In mitigation of a carbon tax liability

Much controversy (and some valid criticism) surrounds the proposed carbon tax. Despite this, it seems that it's not whether, but when, the carbon tax will be imposed. There are cogent arguments for and against its implementation, not least of which is the potential impact it may have on the competitiveness of companies liable to pay the tax.

The furor and debate surrounding the carbon tax has already resulted in the postponement of its implementation. The date for implementation was originally set for January 1 2015 – subsequently postponed to 1 January 2016, although this date may be postponed again. We do not intend, in this article, to explore the arguments for and against the carbon tax. Our focus is instead on the options available for companies to mitigate their carbon tax exposure, and in some cases to possibly find some benefit.

ArcelorMittal South Africa recently indicated in the press that the carbon tax, if implemented in its current form, would cost the company between R630 million and R650 million a year, prompting it to call for special carbon tax treatment. In its published 2013 annual financial statements, PPC Cement indicated that its carbon tax liability would be in the vicinity of R150 million. These are not insignificant amounts, and on the face of it, the carbon tax could pose a significant threat to the future competitiveness and financial wellbeing of so-called energy-intensive users (EIUs) that will be affected by it – if this impact is not carefully managed.

Initially, the full impact of the tax will be softened by the 60% threshold offered to all companies that fall within the carbon tax net, together with further rebates offered to certain industries that face challenges posed by technical or structural impediments to emissions reduction, that face the possibility of reduced competitiveness due to exposure to international trade and investment, and that qualify for carbon offsets.

EIUs may initially be able to avoid between 70% and 90% of their carbon tax liability, depending on their carbon footprint. Instead of the traditional entitlement to rebates, in addition to the general 60% threshold applicable to all EIUs falling within the carbon tax net. Naturally, the EIU should position itself so that it can claim the highest level of rebates possible.

A central tenet of the carbon tax as a climate-change mitigation strategy is that it should, in some way, encourage behavioural change in those affected by it. In theory, those who proactively integrate climate-change mitigation strategies into their way of doing business should, in the long term, benefit from having been firmly guided into a more sustainable business model that is in keeping with altered world trends.

The carbon tax will weigh heavily on those companies that do not take active steps to mitigate their carbon emissions, and instead merely focus on avoidance of the carbon tax.

How is it possible to find anything positive in another tax? Companies should be considering their mitigation options, and taking active steps to explore possible benefits embedded in these challenges. Closer scrutiny may well reveal opportunities that will benefit the company and its business in the medium to long term. The key lies in identifying and maximising the incentives that are on offer.

An attractive mitigation option may lie in some form of engagement with renewable energy projects, including captive small-scale renewable projects and projects currently under development in the Small Projects Independent Power Producer Procurement Programme. “Green” energy produced by them:

● Can be purchased by the EIU via the Eskom Grid under a so-called wheeling arrangement, potentially lowering the cost of the EIU’s overall electricity bill over its entire sphere of operation; and

● Could give rise to reputational benefits, enhancing the EIU’s profile as a forward-thinking business committed to assuming the climate-change responsibilities that have to be shouldered as a solid corporate citizen.

Certain renewables projects will be eligible to sell carbon credits, and on the assumption that the market for these derivatives will develop, it will create a separate income stream that did not previously exist. In addition:

● Carbon credits may be purchased by the EIU as a way of offsetting its carbon liability;

● Unused resources, such as windfarms or similar, unproductive or economically unfeasible land, may be harnessed to produce a financial return – for example, the renewables project being partnered with may pay rental for the use of the company’s unused land in connection with the project; and

● It is possible that the carbon tax liability of EIUs doing business in countries and regions with already existing carbon tax regimes, such as the European Union, may be lowered in recognition of the cost being paid (or mitigation strategies being adopted) in South Africa, thereby enhancing international commercial competitiveness.

Companies with a proactive and open-minded approach to these challenges may well find that they are not only able to craft solutions that limit their carbon tax obligations, but will, in the process, also create thought-leading initiatives that will set them apart from their competition in the future.

— Coldron Denichaud, associate, Norton Rose Fulbright