

PHASE 2 CARBON TAX DISCUSSION PAPER

Summary of Stakeholder Comments and Suggestions

Carbon Tax Discussion Paper Stakeholder Consultation
Workshop, 16 January 2025

Environment & Fuel Tax
Directorate

Tax and Financial
Sector Policy
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REPUBLIC OF SOUTH AFRICA



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Main comments

1. Carbon offsets allowance and carbon markets
2. Basic tax free allowance
3. Process and fugitive emission allowance
4. Trade exposure and performance allowances
5. Electricity sector structural reforms and price neutrality
6. Carbon Budgets and Revenue Recycling
7. Other

1. Carbon offset allowance and carbon markets

Carbon offsets – support for 15 percentage point increase

- **We fully support the government's proposal outlined in paragraph 48 of the discussion paper to stimulate carbon market activities under the carbon tax by raising the carbon offset allowance by 15 percentage points.**
- This increase would raise the allowance to 20% for fugitive and process emissions and 25% for combustion emissions. Such a significant adjustment, implemented immediately rather than through gradual increases, would send a strong market signal to incentivise investment in local carbon offset projects.
- This **bold step aligns with broader efforts to drive green growth** by fostering a sustainable economy and promoting innovations in emissions reduction
- Raising the carbon offset allowance by 15 percentage points represents an opportunity to accelerate South Africa's transition to a low-carbon economy.
- By implementing this adjustment, in a responsible way the government **can unlock significant economic, social, and environmental benefits while driving innovation and strengthening the domestic carbon market.**
- This proactive approach will not only support businesses in meeting compliance requirements but also promote **equitable development, foster biodiversity conservation, and enhance resilience to climate change.**
- **We support the increase of the carbon offset allowance by 15 percentage points as this will provide the market with opportunity to be more aggressive in the development of project that develop offsets** with the confidence of knowing the market for the offsets is growing. This will contribute to the National Development Goals for South Africa as the bulk of these projects will focus of small scale renewable and sustainable energy generation and utilization.

Carbon offsets – support for 15 percentage point increase (2)

- **The increase in the offset allowance to 20 25% is a welcome measure to incentivise emissions reductions.** However, at the current rate of eligible carbon credit supply, the proposed increase is likely to exacerbate the existing **mismatch between supply and demand**.
- As the Offset Allowance provides a volume discount on the gross taxable emissions, it tracks the marginal tax rate. It is therefore unlikely that the supply of eligible carbon credits will increase as a result of an increase in demand following the proposed change to the Offset Allowance.
- To address this, we **recommend accelerating the development of local offset standards under the domestic framework**.
- **We strongly advocate for the reintroduction of Section 12K** of the Income Tax Act. This provision, which previously incentivized carbon credit generation, would stimulate the development of projects that create eligible credits. Such a measure is essential to ensuring that SA's carbon market remains robust and sustainable in the long term.

Carbon offsets – support for 15 percentage point increase (3)

- **We welcome the intent to significantly increase effective carbon prices in South Africa in the period up to 2030 and then beyond to 2050.** Such prices are not only needed to incentivize mitigation but also to offer fair returns and incentives for project developers.
- We note that a declining recognition and rebate for early mitigation measures may be seen as appropriate over time. Similarly, **over time it may be expected that more progress in reducing process and fugitive emissions is made.**
- The provision to surrender carbon credits for offset purposes against carbon tax obligations is a strong measure that provides flexibility while still driving mitigation.
- In light of the ambition in raising carbon prices so substantially through the carbon tax, **it is a sensible and robust approach to increase the level of allowable carbon credit surrender as proposed.**
- While the proportion of tax obligations that may be met through carbon credits should be reduced at some point in the future, the ambition of the carbon price increase warrants that such a decline would occur in South Africa sometime after the 2035 timeframe considered in the proposal.
- We would further **suggest that South Africa may consider expanding the source of credits – or a portion of the allowable credits – to the broader Southern African region.**
- **May have the practical consequences of easing the transition to higher carbon prices under the carbon tax and enhancing the relationships with South Africa's neighbours through Article 6 of the Paris Agreement.**

Carbon offsets – support for 15 percentage point increase (4)

- Offset supply is likely to remain constrained during Phase 2. One potential solution to alleviate some of this shortfall is to **expand the eligibility criteria to include offset projects from the broader Southern African Development Community (SADC) region**.
- While the evolving framework of Article 6 under the Paris Agreement may introduce additional considerations (e.g. how the accounting of offsets within host and acquiring parties' nationally determined contributions should be undertaken), **this approach offers a practical short-term measure to ease supply constraints**.
- Consider expanding the eligibility criteria to include those developed within SADC **under the accepted internationally recognised standards (Verra and Gold Standard)**.
- To maintain a balance between addressing supply constraints and fostering domestic project development, we **recommend introducing a cap on the allowable contribution from SADC projects (e.g. 20% of total offsets)**. This approach would provide immediate relief to supply challenges while ensuring continued support for South African-based initiatives.

Carbon offsets allowance increase – support for phasing in of the increase

- **We support the proposed increase to the carbon offset tax-free allowance. The increase must however not be to compensate for the reduction of the basic tax-free allowance at this stage** as there is currently a lack of carbon offsets available in the market, carbon offset projects are complex, time-consuming and costly to develop and local carbon standards are not developed, operationalized nor can we gauge their effectiveness at this stage.
- **Carbon offset allowance does not replace the basic tax free allowance**, as these instruments serve different purposes and address distinct aspects of exposure and vulnerability. The basic tax-free allowance directly reduces the tax burden without additional financial outlay, whereas the offset allowance requires companies to invest in carbon credits, creating a cost burden that many businesses may struggle to manage.
- **There is often not a reduction in cost.** The lack of supply of carbon offsets means that the price demanded for carbon offsets is often close to, in line with or above the carbon tax rate. As such, the carbon offset tax-free allowance provides limited to no reduction to carbon taxpayers. Given the above, it is unlikely that companies will be able to make use of an increased carbon offset allowance immediately. Nor will the carbon offset allowance shield a company from the 25% increase in carbon tax liability resulting from reduction of 10 percentage points in the basic tax-free allowance

Carbon offsets allowance increase – support for phasing in of the increase (2)

- **There is support for the proposed increase in the carbon offset allowance**, as it offers a valuable incentive for stimulating low-carbon investments and driving technological innovation.
- However, given the current constraints in South Africa's carbon market, it is essential to focus on fostering its growth and development.
- This includes addressing structural barriers and enhancing participation across diverse sectors to ensure the market can effectively support emissions reductions and broader economic transformation.
- A **well-developed carbon market is critical for maximising the decarbonisation impact on the national economy**
- **Given the current constraints and limited supply in South Africa's carbon market, a phased approach to increasing the carbon offset allowance by 5 percentage points annually is more practical than a once-off adjustment.**
- This gradual transition provides companies with sufficient time to prepare, develop projects, and access the benefits of the higher offset allowance, ensuring a smoother implementation.

Carbon offsets allowance increase – support for phasing in of the increase (3)

- This proposal directionally indicates a shift to a carbon market/carbon trading mechanism.
- **This is welcomed as an addition to the overall toolkit to facilitate the transition**, but it should not be seen as an umbrella approach to incentivising transition investments.
- Based on the top emitting companies in South Africa, it is estimated that roughly 64 million carbon credits will be needed per annum for companies to fully utilise the offset allowance.
- **The market for offsets in particular needs to be stimulated** before it can become a much needed prominent feature of the carbon tax regime

Carbon offsets allowance increase – support for phasing in of the increase (4)

- **Standards under which carbon offset projects can be developed are complex**, requiring specialists to develop the projects and specific auditors to validate them before they can be registered and verify them before they can be issued with carbon offsets.
- This means that **the process to develop carbon offsets projects is time consuming and costly**. Typically, it **takes more than a year to register a project and then another year before carbon offsets are issued**. It also typically **costs in excess of R1 million**.
- The complexity, time and cost are severe limitations in the development of projects, the expansion of the carbon offset market, and the use of the carbon offset tax-free allowance.
- **There are limited standards under which a carbon offset project can be developed**. Of the standards listed in the Carbon Offset Regulations, the Clean Development Mechanism (CDM) is not operational.
- **It is meant to be replaced by the Article 6(4) mechanism** which is not yet operationalised, as acknowledged in the Discussion Paper - 'Once the Article 6(4) mechanism standards and methodologies are approved and the mechanism registry is operationalised, it is proposed to include the mechanism as an eligible standard under the carbon offset scheme.'
- Even when operationalised, it is unlikely to alleviate the challenges around complexity, time and cost.

Carbon offsets allowance increase – support for phasing in of the increase (5)

- Given the complexities, time and cost associated with developing carbon offset projects under the eligible standards, there is a **limited supply of carbon offsets in the market**.
- With the carbon offset tax-free allowance currently set at 10%, many **companies struggle to make use of this allowance due to lack of supply**. The lack of supply of carbon offsets means that those available trade at close to the carbon tax rate. Therefore, the carbon offset tax-free allowance does not significantly reduce the burden on taxpayers.
- This limitation has discouraged participation and investment in offset projects, despite their potential to reduce net emissions and support local development.
- **It would be prudent to consider a phasing of allowances to cater for this shift.** It is however acknowledged that an **inclusive offset framework would encourage greater participation from hard to abate sectors such as cement**, enabling producers to mitigate their tax liabilities while contributing to South Africa's decarbonisation efforts
- **A gradual increase in the carbon offset tax-free allowance and a gradual decrease in the basic tax-free allowance is preferred** until the above challenges have been solved through the implementation of local carbon standards and there is a sufficient supply of carbon offsets.

Carbon offsets allowance increase – support for phasing in of the increase (6)

- **Summary of Options suggested by stakeholders:**
 - **Reduction of the basic tax-free allowance of 2.5 percentage points per annum in favour of an increase in the carbon offset tax-free allowance should be considered when the local carbon standards have been implemented** and are working effectively. Until such time, the basic tax-free allowance should be retained at its current level. The proposed options allow the domestic carbon offset market to expand and mature, making credits more accessible and affordable for businesses. Once the carbon market is well developed, technology solutions are available, and economic conditions are more favorable, a gradual reduction of the basic tax-free allowance could be implemented without undue hardship
 - **Gradual increase in the carbon offset allowance by 5 percentage points per year until it reaches 25 per cent.** It is true that there might be a likelihood of a shortage of credit supply in the short-term, and companies would be afforded a longer-time period to prepare and have projects ready in order to access the higher offset allowance.
 - **Proposed carbon offset allowance of 15%.** South Africa has a very immature and thin carbon market. Until we have an experience of trades and a track record that can be appraised for impact, we feel it would have made more sense to be conservative. 10 – 15% is the proportionate and safe contribution that a market instrument can reliably make to decarbonization efforts.

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Carbon offsets allowance increase - do not support

- **Keep the carbon offset allowance at a maximum of 5% for all emissions.**
Carbon offsets are not the equivalent of GHG mitigation and should thus not be treated as such.
- A domestic carbon market is not a solution to either earning more revenue or mitigation and should not be encouraged for South Africa
- **While carbon markets are helpful, we do not see carbon offsets as a general solution.** They can prove a distraction to businesses/sectors that can themselves feasibly take energy efficiency and carbon reduction measures.
- **We agree with a cap on use of offsets similar to the international one,** and not as high as 20% or 25%.
- **The use of carbon offsets often results in the overstating of emissions reductions,** and many emitters employ offsets as a more cost-effective option to investing in tangible emission reductions in their own supply chains. Without robust regulatory frameworks, there is significant scope for abuse of offsets.

Carbon offsets allowance increase - do not support (2)

- The reality is that in South Africa **the offset credit market is small and will take years to develop, compared to investment in renewables**, and that globally carbon credit markets have remained much smaller than anticipated.
- We **oppose the proposed increase in carbon offsets of up to 20% for process or fugitive emissions and 25% for combustion emissions**.
- Expanding **carbon offsets would stimulate demand for cheap emissions offset** credits, delay the structural changes that are needed for decarbonising economies, and would be administratively onerous.
- It will also **introduce additional risks of ‘leakage’, “creative” carbon accounting, and of adverse impacts of activities that are designed to generate offsets cheaply**. These risks will already be elevated by introducing the less demanding standards for the certification of offsets with the methodology proposed by the Department of Mineral Resources and Energy.
- The **administrative burden to ensure a credible, effective offset credit market is likely to be huge, and far costlier than pursuing an assertive carbon tax** combined with effective renewable energy infrastructure support.
- There are also **serious concerns about additionality**: large-scale renewable energy projects should not, for example, be counted for offset purposes at all, given that South Africa is already “oversubscribed” with such renewable projects, with the main constraint now being a lack of grid availability to accommodate the large volumes of renewable energy supply potentially available.

Carbon offsets – 12L tax incentive

- **The 12L incentive has been instrumental in promoting energy efficiency projects** by offering tax deductions for verified energy savings under the SANS 50010 Energy Efficiency Savings standard.
- **In principle, we support the proposal to expand the carbon offset mechanism to include energy efficiency projects, such as eligible 12L projects approved under the SANS 50010 standard.** This integration will ensure continuity for energy efficiency initiatives and provide a seamless transition for projects that currently rely on the 12L incentive.
- Recognising these projects as high-quality offsets will not only maintain momentum in energy efficiency efforts but also contribute to the broader objectives of the carbon tax framework by reducing emissions in a cost-effective and verifiable manner.
- **As a practical proposal, we recommend delaying the phaseout of the Section 12L Energy Efficiency Incentive beyond its current 2025 deadline.** While the proposed transition to include eligible 12L projects under the carbon offset mechanism is promising, several challenges must be addressed to ensure a smooth and effective implementation.

Carbon offsets – 12L tax incentive (2)

- **These challenges include:**
 - **Clarifying Taxable Boundaries:** Many 12L projects are implemented within the taxable boundary of tax-paying entities. While energy efficiency measures in electricity systems do not directly reduce carbon tax liability, there is potential confusion regarding the taxable boundary. Clear guidance is needed to ensure consistent interpretation and application.
 - **Facilitating Transition to Offsets:** Many energy efficiency projects are smaller in scale than the typical threshold for viability under existing international carbon standards.
- **Developing a domestic standard is crucial to enable these smaller projects to access the carbon offset market.** However, since the Framework for Approval of a Domestic Standard is only expected to be published in 2025, it may take additional time before these projects can reasonably participate in the carbon market. This delay underscores the importance of transitional measures to support such initiatives in the interim.
- Additionally, it would allow for the development and implementation of a robust domestic carbon standard, enabling smaller-scale projects to access the carbon market effectively.

Carbon offsets – 12L tax incentive (2)

- **The section 12L incentive should not lapse until the local carbon standards have been implemented** and are working effectively.
- In light of the above considerations, **it is recommended that the Section 12L Energy Efficiency Incentive be extended until 2030.**
- This extension would provide sufficient time for a smooth transition to the carbon offset mechanism, ensuring that energy efficiency projects continue to contribute to South Africa's emissions reduction goals without disruption.
- **Stakeholders are of the view that the inclusion of energy efficiency as a carbon offset mechanism violates the fundamental principle of additionality and they frequently fall within tax-liable sectors.** Energy efficiency measures should not be considered as a carbon offset, and there is support for the extension of the section 12L rebate for a further period as a strategic means of recycling revenue to support the transition.
- **All stakeholders supported the extension of the 12L tax incentive.** There was broad support for an end date of 2030 and some stakeholders suggested an adjustment of the 95c/kWh by inflation

Carbon offsets allowance – Domestic standard framework

- Although there are several developments underway to develop a local carbon offset framework and a local carbon offset standard, this has not been finalised, and even once the regulatory framework is in place, the market still needs time to develop.
- It is not expected to be ready by 1 January 2026 and it is not expected to have addressed the significant shortfall of credits in the market by this date.
- We require further clarity on the timing for Domestic Carbon Standards. The document refers to the Framework for approval being released “before the end of the financial year”
- All carbon standards in South Africa, and most particularly Domestic Carbon Standards, should serve the country’s flagship Just Transition Framework (JT). The notions of distributive, restorative and procedural justice contained in the JT Framework are essential to carbon markets. Indeed, existing carbon market failures in terms of high transaction costs, low proportion of transaction value reaching the ground, inability to support smaller and informal settlement projects and lengthy time delays, can be linked to deficits in these three strands of the JT.
- The approval of Article 6 at COP29 creates a rare moment for countries to articulate the ‘rules of the game’ of carbon markets and if South Africa were to not mention the JT in its market rules it would be doing a dis-service to the global carbon market and itself.

Carbon offsets allowance – Domestic standard framework (2)

- The development and implementation of local carbon offset standards should be prioritised. Local standards would reduce costs, streamline processes, and make carbon markets more accessible to domestic project developers.
- This approach would enhance participation, support the growth of high-quality local projects, and contribute significantly to South Africa's emissions reduction and economic transformation goal.
- To support this initiative, the administrative costs associated with implementing the Framework for Approval of Domestic Standards should be funded through the recycling of carbon tax revenue.
- This approach will provide the necessary resources while reinforcing the alignment of carbon tax revenues with South Africa's low-carbon development objective

Domestic Standard – Potential Risks

- We note the ongoing wish to develop a new domestic offset standard in South Africa, largely as a result of costs and lengthy processes in global crediting programs.
- This is the sovereign right of any country and we note that such a domestic standard would operate alongside the ongoing use of independent credit programs such as Verra's Verified Carbon Standard (VCS).
- We should however draw attention to the **substantial financial and resource costs involved in establishing and then maintaining the governance, standards, methodologies and processes required to effectively and efficiently operate crediting programs.**
- It should be an important consideration that **operating a domestic crediting program may not be as low cost as may be initially expected and that the pressure to demonstrate the highest integrity will be very strong.**
- Verra – as well as some other international crediting programs – is investing heavily in the digital transformation of project and credit processing.
- We firmly believe there is very significant potential for countries to benefit from independent crediting programs, in providing efficient and low-cost crediting services, in ensuring high integrity and credibility of carbon credits, and in facilitating linkages to other countries and markets.

Domestic Standard – Potential Risks (2)

- **Without robust safeguards and a commitment to the highest levels of integrity**, there is a **significant risk** that the market could become saturated with **low-quality credits**.
- Such an outcome would **undermine confidence in the system**, dilute environmental benefits, and diminish the market's credibility.
- To mitigate these risks, **policy intervention is needed to ensure that a domestic standard promotes high-quality credits**, and balances market expansion with environmental integrity.
- This approach would enable South Africa to achieve its sustainability goals while maintaining trust and transparency in the offset market.
- Ensure, through **working groups comprising local and international experts**, that the ratification of any domestic standard is done via an **informed process to ensure alignment with international best practices and integrity measures**.

Carbon offsets increase – CBAM implications

- **The use of carbon offsets is not recognised under the EU CBAM and the UK CBAM.**
 - Using the carbon offset allowance effectively decreases the explicit price of carbon paid when calculating the financial implications of importing goods into countries with a CBAM in place.
 - This decreases the recognised price of carbon paid in South Africa for purposes of avoiding double taxation at the EU and UK border.
 - This should be considered when decreasing allowances and increasing the carbon offset allowance as a trade-off.

Cashflow challenge for carbon offset project developers

- **A key challenge to carbon offset project development is the strain on cash flow.** Project developers are required to cover all upfront and ongoing monitoring costs, while buyers typically purchase credits only once a year, just before the carbon tax submission deadline.
- This misalignment creates significant cash flow pressures, particularly for smaller operations, and can hinder the growth of the offset market.
- **To address this issue, policymakers could consider requiring taxpayers to submit an interim tax position in January,** reflecting the first six months of the carbon tax year.
- **This adjustment would enable the offset benefit to be realised based on mid-year data,** improving cash flow for project developers and offering buyers greater flexibility in managing their own financial planning.
- Such a measure could alleviate financial strain and foster a more robust and inclusive carbon offset market.
- **It is recommended that provision is made for an interim carbon tax payment** as a means of improving cash flow positions of carbon offset project developers and buyers alike.

2. Basic tax free allowance

Basic tax free allowance – General concerns

- Tax-free allowances are meant to cushion industries while the necessary structural adjustments take place and technologies are developed and available at scale.
- **Industries, and especially those industries defined internationally as being hard-to-abate, require time for technologies to be developed**, innovation, alternative materials and significant investment in order to optimise the decarbonisation journey.
- **Funds diverted to cover increased carbon taxes would limit investment in expansion and innovation projects** which could support reduced emissions. Suggests phased implementation of gradual increases in the carbon tax rates to allow industries time to adapt and invest in low-carbon technologies.
- **Tax-free allowances are needed to at least sustain current levels of decarbonisation** and to explore and pilot the relevant technologies for South Africa. Currently there are no viable alternatives to coal. Until such time as viable alternatives are available, the impact of the carbon tax on emission reduction will be limited.
- **Any significant reduction in the basic tax-free allowance should therefore only be considered when companies have access to natural gas, green electricity, biomass and/or hydrogen.**
- The carbon tax will increase the burden on companies without achieving the intended reduction.

Basic tax free allowance – General concerns

- **Carbon tax cannot be considered in isolation:**
 - **Rising costs** of energy, raw materials, and labor have squeezed profits margins for manufacturers.
 - **Competition from imports:** South African manufacturers face stiff competition from lower-cost producers in countries like China and Vietnam.
 - **Loadshedding:** Over the last few years, regular power outages disrupted production schedules, increased operational costs, and reduced overall output.
 - **Logistics challenges:** Inefficiencies in the logistics sector, particularly at ports and railways, have led to delays in the movement of goods, increasing costs and hindering exports. Failing road infrastructure and readiness levels for consideration such as EV and relevant infrastructure.
 - **The global economic downturn** has reduced demand for South African manufactured goods, particularly in key export markets like China and Europe
 - **Insufficient investment in the manufacturing sector** has hindered its modernization and competitiveness
- These challenges have resulted in declining manufacturing output, job losses, and a weakened manufacturing's contribution to the overall economy.
- These challenges must be considered in the design of Phase 2 of the carbon tax.

Basic tax free allowance— Just Transition

- **The carbon tax may disproportionately affect low-income workers employed in GHG emissions-intense industries.** If businesses reduce jobs or wages to offset the additional financial burden of carbon tax in Phase Two, then workers in these sectors could face increased economic hardship.
- **A rapid phase-out of the basic tax-free allowance and the removal of the trade exposure allowance could compel industries to reduce their workforce,** leading to job losses and negative socioeconomic consequences.
- This would **disproportionately impact communities reliant on GHG emissions-intense industries,** without providing sufficient support for these sectors to shift to more sustainable practices or to create new employment opportunities, consequences which would not be in accordance with the idea of a "just transition"
- **Framing the adjustments to the basic tax-free allowance for 2026 to 2030 as 'relatively moderate' is inaccurate.** The reduction of the basic allowance and removal of the trade exposure allowance places companies in export-driven sectors at a competitive disadvantage

Basic tax free allowance– Just Transition (2)

- While Phase 2 represents a critical step towards aligning South Africa's climate policy with international standards and achieving its decarbonisation commitments, **it is evident that significant adjustments and support mechanisms are required to ensure a just and sustainable transition.**
- The **proposed measures**, including the drastic reduction of tax-free allowances and increased tax rates, **pose substantial risks to key sectors of the economy**, especially those heavily reliant on carbon-intensive processes.
- **Without adequate enablers, such as technology innovation, financial support and infrastructure development, the ambitious timelines outlined in the discussion paper may prove untenable for industries and communities alike.** It is crucial for the government to balance the objectives of fiscal relief, carbon reduction, and economic growth while mitigating the adverse socioeconomic impacts on vulnerable sectors, small businesses and affected communities.
- As emphasised, **a nuanced and phased approach, including incentivisation, retention of allowances, exemptions or tax credits that incorporates the realities of South Africa's coal-dependent economy and prioritises equity, economic readiness and industry-specific challenges is essential.** Moreover, alignment with international mechanisms such as the EU's CBAM should reflect the unique trade, production and consumption patterns within the domestic economy.
- **Urges the government to adopt policies that balance fiscal relief with economic readiness, equity, and sustainability.** Retaining current allowances, gradually increasing offset mechanisms, and addressing the unique challenges faced by carbon intensive and hard-to-abate sectors are vital to safeguarding South Africa's industrial base.
- Furthermore, **greater alignment with domestic realities, including trade dynamics and the socioeconomic impacts on communities and small businesses, is essential** for achieving a truly just transition. By integrating these considerations, South Africa can move closer to its climate ambitions while ensuring the resilience, competitiveness, and inclusivity of its economy

Basic tax free allowance – Retain current allowances

- The steep accelerated increases to the carbon tax rate already published are placing pressure on carbon taxpayers, as the carbon tax rate was initially going to increase by CPI plus 2% in the first few years and Consumer Price Inflation (CPI) thereafter.
- In addition, it is understood that the intention of National Treasury is to accelerate the carbon tax rate even further after 2030. This coupled with the **latest proposal to reduce the basic allowance by 10% in 2026 will place immediate significant financial pressure on carbon taxpayers.**
- This pressure is further increased by rising energy prices which are also increasing by more than CPI. This must be considered when decreasing the basic tax-free allowance.
- **There is a view that the phase out proposed to be implemented is at too fast a pace and will be detrimental to businesses.** The more gradual the phase out, the more this will assist companies to adjust
- The significant reduction in 2026 should also be reconsidered in light of the objective of the carbon tax which is to reduce emissions and the lack of alternatives available to companies
- **A 10-percentage point reduction in one year is significant.** It lowers the basic tax-free allowance from 60% to 50%, a 17% reduction. It increases the effective carbon tax rate in 2026 by 25%. A 25% increase in a company's carbon tax liability is significant and above inflation
- We **request that National Treasury retains the basic tax-free allowance at 60%** and only decreases it once the impact on the economy is modelled and the alternative energy sources are available. The reduction of 10 percentage points in 2026 should be reconsidered.

Basic tax free allowance – Delay the reduction in basic or apply 2,5 percentage point reduction from 2026

- Specifically, a **10% reduction in 2026 is too drastic** and would need to be more gradually decreased
- Many companies note that their **decarbonisation efforts will not yield linear reductions** and that they **expect a greater step change in emissions reductions from 2030**.
- This is particularly the case in South Africa, given a current lack of economically feasible alternatives e.g. on feedstock/ baseload power.
- Instead of reducing the basic allowance by a step change of 10% in 2026, we would **recommend maintaining a higher basic allowance this decade and rather implementing a step change post-2030**.
- Based on the data available for roughly 22 different companies in various industry sectors, the overall **net impact of these changes result in an increase of their carbon tax liability of 244% from 2025 to 2026** (and this has considered that companies can claim the performance benchmark allowance). The average increase of the carbon tax from 2023 to 2026 is more than 350%.
- Given the steep increase in 2026, it is **recommended that the basic allowance be phased out more gradually or even delayed by another 5 years to 2031**. It is proposed that the basic allowance be phased out by 2.5% per year from an agreed-on start date.
- Proposed that the proposed **10% reduction of the basic allowance in 2026 be reconsidered rather be a 2.5% reduction**.

Basic tax free allowance– iron and steel

- **This is the only allowance that is stable and predictable** independent of any investment, market condition, trade exposure or performance. The proposed reduction of this allowance is not supported.
- Increased rates until 2030 combined with the phase down of tax - free allowances as predicted are unaffordable for the primary steel industry.
- The implications of the proposed tax and phase-down of tax-free allowances will potentially cause downsizing and/or closure of operations, will affect competitiveness and may lead to job cuts.
- **Companies along the steel value chain, cannot afford to incur the total cost of decarbonisation technologies, carbon tax, a carbon budget penalty if/when applicable, and CBAM on top of standard operational and costs and essential capital expenditure**, especially in the context of depressed local demand, and high logistics and energy costs, as well as scrap taxes.
- No major changes in terms of enablers and technology development have been experienced in our sector since the first phase of the carbon tax. Therefore the pace and scale at which carbon pricing is expected to evolve in South Africa, while justifiable for many sectors, is not viable for steel, and will render the industry significantly uncompetitive. Steel industry carbon tax liability from 2025 to 2026 will increase by more than 200% in one step.
- **Request exemption from the carbon tax or at least to retain the current level of tax-free allowances while viable investment in lower-carbon technologies is underway**, and new technologies are developed at scale to enable the transition. **Support mechanisms to be considered** ie. Incentives, subsidies, or grants to support decarbonisation efforts in the steel sector.

Basic tax free allowance – cement

- The **cement industry has been recognised as a difficult to abate industry** and the process emissions based on the chemical reaction of calcination of limestone cannot be altered.
- This chemical reaction cannot be changed. The process emissions associated with cement manufacturing cannot be adjusted, but there is scope for cement businesses to make changes in its processes to reduce combustion emissions.
- It is **crucial that hard to abate industrial sectors are offered feasible pathways for decarbonisation, including through Carbon Capture and Storage (CCS)**.
- **Absence of CCS opportunities and infrastructure**, including storage capacity, is a fundamental risk to South Africa's industrial decarbonisation and climate ambition, implying massive job losses through closures and increased reliance on imports.
- A **major challenge remains the lack of strategy on CCS infrastructure**. The business case for CCS must be supported by a regulatory framework that is flexible and fit for purpose, incorporating incentives and de-risking mechanisms to encourage investment.
- It is **recommended that the National Treasury provide increased process-related allowances** to ensure the viability of the industry. In summary, it is important that the National Treasury consider the challenges facing the cement sector in terms of process-related emissions that cannot be mitigated.

Basic tax free allowance – Liquid fuels

- **Retain the allowance framework in its current form, including the basic tax-free allowance at 60%, with distinct incentivisation for direct investment into the energy transition and low carbon industrial development.**
- **Different jurisdictions adopt selective carbon pricing policies reflecting their unique economic and developmental priorities.** Developing countries like Colombia and India exempt exports and coal-based power to prioritise economic growth and energy access, while developed economies like the UK and EU focus on energy intensive industries and power generation, often excluding agriculture to minimise economic disruption.
- **Emissions Trading Systems (ETS), like those in the EU, South Korea and China, focus on sectors with high emission reduction potential, such as power generation and heavy industries, using a phased or sectoral approach** to balance economic and environmental goals. Meanwhile, global sectors such as aviation and maritime shipping are partially regulated under international frameworks like CORSIA, reflecting the complexities of cross-border emissions management.
- **Differentiated carbon taxation within economies has become a central feature of emerging industrial policy** as national governments globally make strategic choices on the pace and scale at which different sectors must price their emissions and transition.
- **To enable investment in advanced, low carbon opportunities, a tax allowance up to a 100% of our carbon tax liability is suggested to deliver on renewable and sustainable initiatives for our transition and South Africa's economic growth and social upliftment.**

Basic tax free allowance– energy intensive industries including mining

- **Reduction of allowance over time will dramatically increase carbon tax liabilities, impacting the profitability and sustainability of energy intensive industries.** This is particularly true with no alternative low-carbon technology or energies available e.g. biofuels.
- The gradual reduction of tax free allowances may present **challenges for mining industries that have limited access to low carbon technologies**, potentially impacting their competitiveness and financial stability
- This submission is based on the rationale that **mining is a price taker and cannot pass through the effect of the tax to the final price without losing competitiveness**, thus negatively impacting on its overall profitability and sustainability and erosion of its investment attractiveness.
- An increase in costs will reduce overall mining output, investment, and employment. Recent analysis undertaken which looked at two industries (gold and coal mining) found that gold mining will be the most affected during Phase Two with the negative impact coming through indirect taxation via the price of electricity.
- **Our proposal would be to only consider a gradual reduction of <2% per annum for the next 2–3-year period**, whereafter a further evaluation would be required.
- **Mining is a marginal sector, where slight changes in operational costs can represent tipping points** (between continued operations and closure) for some industry players, **mining companies should be exempted from the carbon tax.**

Basic tax free allowance – Other

- The Discussion Paper indicates that if the carbon tax rate is increased to \$120 per ton of CO₂ by 2030, the model predicts that emissions could be reduced to between 377 and 453 MtCO₂ during the period from 2026 to 2030, aligning with the NDC commitment range. **The Discussion Paper does not mention that South Africa's emissions for 2022 were already within the NDC commitment range for 2025. This implies that carbon pricing has already been effective in lowering South Africa's emissions trajectory.**
- Therefore, **raising the carbon tax that companies must pay could deplete funds needed for the future implementation of cleaner technologies.** Incurring high carbon costs through taxes while low-carbon technologies are still being developed, at a time when South Africa's emissions are within the NDC commitment range, may not be the most efficient use of financial resources.
- **Preliminary research available suggests that a carbon tax negatively impacts on the economy.** According to a study done by Abel and Roux namely, 'Carbon Tax and Environmental Quality in South Africa in 2023, a reduction in GHG emissions in South Africa by 1.42% leads to a reduction in real GDP by 1.17% and household consumption by 2.34%. They further note that as the tax rate increases, welfare is decreased due to loss in household consumption. This is a “major setback to inclusive growth which is a major policy objective for National Development Plan (NDP) 2030

Basic tax free allowance – Other (2)

- The Presidential Climate Commission (“PCC”) has commenced the process to advise government on the drafting of the next NDC. **It is proposed that the development of carbon tax rates and the phased reduction of tax-free allowances be aligned with the NDC development process.**
- In this context, it is **essential to incorporate the principle of Common but Differentiated Responsibilities, as enshrined in the UNFCCC and the Paris Agreement, to ensure fairness and equity** in South Africa's approach to addressing climate change and to ensure that the carbon tax element of the NDC process does not result in undue hardship being imposed upon carbon taxpayers.
- **National Treasury should conduct a SEIAS to analyze the associated costs, benefits, and risks to the economy.** Moreover, before changes are made as part of Phase 2 of the carbon tax, an assessment should be done of Phase 1 of the carbon tax to see whether it has achieved its emission reduction objective and at what cost to the economy. This should inform us of the future of the carbon tax and the changes to be made under Phase 2.

Basic Tax Free Allowance – Just Energy Transition

- **South Africa is a highly coal-dependent economy, with a high concentration of income and employment in hard-to-abate sectors.**
- **To implement Phase Two of the Carbon Tax in a way that achieves carbon reduction while still supporting economic growth and justice is thus critical.** This should include considerations around the economic context, carbon intensity, and trade-offs between incentives, costs of new technology, and the benefits arising from the implementation of this phase of the carbon tax.
- The publication of the Carbon Tax: Phase Two report follows the enactment of crucial policies by the President namely the Climate Change Act on 23 July 2024 to coordinate South Africa's response to climate change and the Electricity Regulation Amendment Act (ERA) enactment by the Presidency in August 2024. The amendment and passing of these Acts confirms governments commitment towards a reformed and decarbonised electricity sector which is our biggest source of emissions.
- **We believe that the Carbon Tax policy is a crucial part of the overall reforms and should be integrated and aligned with other relevant policies and programmes for an effective Climate Change mitigation and reform agenda.** The proposals do not contain the necessary nuance that is needed to reflect the time frames relating to South Africa's decarbonisation efforts.
- **Though certain critiques of the proposals are valid**, in the spirit of fair risk and reward sharing, **it is essential that businesses reduce their emissions and not simply rely on favourable government regulation to maintain the status quo.**
- **Supports the reform steps that NT has proposed if the nuances that raised can be addressed**, as they are also critical to South Africa's decarbonisation efforts and global obligations toward addressing the significant threats of climate change.

Basic tax free allowance – Urgent action to reduce climate risks and higher carbon prices required

- **Southern Africa is particularly vulnerable to climate change** because of its geographical location and state of socio-economic development. Warming in the interior of southern Africa is occurring at about twice the global average rate.
- **The carbon tax is a crucial tool in the reduction of GHG emissions**, and its design and implementation are of substantial public interest and importance. **Pricing carbon correctly – to reflect the actual costs of emissions to society – would be transformative in limiting the worst impacts of the climate crisis.**
- Taxing carbon emissions (at a rate related to GHG emission reductions commensurate with the best available climate science) is a **powerful tool to change behaviour by altering economic incentives**
- The **current carbon tax remains far too low to create the necessary incentivisation** to encourage a just transition to a low-carbon economy and to ensure that the “polluter pays”.
- The fact that the most **recent (2022) carbon tax increases will not incentivise Paris-aligned climate action is supported by various expert views**, including 2021 research by the National Business Initiative.
- It is essential that amendments to the **carbon tax** ensure that it contributes to the Paris Agreement’s goal to **make “finance flows consistent with a pathway towards low GHG emissions and climate-resilient development”**.

Basic tax free allowance – Urgent action to reduce climate risks and higher carbon prices required (2)

- Multiple additional sources within the country have provided guidance on carbon prices, starting from the optimal R140 per tonne (increasing over time) modelled in the Long Term Mitigation Scenarios in 2007 to the 2016 OECD study detailing a current average price of ZAR 204 and a recommended optimal price of ZAR 438.
- **The proposed full carbon tax prices are consistently well below the recommended levels.** In fact, taking the mean of studies cited in the discussion paper, the proposed carbon tax rate (without rebates) doesn't even fall within a standard deviation of the mean prices proposed.
- The **proposed carbon price is inadequate to drive real ambition across the economy.** Even considering restructuring rebates as suggested above, the full carbon price is well below any of the carbon prices evidenced in literature. It is clear that even the full marginal price is too low to incentivise change according to these sources, with the effective price so low as to have no impact whatsoever.
- When considering the **additional rebates proposed within this discussion paper**, this is viewed as **insufficient motivation for the energy and emissions transition.** The proposed effective carbon price for combustion in 2035 is less than 10% of the mean recommended value
- **Support for carbon pricing in South Africa that is consistent with limiting temperature increases to 1.5°C which requires the carbon tax to be a minimum of US\$226/tCO₂e by 2030 (approx. R4000/ tCO₂e).** Remove the full tax-free allowance as businesses and consumers have had sufficient notification of the carbon tax increases since 2019

Basic tax free allowance – Urgent action to reduce climate risks and higher carbon prices required (3)

- Whilst the **rationale for buffering the economy against price impacts is appreciated**, the **very low effective carbon price undermines any potential effects of the tax**.
- The rationale for this allowance was that business needed time to prepare for a carbon tax. However, **given that the carbon tax process started roughly a decade before implementation, and has now been in effect for five years, adequate preparation time has been provided**.
- The State of Climate Action in South Africa report (July 2024) noted that **‘...studies concur that South Africa is currently on track to meet the 2025 emissions reduction target but will likely fall short of reaching the 2030 target.’**
- The report also notes that where **emissions have decreased, this seems to be driven by economic and climate factors such as the economic crisis and the COVID-19 pandemic, as well as loadshedding**. More importantly, the reduction in emissions are not due to mitigation efforts aimed at reducing emissions.

Basic tax free allowance – Urgent action to reduce climate risks and higher carbon prices required(4)

- The **measures outlined in the paper signal a transformative shift in South Africa's commitment to mitigating climate change** and achieving its Nationally Determined Contributions (NDCs) under the Paris Agreement. There is support for the “polluter-pays principle” as it is a crucial mechanism for driving accountability and incentivising sustainable practices
- The **gradual reduction and/or removal of carbon tax allowances is a positive step** towards achieving an effective carbon price aligned with global benchmarks.
- **However**, to meet the estimated mitigation cost as estimated by the NBI (2021) of 110 USD/tCO₂e by 2040 (approximately 2 000 ZAR/tCO₂e), **the marginal tax rate needs to be increased significantly during the 2030-2040 period.**
- It is therefore **recommended that National Treasury should provide a clear carbon price trajectory beyond 2030.** This would ensure that businesses and investors can forecast future costs and benefits accurately, fostering greater confidence in investments in renewable energy, carbon offset projects, and low carbon technology innovation supporting a circular economy.
- **Without a clear signal, there is a risk of underinvestment in mitigation and adaptation**

Basic tax free allowance – Urgent action to reduce climate risks and higher carbon prices required (5)

- A **blanket exemption makes little sense – for sectors or products where there are specific concerns**, minor adjustments could be made, but an overall exemption merely has the effect of undermining the carbon price.
- **Currently, carbon tax allowances provide significant compliance cost relief for businesses.** However, this approach may inadvertently reduce the incentives for companies to adopt low carbon practices, as the allowances effectively lessen the financial impact of the tax.
- The **baseline carbon price needs to be ramped more strongly in the near term** and over time to achieve the goals of the carbon tax.
- **Support for simplicity rather than too many allowances, deductions or exemptions** as this helps the administration, but also **gives a clear signal to business** that they must pay.
- Encourages minimising exemptions and allowances as they risk undermining the carbon tax impact and to **consider if the current proposed rate is high enough**

Basic tax free allowance – Phaseout of basic by 2030

- This discussion paper envisages the basic tax-free allowance being reduced from 60% in 2025 to 40% in 2030. **This pace of reduction is unacceptably slow, given the purpose of the basic allowance, the long delays in the carbon tax process, and the urgency with which we must act to reduce emissions.**
- The adjustments are far too low to have any meaningful impact at rate at which reductions are being proposed, and assuming the 2.5 percentage point reduction from 2031 is implemented (the discussion paper says that this “will be considered”), **it would take until 2046 to phase the basic tax-free allowance out.**
- The **price of the tax even without all the allowances is still too low** to be effective in meeting the Paris goals it is imperative that the basic allowance be completely phased out by 2030, when science requires global emissions to have almost halved to have a chance of limiting global temperature rise to as close to 1.5°C as possible.
- The reduction of the basic tax-free allowance is some kind of step towards increasing the effective carbon tax rate. **At the phase out rates proposed, 10% in 2026 and 2.5% per year thereafter, it would take until mid-century to phase out. This is not adequate response to the climate crisis.** The basic allowance should be dropped entirely in Phase 2. **Climate action needs to accelerate in this critical decade. Basic tax-free allowance should be 0% by 2030, at the latest.**
- **The 10 percentage point reduction in 2026 is supported and it is proposed that 10% remain the annual allowance reduction, so that by 2031, the basic allowance has been phased out.**

Summary

- **Some stakeholders of the view that:**

- The 10 percentage reduction in the basic tax allowance in 2026 is too steep and will impose a significant financial cost on business and the economy.
- Suggest that the 2,5 percentage point reduction of the basic replaces the 10 percentage point reduction in 2026.
- The current allowances should be retained to enable businesses to transition and decarbonise their activities.
- Delay the reduction in the basic allowance until 2031 and apply a reduction in the allowance from an agreed upon date
- If the allowance reductions are implemented, either exempt or increase the process emissions allowance for hard to abate sectors.
- The effective tax rates are higher as companies may not be able to access carbon offsets to reduce their tax liability.

- **Other stakeholders of the view that:**

- The 10 percentage point reduction in 2026 and 2.5% per year thereafter, it would take until mid-century to phase out. Climate action needs to be accelerated in this critical decade to ensure an adequate response to climate change.
- The headline and effective carbon tax rates are too low and the rates required to drive behaviour change require significant increases to meet the 1,5deg Paris temperature goals.
- Transitional assistance through the basic allowance has assisted sectors and provided sufficient time to prepare for the transition.
- Reduction of the basic allowance by 10 percentage points per year from 2026 recommended until it is phased out in 2030.

3. Process and fugitive emissions allowance

Process and fugitive emission allowance – Retention of process and fugitive emissions allowance supported

- The hard-to-abate steel sector welcomes the retention of the 10% process and fugitive emissions allowance
- We appreciate the longer transitional period proposed for hard-to-abate sectors regarding the process and fugitive emissions allowance. Specifically, we support the proposal to retain the 10% allowance until 2030 as it provides a much-needed buffer for industries that are struggling to mitigate these emissions
- Whilst there is support for the extension of the industrial process and fugitive emissions tax-free allowance for “hard to abate” sectors, it must be acknowledged that there are limited viable solutions to reduce emissions in the cement industry. Consideration should therefore be given by National Treasury to remove the requirement for the cement industry to pay carbon tax on its process emissions as part of Phase 2 of the carbon tax until such a time as viable solutions become available to South African cement producers
- Fugitive mine methane, where unavoidable, should continue to be exempt from carbon tax however, this was not clear in the past and requires clarification. Supports that the 10% basic tax-free allowance for process/fugitive emissions remains in place until 2035.
- **Maintaining the 10% allowance for process and fugitive emissions is supported. 5-year certainty period is insufficient to guarantee significant capital investments in the hard-to-abate sectors. Many process and fugitive emission sources are hard-to-abate. In addition, technology has not yet been developed to decarbonise these emissions or it has not been proven commercially viable**
- **Hard-to-abate sectors, such as cement, steel, and mining, face significant challenges in reducing emissions due to the nature of their processes. Retaining the process and fugitive emissions allowances beyond 2030 will provide these sectors with the support needed to transition effectively.**
- It must be acknowledged that there are limited to no solutions available for the reduction of these emissions in some industries. Therefore, the carbon tax does not act as an instrument for behaviour change and will not do so until solutions become available. Consideration should be given to removing the requirement for those industries to pay carbon tax on industrial process and fugitive emissions until solutions become available.

Process emission allowance – retention partially supported

- The process emissions associated with cement manufacturing cannot be adjusted, but there is scope for cement businesses to make changes in its processes to reduce combustion emissions.
- Process emissions are potentially “hard to abate”, however technological developments are rapid and regular reviews are needed as to what remains truly “hard to abate” per industry.
- **Allowances should only be permitted where these emissions relate to development-critical processes for which there is no alternative.**
- The process allowance should be discontinued after 2030

Fugitive emission allowance – Retention not supported

- **Fugitive emissions are a real impact of the extraction and handling of certain products and have real environmental impacts. The rationale for providing a rebate because these cannot easily be avoided is flawed.** The climate impact of a product necessarily includes all emissions along the supply chain, following a lifecycle assessment approach.
- **The monitoring and pricing of fugitive emissions is a necessary consideration in shifting away from the use of fossil fuels, and also of improving leak detection and remediation in processes.** Moreover, the historically-documented under-reporting of fugitive emissions across industries means that South Africa (and all countries) have a gap in their reporting under the UNFCCC.
- **The current availability of satellite-derived methane emissions detections and improved remote land-based tracking technology means that such emissions can be better detected and tracked** – and in the case of installations and pipelines, remediated.
- Ensuring that such localized fugitive emissions are priced will incentivise such remediation, whilst for diffuse emissions (such as for open-cast coal mines) it helps capture the real environmental cost of the fuel source.
- **Their monitoring and accurate pricing is an essential consideration in the transition.** Such emissions represent a failure to make adequate attempts to detect and repair leaks, and to ensure other remediation. **It is not appropriate to provide an allowance for fugitive emissions** – emitters must account for all emissions along the supply chain.

Fugitive emission allowance – Retention not supported

- **The extension of the fugitive emissions allowance is not supported.**
- This allowance should be phased out according to the overall design of the tax which, in principle, sees allowances being phased out over time. We do not support the continuation of this allowance (even in a phased down manner) beyond 2030.
- In the **2018 Carbon Tax Bill and the related Explanatory Memorandum, provision was made for a process emissions allowance as well as for fugitive emissions from coal mining**, but this was thereafter extended to the current overly generous allowance to all fugitive emissions.
- Our view is that **fugitive emissions should not qualify for this allowance** after 2026,
- **Remove the process and fugitive emissions allowance.** These are essentially fossil fuel subsidies and should be ended so that money is directed towards a just transition in SA.

4. Trade exposure and performance allowance

Trade exposure allowance- Remove or Strengthen Allowance

- **Remove the trade exposure allowance.** If National Treasury wants to retain a trade exposure allowance at a maximum of 30%, it needs a more nuanced approach that doesn't see us further subsidising the Carbon Border Adjustment Mechanisms and ensures that revenue from trade measures remains within the SA fiscus rather than is shifted to other countries.
- We appreciate that the current proposal is a strengthening of the previous phase's allowance by raising the minimum and maximum trade exposure thresholds
- **We support the increase in the trade intensity threshold to 50%, as the previous threshold was too low.** However, while we support the need to protect South African competitiveness against penalties applied by trading partners, **there should be a category of sectors excluded from this allowance, based on their contribution to South Africa's highly-carbon intensive economy.**
- **The consequence of allowing these industries to continue their business as usual – which is what will happen with such a permissive carbon tax – will have an overall negative result on the competitiveness of South Africa's economy** and the millions of enterprises that operate within the country.

Trade Exposure Allowance – Retain Current Design

- **The increase in the qualifying trade intensity for the full trade exposure is not supported.** This will create uncertainty for industries when budgeting for carbon tax liability as there will be an increased risk of meeting the threshold to qualify for the tax-free allowance.
- It is **suggested that assessments are conducted within the different sectors to explore the real impact from imported products and compare the benefit between the trade exposure allowance and the imposition of a duty/tax on imported products.**
- The **change from 30 to 50% trade intensity index as threshold will impact marginal trade-exposed sectors** more than the already highly trade exposed sectors. High exposed trade industries still receive the same allowance, whereas other smaller sectors will now have a lower allowance.
- **Retain the current structure to protect industries vulnerable to international competition.** If reductions are deemed necessary, implement them gradually to allow industries to adapt.
- **An average trade intensity of 69% is high, meaning that South Africa is highly trade exposed. This does not seem to lend itself to increasing the maximum trade intensity threshold from 30% to 50%.** It must also be considered that the trade exposure tax-free allowance is capped at 10% so whilst a sector may have a trade intensity of more than 10%. This means that companies operating in these sectors are not fully protected, particularly as South Africa does not have carbon border adjustment mechanism
- **The cement industry is more trade exposed than before and it is submitted that the trade exposure allowance for the cement industry should rather be increased** than decreased as proposed in the Discussion Paper
- **We recommend that the trade exposure allowance for fuel combustion emissions remains and that the performance allowance remain at 5% for fuel combustion emissions** rather than increasing it to 10%. (for example, liquid fuels sector)
- **Maintain the trade intensity index at 30% until 2035 or later.**
- Consideration should be given to the structure of the carbon tax system for products, which are subject to carbon border tax adjustments in export destinations.
- **It is proposed that the trade intensity threshold be maintained at the current level, or possibly raised from 30% to 40% instead of the proposed 50% trade intensity.**

Trade exposure allowance and CBAM implications

- **An important development with which the current discussion paper also does not engage sufficiently, in our view, and that has significant bearing on determining optimal carbon tax rates**, is the growing momentum around carbon border adjustment mechanisms (CBAMs).
- The current **proposed headline and effective rates through to 2035 will fail to induce the required structural changes in key sectors** of the economy, posing increasing risks to South Africa as we lag other economies, and making needed adjustment more costly in the future.
- Furthermore, there is also the risk of missed dynamic opportunities. **A more assertive carbon tax is integral in driving green industrialisation: it can help to drive local renewables manufacturing and job creation**, providing South Africa with an opportunity to export competitively into the rest of Africa as regional integration deepens.
- The discussion paper notes CBAMs in paragraphs 37 and 38, but **does not adequately address a key risk dimension: where domestic carbon tax rates are perceived as too low by key trading partners such as the EU, they will likely be 'equalised', with revenue going to the trading partner instead of to South Africa** – where it should be recycled to assist with decarbonisation. Conversely, with a higher carbon tax rate, this revenue would go directly to our fiscus and may be used to further incentivise investment in our own transition.
- **Any CBAM concessions to economies that may potentially be negotiated are unlikely to be embedded for the long-term**, and the discussion paper should at least set out these emerging realities as part of the context for consideration.
- **CBAM, which is planned to be implemented at the beginning of 2026 will have a significant impact on the South African economy.** It is thus crucial for South Africa to consider the development and impact of CBAM on South Africa's economy, trade and industries. However, this should not be the only determinant of how the Carbon Tax policy should be crafted.
- **National Treasury refers to alignment with international carbon pricing and motivates that there is a need to do this to protect exports to the European Union (EU) under its Carbon Border Adjustment Mechanism (CBAM).** However, it must be kept in mind that South Africa is a **developing country**. And as such the **socioeconomic dynamics and development priorities must remain at the forefront** of any policy adjustments. In addition, whilst protection from the EU's CBAM is something that can be considered in future, it must be kept in mind that EU CBAM is only applicable to goods imported into the EU. Currently, South Africa's trading portfolio includes several partners who do not have any CBAM type mechanism in place.

Trade exposure- Proposals for South African CBAM

- **Importers are not subject to the same carbon tax as local manufacturers as no CBAM exists in South Africa.** As such, local manufacturing is threatened by cheaper imports. In the same way, South African exports to countries without an equivalent carbon pricing scheme must compete with local production in those countries and also imports into those countries from other countries without an equivalent carbon pricing scheme. Companies that are trade-exposed cannot always pass the carbon tax onto customers as this impacts on competitiveness.
- Other territories have adopted more robust mechanisms to protect their production capacity in the form of carbon border adjustment mechanisms
- **To the extent that CBAM is imposed on other countries, the implementation of stronger steel safeguard measures or imposition of taxes on imported products/steel is suggested.** While this may not be appropriate with developed countries imposing such taxes on developing countries, it may be the only viable option for developing countries embarking on meeting NDC and decarbonisation plans.
- **Introduce mechanisms to ensure imported steel is subject to equivalent carbon costs, levelling the playing field for domestic producers.**
- **CBAM is supported; the cement industry in South Africa faces challenges with cheap imports and dumping of cement from countries like Pakistan, Vietnam, et al.** Notably, these countries are not covered by a Carbon Pricing mechanism. CBAM is required to protect the local industry as well as ensuring global carbon leakages are addressed.

Performance allowance increase

- **Broad support for the increase of the performance allowance, provided that benchmarks are set appropriately**, and all companies and industries are given the opportunity to submit benchmarks for consideration by National Treasury
- **National Treasury would require that the carbon tax declarations are further disaggregated to the facility level.** This would result in a different effective carbon price/MWh produced across the stations which would in turn affect the merit order of dispatch. In principle the concept is supported.
- Meeting the requirements for the performance allowance presents **significant challenges** for the mining sector **due to the stringent performance benchmarks established in Phase One of the carbon tax**

Performance allowance – Benchmark Stringency

- **Reference benchmarks to EU ETS, which have received significant government support in their transition, is not fair** as South African industry has not received the same level of government support. Delay the increase of the performance benchmark allowance until 2030
- It is **essential that benchmarks are never made weaker** – irrespective of poor sectoral performance. This allowance creates an additional burden on Treasury to regularly monitor and update the benchmarks, and on the tax authority to administer these. It is therefore crucial that this allowance be sufficiently ambitious to make the added cost and administrative burden worthwhile
- **Remove the performance allowance.** The performance benchmarks are too low and don't take into account aspects like the lower but very harmful impacts of methane gas. Furthermore, these are an administrative burden.

Performance allowance increase – supported

- **Supports the performance rebate but would like to provide two significant amendments that will improve the efficacy.**
- **1. The performance exemption should be only provided as a clawback on application from a liable entity.** Ensuring payment of the tax in the first instance plays a dual role in improving the deduction:
 - a. Requiring the tax exemption to be specifically invested in improvements provides a ratchet mechanism for performance enhancements
 - b. Provision of detailed information to secure the clawback allows better benchmarking of the best-performing entities per product/sector. Requiring proof of performance against the benchmark will also provide documentary evidence to ensure benchmarks are correctly aligned. This is important in light of the second proposed amendment.
- **2. Performance exemptions should only be provided to the 95th percentile for a given product/process benchmark.** Alignment of the benchmark at too low a level will provide broad tax rebates and remove the explicit incentive for strict improvement, as well as allowing new entrants that lock in poor performance.
- **if the benchmark is not sufficiently ambitious, this allowance will only serve to lessen firms' tax liability** and therefore be counterproductive in encouraging them to prioritise and speed up decarbonisation

Performance allowance and Mitigation Plans

- **Recommends the continuation of this allowance, but it should only consider a benchmark** and not any carbon budget and mitigation plan considerations
- Proposed requirement, in respect of the performance allowance, to include a prerequisite i.e. that pollution prevention plans are approved by the DFFE and implemented in order to qualify for the performance allowance introduces unnecessary complexity.
- The **proposed link between mitigation plans and performance allowance is not supported** as there is potential for overlapping of regulation. Firms that develop and implement a GHG mitigation plan should not qualify for this performance allowance by virtue of having such a plan
- The 5% increase in performance allowance for combustion emissions should be reconsidered, as the performance allowance will be linked to the Carbon Budget process with proposed punitive tax rates for emissions exceeding budget values. the allowance increase on fuel emissions only is not supported. In the cement industry, the combustion emissions is significantly lower than the process emissions.
- **While no objection is raised to this proposal, it must be observed that the regulations governing mitigation plans have not yet been made available**, and as such, it is not possible to provide comprehensive commentary in their absence.
- Also, it is further noted that **not all companies and industries may be required to have mitigation plans in place**. As such, there should be a process whereby any company or industry should be able to submit a mitigation plan to access the performance tax-free allowance, particularly if National Treasury plans to increase this allowance from 5% to 10%.
- **Benchmark consultations will inform technical corrections and adjustments to the benchmark values**. Clarity is required on the nature of the consultation process, and timeline with regards to the benchmark assessment process

5. Electricity sector structural reforms and price neutrality

Electricity Sector Reforms and Electricity price neutrality

- The **removal of the electricity generation levy and allowing electricity generators to continue deducting a portion of the renewable energy premium from their carbon tax liability where there would have been a difference between the carbon tax and electricity levy is supported.**
- The **inclusion of electricity generation in Phase 2 and the replacement of the electricity levy with an equivalent carbon tax are positive steps.** This shift aligns with the goal of incentivizing decarbonization among electricity producers.
- **Eskom should not pass the carbon tax onto its industrial customers,** and customers, protection must be given in terms of ensuring lower, competitive and sustainable electricity tariffs
- **An increase in Independent Power Producer (IPP) generation should be encouraged.** Once there is sufficient IPP generation and a functional open electricity market, it becomes possible for generators of electricity to pay the carbon tax without offsetting the costs of purchasing additional renewable electricity against their carbon tax liability and limiting the impact on the economy. This allows the carbon tax to achieve its intended effect which is to decarbonise South Africa.
- The options to extend the electricity price neutrality commitment from 2026 are gratefully received. In consideration of the two options proposed, we are largely in favour of option 2 if our interpretation is correct that a) **option 2 is expected to continue even beyond 2030;** and b) the net effect of the proposed balancing mechanism would be to limit the overall carbon tax liability to what the concurrent value of the electricity generation levy would have been.

Electricity price neutrality

- **Carbon taxes must be ringfenced in regulated tariff structures** (as opposed to blended in as currently for the environmental levy) and individually charged to electricity consumers that utilise fossil fuel-based electricity.
- **This would create the correct market signals to incentivise lower carbon alternatives**, promote customer choice and encourage decarbonisation. E.g. customers that elect to purchase renewables should avoid fossil-fuel based electricity carbon taxes.
- **Eskom included carbon tax as a reason to request increases in the price of electricity in its submission to Nersa**, which contradicts the statement that the impact on the electricity price would remain neutral
- A careful **review of the Electricity Price Neutrality framework is required**, with the possible inclusion of additional allowance to ensure price neutrality between the carbon tax and electricity levy.

Electricity price neutrality – request for modelling of carbon tax on elec without the carbon offset allowance

- We are **supportive of the proposal which aims to maintain revenue neutrality pertaining to the price of electricity.**
- **Option 2** requires further consideration, as long as it **initially remains revenue neutral. However, certainty is required as to what period of time it will be revenue neutral.**
- In terms of the impact on the price of electricity, it was stated that the impact on the price of electricity ranges from 4.7 c/kWh – 11.7 c/kWh. This includes the basic allowance, and the carbon offset allowance. Carbon offsets come at a cost and the cost of offsets will therefore have an impact.
- **The impact of carbon tax on the price of electricity should be modelled without inclusion of the carbon offset allowance (given the shortage of supply of carbon credits in the market), and the cost associated with acquiring carbon offsets.** The impact of carbon tax on the price of electricity should also be modelled taking into consideration the deduction of the renewable energy premium and the actual impact of the pass-through provided.
- Based on the information available in the public domain and performing a calculation of the Carbon tax for Eskom, taking the renewable energy premium into consideration, **it is expected that a carbon tax pass through will be required in 2028, and the impact is expected to be significant thereafter.** Clarity on the impact on the price of electricity is therefore requested.

Electricity sector benchmark

- We would **request** however, an **opportunity to undertake analysis of the proposed technology specific benchmark** and revert. On the face of it, the **current proposed benchmark appears too low, but it is not clear which stations are considered in the brackets of older, mid-life and new nor which years' data was used.**
- Consider and **develop a performance benchmark allowance for the full scope of electricity generators**, including coal generation assets and co-generation
- **Supports the use of a technology-neutral benchmark from 2031.** However, for the prior period (2026-2030), the benchmark should not be measured against the coal fleet, but rather against the lower of either the system-wide weighted average emission intensity; or best-performing tax-liable generating entity (i.e.: the entity that has the lowest emissions).
- Given the age and unreliability of South Africa's power fleet, using the "average emission intensity benchmark for the best performing power stations" simply does not provide a suitably aspirational target
- The **performance rebate should only be available to the lower of the top 5% of entities or the single best-performing entity** where this entity's emissions are larger than 5% of total sectoral emissions.
- If the system-weighted average emissions intensity of the grid remains higher than the best-performing tax liable entity in 2030, then the lower limit of this entity should be retained until the weighted average intensity drops below this limit.
- **Measurement of the benchmark against the entire coal fleet is a recipe for inclusion of significant new fossil fuel plants and infrastructure, locking in high emissions**

6. Carbon budgets and revenue recycling

Carbon Budgets – Higher tax rate

- **Proposal to introduce a penalty of R640/t on emissions in exceedance of the carbon budget seems premature** as the carbon budget regulations are still under development.
- The proposed higher tax rate of R640/tCO₂eq on emissions exceeding the allocated carbon budgets, depending on the allocation, on top of the carbon tax will be exorbitant to some industries and will cause dire socio-economic effects
- Further submitted that this higher carbon tax rate be reduced as it is significantly high considered in conjunction with the upward trajectory of the carbon tax rate
- **Concern is that we have not seen the regulation governing carbon budgets** so we cannot comment on whether carbon budgets will be set appropriately. As a developing country with other social and development priorities, we cannot limit growth so the carbon budgets must cater for growth
- **We would also not support the disaggregation of the anticipated mandatory carbon budgets (and any potential tax penalties) at the facility level.** If for some reason the carbon budget were to be exceeded, that could not be attributed to an individual station.
- **Concerned that a super tax and a standalone carbon tax will simultaneously apply to the same inventory.** Both these taxes will cause even more financial implications for our business. It is on this basis that Sasol proposes a tax credit to apply. In addition, it is imperative that a fair and reasonable carbon budget be set by DFFE, specifically taking account of Sasol's mitigation potential and the maturity, availability and cost of the suite of potential mitigation technologies. Such fair-play considerations would avoid the undue imposition of a highly punitive "super tax" and allow for the level of free cash flow required to invest in the transition of existing operations and in new low carbon developments, which support the energy transition.

Carbon Budgets – Higher tax rate

- The **implementation of the higher rate of carbon tax should be postponed until the carbon budget regulations** have been fully developed and operationalised.
- A phased approach, similar to the EU CBAM, should be adopted. This would involve an initial reporting phase to establish the principles and practices of the carbon budget system.
- Only once the system is functioning effectively and stakeholders are familiar with its requirements should the government consider transitioning to a phase where tax payments are linked to carbon budget compliance.
- This approach would reduce uncertainty, minimise potential conflicts, and ensure smoother implementation
- **We do not view carbon budget allocation as a practical and sustainable approach moving forward**, as it does not factor in the improvement in economic activity e.g., an increase in government spending on infrastructure, which will require an increase in the utilization of the installed cement capacity and production thereof

Carbon Budgets – Higher tax rate

- While this is an innovative approach to linking two structurally different systems, there is a **significant risk that it could result in the taxation of emissions that are offset with eligible carbon credits at the highest carbon tax rate.**
- This concern arises particularly for entities exceeding their permissible carbon budget while making use of the offset allowance under the Carbon Tax (i.e. this system creates a significant risk of over-taxation for emissions offset using eligible credits).
- Offsets should neutralise tax liability regardless of whether emissions exceed the carbon budget. This principle aligns with international best practices and ensures that carbon credits retain their value and purpose.

Carbon Budgets – Higher tax rate

- **Carbon taxation of emissions and additional penalties for exceedance of budgets do not constitute double penalties.** Tax is not a penalty. It is a legal obligation, a means of securing revenue for the fiscus, and in the instance of Pigouvian taxation, a mechanism for disincentivising activities with negative outcomes to society
- fact that SARS can levy a penalty for non-payment of a tax illustrates the difference: the tax is a legal requirement, and the penalty is an additional amount levied for failure to meet legal obligations. As such, there is no reason that an entity cannot be taxed for carbon emissions, and also have a penalty for failing to adhere to a budget.
- **Concerned that the proposed penalty remains inadequate.** Since carbon budget compliance is regulated over a full five-year period under the Climate Change Act, and assuming such budgets come into play on 1 January 2026, entities will be liable for budget compliance only by 2030. Given that the carbon tax is currently proposed to reach R462 by that date, the R640 penalty amount is only a 38.5% increase on the headline rate.
- We note also with concern that the proposal does not reflect the fact that rebates do not apply to this penalty, as was outlined in proposals earlier this year. WWF maintains that this is not an adequate penalty. The penalty for exceedance of budgets could be strengthened by:
 - Increasing the carbon tax rate to at least double the prevailing tax rate;
 - Retroactively removing all previously granted tax rebates over the carbon budget period; and/or
 - Applying a minimum administrative penalty.
- **A higher carbon tax rate of US\$385/tCO₂e (approx. R6800/tCO₂e) on GHG emissions exceeding the allocated carbon budget in terms of the Climate Change Act is proposed from 1 January 2026**
- Higher penalty rate is **significantly below the optimal tax rate, even for the standard carbon tax.** It is therefore vastly **insufficient to act as a deterrent in the same way that a criminal penalty would**, despite being argued to be the alternative for that provision in the Climate Change Act.²⁵

Carbon budget allowance extension and removal

- The carbon budget allowance was supposed to end on 31 December 2022, with the intended end of the first phase of the carbon tax.
- The budget was available to emitters who voluntarily participated in the development of a carbon budget with DFFE. In the 2022 Budget, this allowance was extended for two years until 31 December 2024.
- It is now **proposed to be extended by yet another year** while the carbon budget system is still voluntary. **This extension is unnecessary**
- **Support the removal of the carbon budget allowance**, since this incentive existed for entities to voluntarily engage in the early stages of the carbon budgeting process.
- **Some companies support the extension of the carbon budget allowance.**

Revenue recycling

- Most **stakeholders supported earmarking of the carbon tax.**
- Carbon pricing mechanisms have been most successful in countries where the revenue collected is ringfenced or earmarked for specific purposes.
- **It is recommended to be transparent and document the percentages of the carbon tax revenue recycled.** This will foster a greater acceptance of the Carbon tax if it is clear that the revenue is not merely cash input to the Fiscus, but that it results in quantifiable GHG reduction projects.
- **Revenue recycling to support decarbonisation projects,** worker reskilling, and social equity initiatives as well as investments in renewable energy, grid infrastructure, and low-carbon technologies. **This is supported**
- **Recommends the establishment of a carbon innovation fund** financed through carbon tax revenues. This fund could directly support research, development, and deployment (RD&D) of low-carbon technologies
- **Proposes a decarbonisation programme for primary industries** modelled on the Manufacturing Competitiveness Enhancement Programme.
- **Extend 12BA to 2030:** Extend the 125% tax deduction for renewable energy investments to 2030
- **Fund article 6 activities using carbon tax revenues,** implementation of the framework for approval of domestic standards and the National Climate Change Adaptation Strategy

Revenue Recycling (2)

- **Introducing targeted revenue recycling is preferable to efforts to provide allowances under the carbon tax**, which are administratively onerous and could lead to undesirable tax avoidance strategies.
- In this regard, we **welcome the comments on 'Support for Strategic Priorities'** in the discussion paper with its focus on enabling a just transition, stimulating a green economy and creating jobs. However, **more detail will be needed in the next few years to ensure that effective measures are introduced timeously.**
- In the **short term**, the focus should be on (1) incentivising change within high-emitting sectors and (2) collecting revenue which can serve as a predictable, transparent and substantial resource for addressing the distributional dimension of the tax and to address the negative impacts of climate change on people living and working in South Africa
- Due to the need to take developmental priorities into account and ensure this is a just transition, **we encourage revenue recycling as per those suggested in the draft proposal especially improvements in public transport and reduced electricity costs.**
- Furthermore, we believe reducing the administration burden for National Departments is important and thus we require a far more simplified implementation plan for Phase Two of the Carbon Tax.

Green Hydrogen

- **While the proposal of 100 per cent depreciation allowance is welcomed**, it is submitted that a much **higher allowance of about 150% as the technology** is quiet costly, but it is considered to be the cleanest energy and will promote investments in energy efficiency measures
- Sasol welcomes the proposal to extend the 100% depreciation allowance for solar PV to green H2 production, but this needs to be designed with a clear view of the market evolution for green H2 derivatives.
- While it represents a credible and potentially lucrative industrial horizon for South Africa in coming decades (particularly as a midhorizon export sector and as a long-horizon replacement for gas), **green H2 will not be economical and will not solve our near-term transition challenge. We only expect the economics to be feasible at commercial scale beyond 2030, potentially post 2035**
- **Supports the proposed green hydrogen depreciation allowance for hard-to-abate sectors with conditions**, but cautions that premature development of a large-scale green hydrogen industry will reduce the potential for grid decarbonisation.
- **Does not support green hydrogen incentive.** This is essentially subsidising companies like Sasol once again. Furthermore, if green hydrogen is really going to be a commercial success, 'the market' will ensure that GH2 producers will earn sufficient profits in the long-run and the money for the depreciation allowance would be better directed to community and off-grid PV solutions

Thank you