SUBMISSION ON THE SECOND DRAFT CARBON TAX BILL (DECEMBER 2017) BY THE SOUTH AFRICAN PROPERTY OWNERS ASSOCIATION (SAPOA)

Introduction

The South African Property Owners Association (SAPOA) is the representative body of the commercial and industrial property industry in South Africa. SAPOA herewith submits, for the kind attention of the South African National Treasury, the aggregated comments of its members in relation to:

- the Second Draft Carbon Tax Bill (December 2017);
- Annexures 1 to 3 to the Second Draft Carbon Tax Bill; and,
- the Media Statement accompanying the Second Draft Carbon Tax Bill.

SAPOA has previously submitted comments to Treasury on previous iterations of the carbon documentation. SAPOA as an organisation supports the growth of the South African economy and the implementation of the country's contribution to the international climate change response, with particular reference to mitigation of greenhouse gas emissions, in the form of the Nationally Determined Contribution read with relevant national policies, e.g., the National Climate Change White Paper, the National Development Plan and the Department of Environmental Affairs' design for the post-2020 mitigation scheme which *inter alia* encompasses the carbon tax as a greenhouse gas mitigation mechanism.

The carbon tax and economic recovery

Against this context, SAPOA advises Treasury that the South African property sector is facing significant challenges, including:

- above-inflation increases in electricity prices and rates and taxes; and,
- the elevated taxation announced by Finance Minister in the Budget Speech 2018, including with respect to Value Added Tax.

Taken in the light of the existing cost pressures faced by SAPOA members, Treasury's intended imposition of the carbon tax is expected to cause significant increases in the administered cost pressures borne by the sector. Given the Finance Minister's indication (in the 2018 Budget Speech) of his desire to see a resurgence of national economic activity, SAPOA is of the considered view that implementation of the carbon tax, in the near- to medium-term will be counter-productive and a hindrance to recovery of the broader economy. In the current time of the near-austerity (as anticipated by the 2018 Budget Speech) SAPOA is of the view that incentivisation of economic activity should be the approach adopted by Treasury, rather than one in which additional financial burdens are placed on the very sectors that can assist in recovery of the national economy. SAPOA members represent one such sector, including by supporting livelihoods in the form of some [*insert indicative number of jobs in the sector*] employment opportunities. Imposition of the carbon tax has the potential to curtail the contribution that the sector can make to national economic recovery.

SAPOA therefore wishes to raise its concerns regarding the timing of the imposition of a carbon tax and the impact on the industry could see significant cost increases in an already high administered cost industry. SAPOA's overall recommendation to National Treasury is to delay the implementation of the carbon tax to permit a broader economic recovery and to allow time for the uncertainties with the design and implementation features (discussed below) to be resolved.

In addition to the abovementioned general comment, SAPOA members bring the specific issues set out below to the attention of the Treasury.

Impact of the carbon tax on the property sector

SAPOA members will, by-and-large, experience an indirect impact of the carbon tax, i.e., SAPOA members are unlikely to be carbon tax liable entities but members' upstream and downstream value chains will include numerous carbon tax liable entities whose reaction to the increased costs occasioned by the tax will be to seek to pass-through their liability to their commercial counterparties, including SAPOA members. This issue is most prevalent in the context of the potential impact of the carbon tax on the price of electricity – and notwithstanding that the Second Draft Carbon Tax Bill (and associated documentation) contains mechanisms that may ameliorate this impact (addressed below).

For these reasons, and in the event that the carbon tax is implemented in the manner as indicated by the documentation under review, then, in order for SAPOA members to seek reasonably to manage the indirect impact of the carbon tax (which they will experience via pass-through from their value chains):

- in respect of the carbon tax's impact on the electricity price: the proposed process to neutralise such impact should be precisely articulated and implemented beyond the first phase;
- in respect of the design and application the tax, with particular reference to the allowances and the administration: such design and application should be clear and user-friendly; and,
- in respect of the objective of revenue-recycling: the mechanisms for achieving this objective must be clearly defined and Treasury's commitment to the objective should be unequivocal.

SAPOA is of the respectful view that the content of the documentation under review does not demonstrate that the carbon tax achieves the abovementioned design objectives – as more specifically set out, below.

SAPOA's specific comments

Each of the abovementioned design-features are addressed, below:

The carbon tax's impact on the electricity price

SAPOA notes, with appreciation, Treasury's attention to this issue, in particular the proposed mechanism to neutralise the carbon tax's impact on the electricity price. SAPOA notes, however, that the documentation under review reveals the following, in relation to the proposed mechanism:

- the mechanism is over-complex and relies upon a range of future administrative arrangements, the mechanism is not precisely articulated as at the present date; and,
- application of the mechanism is time-limited, i.e., neutralisation of the carbon tax's impact on the electricity price is limited to the first phase.

SAPOA comments that future certainty with regard to the cost of electricity is essential for the economic viability of the property sector. Property investments are, typically, planned years in advance and investment decisions must be informed by accurate medium- to long-term financial scenarios. The abovementioned uncertainty of articulation of the proposed mechanism to neutralise the carbon tax's impact on the electricity price; and, the time-limitation thereof to the first phase, means that an essential aspect of such investments decisions, i.e., certainty on the future trajectory of the cost of electricity, will be unavailable to the sector. This is likely to dampen investment in the sector.

Consequently, in the event that Treasury is determined to implement the carbon tax, SAPOA urges Treasury:

- to provide certainty in relation to the articulation of the mechanism; and,
- to extend the application of the mechanism beyond the first phase of the carbon tax.

The design and application the tax

SAPOA comments that the design and application of the carbon tax must be clear and user-friendly but notes, with concern, that two essential components of such design and application are, currently both unclear and uncertain, namely, the features relating to the allowances and to the administration – as follows:

- Allowances: SAPOA thanks Treasury for the conceptual work that has given rise to the propose system of allowances, but notes in relation to this system that it is over-complex and relies on (at least) three set of regulations that are still to be drafted and finalised (acknowledging that the Offsets Regulations have appeared in draft). As abovementioned, SAPOA members will experience an indirect impact of the carbon tax as a pass-through from the carbon tax liable entities forming part of their upstream and downstream value chains. The allowances provide the means for liable entities to limit their exposure to the carbon tax; and, significantly, such allowances are not available to the likes of SAPOA members as a means to limit an indirect impact. Effective use of the allowances, by carbon tax liable entities, requires their design and application to be clear and user-friendly. By contrast, the documentation under review describes an overly-complex legal regime for the allowances, large elements of which (in the form of the missing regulations) are still to be articulated.

- Administration: SAPOA understands that administration of the carbon tax will be undertaken by the South African Revenue Services (SARS), in terms of the Customs and Excise Act. SAPOA notes, however, that effective administration of the carbon tax will require the establishment, by SARS, of an appropriate architecture. None of the documentation under review gives any indication of the parameters and operation of such administrative architecture.

In light of the above, SAPOA urges Treasury to provide more certainty in relation to the design and application of those aspects of the carbon tax legal regime applicable to allowances and administration, before the carbon tax is implemented.

The objective of revenue-recycling

SAPOA notes that the mechanisms for achieving the objective of revenue-recycling must be clearly defined; and, that Treasury's commitment to the objective should be unequivocal. With respect, SAPOA comments that the documentation under review does not provide comfort and certainty in relation to either of these issues.

SAPOA's abovementioned comment is based on the following considerations:

- the documentation under review indicates that carbon tax revenues will not be ear-marked for recycling but will, rather, be placed into the National Revenue Fund; and,
- (as indicated in Annexure 2 to the Second Draft Carbon Tax Bill, Socio-Economic Assessment, at page 20), the proposed mechanism to neutralise the carbon tax's impact on the electricity price will leave very little additional revenue for recycling, in the first phase.

SAPOA's further respectful comment is that Treasury would (more clearly) demonstrate its commitment to the objective of revenue-recycling by:

- agreeing to ear-mark carbon tax revenues for these purposes; and,
- separating the proposed mechanism to neutralise the carbon tax's impact on the electricity price from the mechanisms for achieving the objective of revenue-recycling, i.e., these mechanisms should not be conflated with one another as they

are intended to achieve different outcomes; and, their current overlap is a weakness in the overall carbon tax design.