

It is argued that the Carbon Tax Bill does not provide certainty and clear time frames on the phasing out or scaling down of allowances post phase 1. Further tax policy guidance is requested on both the carbon tax rate trajectory and the level of tax free thresholds beyond the first phase that is, phase 2. This will help provide certainty to industry on the broader carbon tax framework and assist with investment planning and decisions.

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The Explanatory Memorandum includes the statement (p16): *“The headline carbon tax will be introduced at a rate of R120 per ton of CO<sub>2</sub>-equivalent. The actual rate will be confirmed by the Minister of Finance through the annual budgetary process.”*

- It is recommended that the carbon tax rate and tax free allowances for the first and second phases of the carbon tax are fixed and included in the legislation.
- This will provide certainty over the long term and will be more effective at stimulating investment in environmentally friendly and energy efficient technologies as businesses are able to consider the carbon tax in their long term investment decisions and strategic planning processes.

### **RESPONSE:**

During the sector based and general consultation sessions held in April 2016, stakeholders suggested that the rate of the tax and proposed carbon tax rate trajectory including the rate of increase to the nominal rate of the tax for phase 1 and 2 should be clearly stipulated in the legislation. Section 5 of the bill has been amended to include the annual increase in the headline carbon tax rate, starting at R120 per ton of CO<sub>2</sub> eq. instead of leaving such announcements for the annual budget.

It should be noted that the tax free thresholds are already included in the Draft Carbon Tax Bill and these will remain fixed for the duration of the first phase, up to 2022.

The recommendation by the Davis Tax Committee of a 100 per cent tax free threshold during 2017 is not supported as the tax free thresholds during the first phase, up to 2022, is already very generous and varies between 60 and 95 per cent.

The Department of Environmental Affairs has introduced the mandatory GHG Emissions Reporting Regulations in April 2017, so companies will be familiar with the reporting and administration of GHG emissions when the carbon tax is implemented.

Beyond the first phase, a review of the impact of the tax after at least three years implementation will be conducted. Any adjustments to the carbon tax instrument beyond the first phase will depend on the economic circumstances and emissions mitigation efficiency achieved. The review will take into account the progress made to reduce GHG emissions, in line with NDC Commitments. Future changes to rates and tax free thresholds in the Carbon Tax will only follow after the review, and be subject to the same transparent and consultative processes for all tax legislation, after any appropriate Budget announcements by the Minister of Finance.

### 3 TECHNICAL COMMENTS:

#### 3.1 Legal and Administration

This section provides a summary of comments submitted on the different sections of the bill.

SECTION	COMMENTS	RESPONSES
Preamble	Suggests: SINCE the causality of the increasing of greenhouse gas emissions in the atmosphere and the resultant global climate change has been scientifically confirmed to be <u>anthropogenic in nature</u> .	Accepted
	There is no indication of penalties or appeals procedure that could be involved should the Commissioner deem some arrangements impermissible. The Bill should make an allowance for a dispute resolution mechanism.	This will be dealt with under the Tax Administration Act.
General	<p>We are unsure of the status of these documents as they have not been published officially for comment in the government gazette, we are providing initial comments on the understanding that there will another opportunity for public comment once government approves publication for comment in the government gazette.</p> <p>The Bill should set a time limit that cannot be exceeded for the tax over time to provide some certainty.</p> <p>The draft Bill should have been published in the Government Gazette as publishing via website prejudices a number of stakeholders.</p>	The draft bill has already been published for public comment followed by stakeholder consultations and will follow the normal budgetary process .
	It is self-evident that the draft Bill is not a money bill as per requirements laid down by the Constitutional Court and should be tagged and subsequently be introduced as either a section 75 or 76 Bill.	<p>Section 77 reads: A Bill is a money Bill if it—</p> <p>(a) appropriates money;</p> <p>(b) imposes national taxes, levies, duties or surcharges;</p> <p>(c) abolishes or reduces, or grants exemptions from, any national taxes, levies, duties or surcharges; or</p> <p>(d) authorises direct charges against the National Revenue Fund, except a Bill envisaged in section 214 authorising direct charges.</p> <p>The carbon tax falls under paragraph (b).</p>
1. Definitions		
	<p>Definition of GHGs:</p> <ul style="list-style-type: none"> <li>Greenhouse gas: should be defined as defined by DEA: greenhouse gas</li> </ul>	<p>Accepted.</p> <p>The definition of GHGs is aligned with the Air Quality Act however;</p>

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	<p>'means as defined in the National Environmental Management: Air Quality Act, 2004.</p> <ul style="list-style-type: none"> <li>• Recommends that this definition is aligned with the DEA declaration of GHGs as priority air pollutants which specifies carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulphur hexafluoride.</li> </ul>	it includes all 6 Kyoto greenhouse gases as per DEA Declaration of GHGs as Priority Air Pollutants.
	<p>Definition of CO<sub>2e</sub>:</p> <ul style="list-style-type: none"> <li>• Carbon dioxide equivalent: for legal purposes, there needs to be clarity as to the global warming potential that must be used for this calculation. Reference should be the DEA regulations.</li> </ul>	Accepted. Under schedule 1, a table on the global warming potential for the different GHGs has been included based on the IPCC Third Assessment Report.
	<p>Definition of 'emissions':</p> <p>Includes reference to greenhouse gases 'or their precursors and aerosols'. The very broad definition including precursors and aerosols is problematic. Technically, this would include nitrogen oxides (nitrogen oxide and nitrogen dioxide) which ultimately contribute to the formation of ozone which is a GHG.</p> <ul style="list-style-type: none"> <li>• Nitrogen oxides are already controlled in terms of the National Environmental Management: Air Quality Act of 2004 (amended in 2013) with minimum emissions standards.</li> <li>• Suggest that the definition reads: 'emissions' means the release of GHGs as specified in the Notice issues by the Minister responsible for Environmental Affairs in respect of the declaration of GHGs as priority air pollutants.</li> <li>• Alternatively, the phrase 'or their precursors and aerosols' should simply be deleted.</li> </ul>	Accepted. This definition has been amended to refer to greenhouse gases and their precursors and the reference to aerosols has been removed.
	<p>Definition of offset: The bill does not provide a definition of a carbon offset which creates uncertainty. This should be defined.</p>	The definition of an offset is provided in the Draft Regulations on the Carbon Offset which has been published for public comment.
	<p>Specific proposals for definitions:</p> <ul style="list-style-type: none"> <li>• Carbon budget: for clarity in this context "company means the 'taxpayer' otherwise alignment is difficult to interpret</li> <li>• Emissions: 'emissions' is the noun for the verb 'emit' but is defined as if it were a verb. In addition, emissions are not necessarily time or area bound</li> <li>• Person: reference DEA definition to ensure alignment</li> <li>• Product use: this is not a correct definition and is not in line with the IPCC approach to product use. The IPCC approach essentially refers to carbon dioxide emissions released as a result of use of certain products, not the use of GHG in the products. See comments on schedule 2.</li> </ul>	<p>Accepted. "Company" should read "taxpayer"</p> <p>Emissions: Not accepted "release is both a noun and verb.</p> <p>The definition of person is not accepted. If the DEA definition is used, then partnerships and trusts will fall through the tax net since they are not juristic persons.</p> <p>This is noted. The definition of product use has been deleted.</p>

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SECTION	COMMENTS	RESPONSES
2. <b>Imposition of the Carbon Tax – National Revenue Fund</b>	This section indicates that the carbon tax will be paid into the National Revenue Fund. This is regarded as a major weakness of the carbon tax system as the revenues should be used to support environmentally, cleaner initiatives.	Refer to response above in section on revenue recycling.
3. <b>Persons Subject to the Tax</b>		
	<p>Definitions of who is liable and on which activities should be aligned between the draft Bill and reporting regulations i.e. 'data provider' and 'person', 'conducts an activity' and 'reporting boundaries for each installation based on operational control.</p> <p>In terms of annexure 1, the full scope of industry sectors have not been clearly defined or included in the list of activities. It is not clear whether a sector is liable to pay the carbon tax if it has not been included in the Annexure. It is also unclear how this annexure is aligned with the list provided in schedule 2.</p> <ul style="list-style-type: none"> <li>Recommend that the activity and the liable entity be made clear in the Carbon Tax Bill.</li> </ul>	After consideration of the comments received, the definition of the person liable for the tax has been amended and defined as persons undertaking activities defined in Schedule 2 of the Carbon Tax Bill. This list of activities is aligned with the GHG Reporting Regulations and Technical Guidelines.
	<p>It is not clear whether emissions that are not required to be reported in terms of the GHG Mandatory Reporting regulations are eligible for the carbon tax. The Reporting Regulations exclude many different types of emissions (see the long list of thresholds in Annexure 1) that appear to be included in the Bill.</p> <ul style="list-style-type: none"> <li>It is recommended that the Bill state clearly that any emissions that are not required to be reported in terms of the GHG reporting regulations are not liable for the carbon tax.</li> <li>The EM highlights that the carbon tax covers all direct GHG emissions from sources owned or controlled by the relevant entity (scope 1 emissions) while the Bill seemingly limits reporting boundary to operational control, thus the EM expands the reporting boundary to legal ownership;</li> </ul>	Not accepted. From a legislative drafting perspective this wording would be redundant.
	<b>Thresholds</b>	
	<p>The Draft Carbon Tax Bill does not include a threshold that determines whether a company is required to pay a carbon tax. However, the draft EM states that the threshold is 10MW thermal capacity. Appears to be discrepancy between the bill and the EM.</p> <p>There is a discrepancy between the draft Tax Bill, which states no thresholds and</p>	<p>Accepted.</p> <p>Schedule 2 of the bill has been amended to include a column on the thresholds that will apply for the activities covered under the carbon tax. This is aligned with the thresholds prescribed in the Technical Guidelines of the National GHG Emission Reporting</p>

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SECTION	COMMENTS	RESPONSES
	<p>the Explanatory Memorandum which does state a threshold (through reference to the Draft National Greenhouse Emission Reporting Regulations), but where the result of exceeding the threshold places a reporting requirement on a company, but does not seem to have a tax implications.</p> <p>It is not clear whether the 10 MW threshold referred to in the Explanatory Memorandum (and the GHG Reporting Regulations) refers to individual installations / equipment or to a facility or company.</p> <ul style="list-style-type: none"> <li>It is recommended that the threshold be applied in line with the GHG Reporting Regulations in order to minimise the bureaucratic burden of applying the legislation</li> </ul> <p>Requests clarity on whether there is any energy consumption or GHG emissions threshold that determines whether a company is liable for the carbon tax.</p>	<p>Regulations (NGERs).</p> <p>The NGERs have a series of thresholds as follows which will apply for purposes of the carbon tax as well:</p> <ul style="list-style-type: none"> <li>Combustion emissions – Thermal input threshold</li> <li>Fugitive emissions – Operation-specific thresholds</li> <li>Process emissions – primary product type thresholds]</li> </ul>
	<p>Clarification is needed on what is meant by thermal capacity of around 10 MW. Does the installed capacity refer to an individual site or a combined value across different sites? (The Draft National Greenhouse Emission Reporting Regulations make reference to 'individual combustion installation with a 10MW energy capacity')</p>	<p>The NGERs makes reference to total installed capacity of 10MW or above at company level. That means a combined installed capacity of all installations across all facilities under operational control of a company that is reporting.</p>
	<p>The thresholds for entities which will be subject to the carbon tax are those with a thermal capacity of 10MW or more. The DEAs threshold for entities to report their emissions on NAEIS is 50 MW heat input. Therefore DEA's database will not include entities with emissions of less than 50 MW and information on which DEA is going to monitor taxpayers' carbon tax submissions could be inaccurate.</p> <ul style="list-style-type: none"> <li>There is a different threshold for combustion installations (thermal capacity of 50 MW) for facilities that are required to comply with minimum emissions standards for particulate matter, sulphur dioxide and nitrogen oxides in terms of section 21(1)b of the National Environmental Management Act (Act No 39 of 2004)</li> </ul>	<p>There are two different reporting requirements: the NGERs are separate from the reporting under the Air Pollution Reporting Regulations which stipulates reporting of <b>individual</b> thermal installation of 50MW or above (section 21 of the AQA act) as well as <b>individual</b> thermal instillation of 10MW or above (section 23 of the AQA).</p> <p>The NGERs differs from the Air Pollution Regulations in that:</p> <ul style="list-style-type: none"> <li>the NGERs focus on total installed thermal input capacity and not individual installations</li> <li>the NGERs focuses on the minimum threshold of 10MW which by implication will capture all individual thermal instillations that meet the section 21 and 23 of the AQA.</li> </ul>
<p><b>4. Tax Base</b></p>		
	<p>We propose that Section 4(2) be amended so that other methodologies may be used as alternatives to emission factors as published;</p>	<p>The legislation provides for the use of default emissions factors and methodologies to the extent that companies have not used Tier 2 and 3 methodologies to calculate their emissions. If companies have developed these methodologies which have been approved by the DEA, then this will accepted for purposes of</p>

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SECTION	COMMENTS	RESPONSES
		calculating GHG emissions under the carbon tax.
<b>5. Rate of Tax</b>	Refer to summary on policy comments.	Section 5 of the bill has been amended to provide for adjustments to the rate of the tax by the rate of inflation plus 2 per cent until 31 <sup>st</sup> December 2022 and rate of inflation thereafter.
<b>6. Calculation of Tax Payable</b>		
	<p>The application of the carbon tax to product use has been included in the Bill. However, there is no clarification on how this will be measured and monitored.</p> <ul style="list-style-type: none"> <li>• Recommends that product use be excluded from carbon tax until there is clear understanding how this will be implemented.</li> </ul> <p>The application of the carbon tax to product use has been included in the Bill without clarification on how this will be measured and monitored. Recommends that product use be excluded from carbon tax until there is clear understanding how this will be implemented.</p> <ul style="list-style-type: none"> <li>• In discussions with the DEA, it has been agreed that product use will not be determined at company level due to the challenges associated with it. Use of the DEA mandatory reporting system therefore does not provide for measurement of emissions from product use.</li> </ul>	Accept. Product use has been deleted.
	The Bill's requirement that diesel- and petrol-related emissions be calculated at 4(1) (a) and then subtracted at 6(1) (c) is an unnecessary bureaucratic burden and should be removed.	Section 6(1)(c) provides for the reduction of the carbon tax payable for emissions emanating from the use of liquid fuels (petrol and diesel) in stationary processes is provided to avoid double taxation. Non-stationary emissions such as transport will be included under the fuel tax regime as an add-on. Schedule 1 Table 1 of the carbon tax bill provides for energy combustion emissions to be reported by fuel type based on the emission factors per GHG gas which is aligned with the DEA Mandatory Reporting Regulations for GHG Emissions.
	<p>The recognition of a renewable energy premium included in the electricity tariff is welcomed. It is proposed that this rebate should be extended to include renewable energy allowed as a recovery of cost by Eskom as well and not limited to the Independent Power Producers only.</p> <ul style="list-style-type: none"> <li>• Eskom will seek to diversify its electricity generation portfolio away from coal and this may in future include a new build allocation of renewable capacity to Eskom from the Minister of Energy. Exclusion of Eskom-owned renewable energy costs from this clause will create additional barriers for</li> </ul>	Accepted. The bill has been amended to provide the credit for all renewable energy producers including private producers, and is not limited to the IPP programme. The amount will be determined by the Minister of Finance by way of a notice.



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	<p>Eskom to diversify its generation portfolio. Furthermore, there are some Independent Power Producers that do or will produce electricity from non-renewable sources.</p> <ul style="list-style-type: none"> <li>○ It is proposed that the wording be amended in 6(2)(c) to read:....accrued in respect of the electricity tariff or price allowed as a recovery of cost for the procurement of deployment of renewable energy as determined in terms of the Multi Year Price....</li> </ul>	
	<p>This clause limits sequestration to ‘carbon reservoirs’ but this definition should be extended to include carbon and geological reservoirs as geological reservoirs hold great potential in SA for storing CO<sub>2</sub> captured from fossil-fuel fired plant. The technology is currently considered too expensive for implementation in SA but it may become economically viable in future and remains the only way to decarbonise existing coal-fired power stations (through retrofit).</p> <ul style="list-style-type: none"> <li>○ It is proposed that the wording be amended in 6(3) to read: ....sequesterate means the process of increasing the carbon content of a carbon reservoir other than the atmosphere or an approved geological reservoir’ . This should be acceptable given that ‘S’ has to be “verified and certified by the Department of Environmental Affairs.</li> </ul> <p>Definition of sequesterate should include the capturing of CO<sub>2</sub> or other GHGs for use in third-party applications.</p>	<p>Accepted. The definition of sequestration has been expanded to include storage of GHGs.</p>
<p><b>7. Allowances For Fossil Fuel Combustion</b></p>	<p>Reference is made to ‘may receive allowances’ in many of the allowances which creates the impression there is some other compliance rules that is not published. This needs to be clarified.</p>	<p>Accept. May has been changed to ‘must’ in the revised bill.</p>
	<p>A percentage of a percentage is an incorrect approach to the required calculation.</p>	<p>Accepted. This has been rephrased.</p>
<p><b>8. Allowances For Industrial Process Emissions</b></p>	<p>A percentage of a percentage is an incorrect approach to the required calculation</p>	<p>Accepted. This has been rephrased.</p>
<p><b>9. Allowances For Fugitive Emissions</b></p>	<p>The Chamber of Mines suggests that the bill should exclude fugitive emissions from other mining commodities until such time as there is an IPCC approved monitoring and reporting methodology for such commodities.</p> <p>The Chamber suggests that the bill should exclude fugitive emissions from other mining commodities until such time as there is an IPCC approved monitoring and</p>	<p>Fugitive emissions are currently only relevant for coal mining.</p> <p>Mining of other commodities is only applicable if their stationary combustion activities meet the reporting thresholds for stationary combustion or if they have process emissions.</p>

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	reporting methodology for such commodities.	
	A percentage of a percentage is an incorrect approach to the required calculation.	Accepted. This has been rephrased.
<b>10. Trade Exposure Allowance</b>	See section on policy.	
	We propose that in Section 10(a)(i), the word “amount” be deleted and substituted with percentage.	Noted. The trade exposure allowance has been revised (see section 2.3. above).
<b>11. Performance Allowance</b>	The wording of this section seems to imply that even if a taxpayer achieves emissions intensity below the industry benchmark, it will only qualify for the allowance if it can show it has taken additional measures to further reduce its emissions in each tax period. What constitutes ‘additional measures’ remained undefined.	Additional measures were defined in the draft bill and simply refer to a priori actions taken by the entity to reduce their emissions.
<b>12. Carbon Budget Allowance</b>	Some sectors such as aviation requested further information on how the carbon budget allowance could be applied to aviation. <ul style="list-style-type: none"> <li>• There is support that this should be a deeming provision for a company to automatically qualify for the allowance if they are not included in the carbon budget process.</li> </ul>	Following consultations with the DEA, it was clarified that companies that voluntarily participate in the carbon budget can apply to the DEA for a carbon budget. The bill has been amended to allow for all companies that have been issued with a letter from the DEA approving a carbon budget will qualify for the allowance.
<b>13. Offset Allowance</b>	The rationale for the different levels of the offset allowance (5 or 10 per cent) was requested.	See response on offset allowances in the policy section.  The allowance of 10 per cent applies for energy combustion emissions. A 5 per cent offset allowance, and not 10 per cent, is provided for activities falling into the fugitive and process emissions categories as these activities already qualify for the 10 per cent fugitive and process emissions allowances, respectively.
<b>14. Limitation on Allowances</b>	The drafting of this section is unclear as it implies that the taxpayer will need to multiply the value in the column ‘maximum total allowance %’ by 95 %, thus implying that a taxpayer with activities in the waste water sector, for instance, would still be liable for tax, or taxpayers with activities in other sectors will have their allowances capped at a value less than 95 %. <ul style="list-style-type: none"> <li>• The intention of this section requires clarification.</li> </ul>	Noted. The activities in the AFOLU and waste sectors qualify for 100 per cent allowance and therefore a zero rate of tax.

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<b>15. Administration</b>		
	<p>Several respondents suggested that the carbon tax design is very complicated and that the inter-relationship between the DEA and SARS reporting requirements is not clear at this stage. As the carbon tax is linked to these reporting regulations, recommend that the reporting regulations be allowed to be bedded down.</p> <p>The registration process of SARS is unclear and there is currently no link between this registration and the registration process of DEA. This is essential if the DEA database, for which companies reporting GHG data will be registered, is to be used as a verification mechanism for the carbon tax.</p> <p>There are concerns that the rules determined by the Commissioner are not subject to consultation. The lack of consultation associated with the application of environmental levies is problematic and not supported as the implementation instrument for this tax.</p> <p>The regulation of the tax base is fragmented which will require clear and formalized lines of communication and responsibilities to be established between regulatory agencies and departments. There will obviously have to be a strong relationship between SARS and the Department of Environmental Affairs (DEA), since the latter has the primary responsibility for monitoring greenhouse gas emissions and this is a technical field which SARS will have no particular competence in. Real time access to the NAEIS system will be required by all of the regulatory bodies.</p> <p>Reporting requirements to two different departments will require coordination and sequenced timing to ensure all information is available to taxpayers so that they can calculate their liabilities and authorities can to process and verify the return.</p> <p>This is noted and further discussions are underway between NT, DEA, and SARS.</p> <p>As per the explanatory memorandum, the South African Revenue Service (SARS) will be the main implementing administrative authority on tax liability assessment. In order to audit the self-reported tax liability by entities, SARS will be assisted by the DEA.</p> <p>The DEA will lead the MRV process, collecting the GHG emissions data which will form the tax base hence incorporating the carbon tax within the National Atmospheric Emissions Inventory System (NAEIS – part of the South African Air Quality Information System, SAAQIS).</p>	<p>This has been noted and discussions between the NT, SARS, and DEA on a streamlined administration system has commenced.</p> <p>As per the explanatory memorandum, the South African Revenue Service (SARS) will be the main implementing administrative authority on tax liability assessment. In order to audit the self-reported tax liability by entities, SARS will be assisted by the DEA. The DEA will lead the MRV process, collecting the GHG emissions data which will form the tax base hence incorporating the carbon tax within the National Atmospheric Emissions Inventory System (NAEIS – part of the South African Air Quality Information System, SAAQIS).</p>
	<p>SANAS is of the view that the process of validation or verification performed to an SANAS accredited V/VB will enhance the credibility, consistency and transparency</p>	<p>Not accepted. The DEA GHG Emissions Reporting Regulations stipulates that the validation and verification process will be done</p>

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	<p>of GHG quantification, monitoring and reporting. This will support the assertion made by the NT which state that the implementation of the carbon tax requires accurate systems for monitoring, reporting and verifying emissions. SANAS proposes that a similar accreditation system be utilised in respect of the carbon tax bill. Suggests the inclusion of a new clause 15(3):</p> <ul style="list-style-type: none"> <li>“the greenhouse gas reported by a taxpayer shall be verified by a South Africa National Accreditation System accredited Validation and Verification Body”.</li> </ul>	<p>by the competent authority and that third party verification will not be required.</p>
	<p>Caution against a downstream rather than upstream tax: Levying the carbon tax upstream on fuel supply means application to coal producers and at the refinery gate. Rather the bill proposes to administer the tax downstream on industrial sources (which implies a greater number of taxpayers and also excludes small-scale sources from small enterprises, vehicles, and heating fuels). There are several challenges with this as argued by the IMF:</p> <ul style="list-style-type: none"> <li>The tax base is broad and the larger the tax base, the harder for administrations to manage. Consideration could be given to taxing at the source of the fuel (refinery, and/or mine mouth) vs. at the consumer level.</li> <li>Production of the product would be easier to track than consumption and the size of the tax base that would have to be administered would be reduced. It may also be easier to set up processes to administer as it would mimic processes already in place for excise taxes</li> </ul>	<p>This comment is noted. However, the DEA has developed a rigorous monitoring, reporting and verification system for reporting emissions and robust emissions methodologies in consultation with affected parties using the 2006 IPCC Guidelines. This MRV system will be used for the carbon tax, carbon budget and reporting of South Africa’s Nationally Determined Contributions.</p>
<b>16. Tax Period</b>	-	-
<b>17. Payment of the Tax</b>	<p>This requirement is considered more onerous than needs to be and should be reviewed. Reporting to the DEA is on an annual basis and a different timeframe would make it difficult to assess the GHG amount submitted by the taxpayer to SARS against the amount submitted to DEA.</p>	<p>Entities that engage in activities that produce direct GHG emissions will be liable for the tax and will need to submit their tax returns based on their own / self-assessment of emissions to SARS. The Department of Environmental Affairs has introduced the mandatory GHG Emissions Reporting Regulations in April 2017. The DEA will help the verification process of the self-reported GHG emissions for the purpose of the carbon tax liability and for SARS’ auditing purposes.</p>
	<p>Also unclear when these reports must be submitted, annual report submitted to DEA are only required within 4 months of the end of the calendar year.</p> <ul style="list-style-type: none"> <li>It is proposed that the system for payment of the tax should be aligned to the reporting requirements of the DEA, given that this information is likely to be used as a basis of verification.</li> </ul>	<p>Noted. Based on consultations with SARS, the option for submission of reports and reconciliation of tax returns will be explored for within 6 months of the end of the calendar year. This will allow sufficient time for the emissions to be reported and verified before finalisation of the tax return.</p>

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<b>18. Impermissible Tax Avoidance Arrangements</b>	<p>Provisions in Section 18 may render the objectives of the carbon tax as outlined in the media statement to change behaviour almost impossible to achieve. In particular the 'dealing at arm's length' definition is problematic in this regard as it includes the need for taxpayers to act without regard to the liability of the tax for a taxpayer to be dealing 'at arm's length' in a transaction. Sasol believes that this will preclude the use of offsets in particular as a means of reducing a taxpayer's tax liability.</p> <ul style="list-style-type: none"> <li>• This section should be carefully reconsidered and redrafted.</li> </ul>	<p>Noted. Section 18 on Impermissible tax Avoidance arrangements has been deleted from the carbon tax bill.</p>
<b>19. Reporting</b>	<p>Section 19 (a): the Commissioner cannot be held liable for the GHG emissions reported as there is no requirement for anyone to report to him. The Commissioner can only report on the amount of GHG gases for which a tax liability has been calculated by a taxpayer.</p> <ul style="list-style-type: none"> <li>• If this is what is intended, the language needs to be clear.</li> </ul> <p>Also assumed that this report will provide aggregated information so as not to compromise commercially sensitive information. Provision should be made for this report to be made public.</p>	<p>Accepted. This section has been amended.</p>
<b>20. Regulations</b>	<p>It is recommended that there should be clear provision for mandatory consultation on any regulations developed in terms of the Act.</p>	<p>See responses in Sections 2.3, 2.4, and 2.5 above.</p>
<b>21. Schedule 1</b>	<ul style="list-style-type: none"> <li>• Nampak estimates that the emission factor should be closer to 0.1500 to 0.1700 tonnes CO<sub>2</sub>e per tonne of glass excluding cullet production. This factor is overstated by 25 per cent. The 2006 IPCC Guidelines emissions factor of 0.200 tonnes CO<sub>2</sub>e per tonnes of glass does not necessarily hold true for all glass production.</li> <li>• Table 1 of Schedule 1, which lists GHG emissions factors, includes "other primary biomass" and "wood / wood waste. These are renewable fuels and their listing in this Schedule appears contrary to the stated intention of levying the carbon tax. It is recommended that these items be removed from Schedule 1.</li> </ul> <p style="margin-left: 20px;">- The inclusion of renewable fuels like biodiesel, charcoal and wood in Schedule 1 with EFs, if legislated will defeat the objective of the carbon tax</p>	<p>The emissions factors provided in the Schedule 1 of the carbon tax bill are default emissions factors based on the 2006 IPCC Guidelines and are aligned with the Mandatory reporting regulations and Technical Guidelines. A process to submit alternative emission factors is clearly stated in the NGERs and associated technical guidelines of the DEA.</p> <p>Noted. Currently, DEA requires reporting on biomass used as fuels for emissions of methane and nitrous oxide. Therefore, these fuels have been included under the carbon tax net.</p>

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	<p>by burdening renewable fuels in the same way as fossil fuels.</p> <ul style="list-style-type: none"> <li>• Specific emission factor concerns regarding the cement sector which also needs to be carefully reviewed: <ul style="list-style-type: none"> <li>○ Emission factors for industrial waste, tyres, and solid derived fuels and municipal waste are not included.</li> <li>○ Wood has been assigned an emission factor of 1.7764 tCO<sub>2</sub>/t. emission factors for biomass or carbon neutral material needs to be shown as zero.</li> <li>○ Emission for all non-fossil fuel emission should be zero.</li> </ul> </li>   <li>• IATA would like to seek a clarification on the value or unit of the emission factor provide in Schedule 1 for aviation fuels. Indeed, the emission factors in Schedule 1 for fuels used in aviation appear to differ significantly from the IPCC emission factors. For example, the default IPCC CO<sub>2</sub> emission factor for jet kerosene is 71,500 kg/TJ, for a default net calorific value of 44.1 TJ/Gg (i.e. 3.15 tonnes of CO<sub>2</sub> per tonne of jet kerosene). The error in Schedule 1 may either be related to the value itself or to the units indicated (mass of CO<sub>2</sub> per mass of fuel vs. mass of CO<sub>2</sub> per volume of fuel). <ul style="list-style-type: none"> <li>○ IATA requests that the values in Schedule 1 be verified to ensure consistency with the values recommended by the IPCC.</li> </ul> </li>   <li>- Some terminology could create confusion as they are not in general use in South Africa e.g. jet gasoline – confusion is created as to whether it refers to jet fuel or aviation gasoline;</li> </ul>	<p><i>Emissions Factors for tyre derived fuels.</i> According to the DEA, the IPCC guidelines provide emission factors for some of these alternative fuels. However, due to the varying composition of this material, it is difficult to have accurate emission factors. It is suggested that tier 2 or 3 methodologies should be developed to track the carbon content and amount of fuels used in this case.</p> <p>Noted. This translates into expressing the units in their indigenous form as opposed to CO<sub>2</sub> equivalent.</p>
	<p>The emission factors for fugitive methane emissions from coal mining are incorrect and greatly overestimate the methane emissions for the country. Due to the significant variance in estimating these emissions, the bill must provide flexibility and allow companies to use (Tier 1, 2 or 3) - the NT/DEA factor or to use an auditable Site or Process specific factor or a combination thereof.</p>	<p>The draft bill provides default emissions factor based on the IPCC Guidelines. However, this not prevent the use of tier 2 or 3 methodologies if this is approved by the DEA. The Technical Guidelines to the NGER presents both the IPCC and Tier 3 methodologies for fugitive emissions from mining.</p>
	<p><i>Use of Tier 1, 2 and 3 Emissions Methodologies and emissions factors by GHG</i></p> <p>All emissions factors are not calculated by a default emission factor as reflected in paragraph 2 figure 1. In contrast, paragraph 1 (page 11) reflects tier 1 methodology as currently being allocated, the reporting regulations provide for three tiers of</p>	<p>The emission factors presented in the tables of Schedule 1 are the</p>

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	<p>methodology for reporting as follows:</p> <ul style="list-style-type: none"> <li>○ Tier 1: activity data and IPCC default emission factors</li> <li>○ Tier 2: technology specific emission factors also referred to as country specific factors. Such emission factors have already been approved by DEA for some sectors.</li> <li>○ Tier 3: use of a variety of methods including mass balances.</li> </ul> <p>The tax liability may be calculated using any one of the above tiers currently, not only in the future. It is therefore not correct to say that the formulas in the draft bill reflect the mandatory reporting requirements; there are significant differences in the methodology of the draft Bill and the methodology in the reporting regulations.</p> <ul style="list-style-type: none"> <li>- EFs outlined in Schedule 1 differ from those of the reporting requirements of the DEA. Reference to the respective technical guideline used for the draft Bill should be provided;</li> <li>- DEA gives companies latitude in terms of reporting methodology that suits them, the draft Bill emphasise tier 1 level which is contrary to DEA recommendations;</li> </ul> <ul style="list-style-type: none"> <li>• Requests that the Draft Carbon Tax Bill make allowance for companies to use alternative emissions factors that are not listed in Schedule 1, Table 3. Requests that the NT allow for Tier 3 methodologies like emissions models, material carbon balances and continuous emission measurement to be used.</li> </ul> <p>It may not be clear to companies as to which source categories, fuel types and source category activities fall within the ambit of their operations. There is need for a guidance to assist companies to determine this for the purposes of calculating the tax.</p>	<p>default emission factors based on the 2006 IPCC Guidelines. This does not preclude the use of Tier 2 and Tier 3 methodologies. Section 4(2) of the bill provides for the use of alternative methodologies as approved by the DEA for determining the GHG emissions of a taxpayer.</p> <p>Accepted. Schedule 1 of the Bill has been amended and will provide emissions factors for each GHG, rather than emissions factors that are converted to CO<sub>2</sub>e, for the different fuel types and activities.</p> <p>A column providing the IPCC codes for different activities has been included in Schedule 2 to assist companies identify</p>
	<p>Requests that the NT allows for these emissions factors to be updated on an annual basis to take into account any reductions achieved in process emissions.</p>	<p>Noted and supported, provided that industry sectors submit revised emission factors by following the procedure outlined in the NGERs and associated technical guidelines</p>
<b>Schedule 2</b>	<p>Basic tax-free allowance for fossil fuels: The table in Schedule 2 should be amended to read 60 per cent, not zero %, as per details provided in the explanatory note.</p>	<p>Accepted. Schedule 2 has been amended to reflect the basic tax free allowance for fuel combustion and process emissions.</p>