12L Income Tax Allowance on Energy Efficiency Savings – And interpretative guide for businesses

Introduction – What is the 12L?

The Department of Energy (DoE) and the South African National Energy Development Institute (SANEDI) as the implementing agency have introduced the 12L Income Tax Allowance on Energy Efficiency Savings ("12L") in order to safeguard the country's energy security through energy efficiency mechanisms. An energy efficiency saving can be understood to be the difference between the actual amount of energy used in the carrying out of any activity in a specific period and the amount of energy that would have been used in the carrying out of the same activity during the same period under the same conditions if the energy-savings measure was not implemented (SABS, 2010).

The 12L Regulation was promulgated on 9 December 2013 in the Government Gazette No 37136. Essentially, the 12L incentive offers a tax deduction for taxpayers who implement energy efficiency saving measures. Broadly speaking, the incentive allowed for tax deductions calculated at 45 cents per kilowatt hour (kWh) or kilowatt hour equivalent of energy efficiency savings. During 2015, this allowance amount was increased to 95c/kWh by the Minister of Finance during the Budget Vote speech in March 2015.

How the 12L Tax Incentive Works

The Regulation for 12L sets out the process and methodology for determining the quantum of energy efficiency savings, and requirements for claiming the proposed tax allowance, which stipulates a prerequisite that energy savings reports have to be compiled by Measurement and Verification (M&V[1]) Professional performing the assessment under the auspices of a SANAS accredited M&V Body and the savings certified by SANEDI through issuing of an **Energy Efficiency tax certificate**.

The proposed tax incentive for 2015 will be 95c per verified kWh (or kWh equivalent) of energy efficiency savings that have been signed off by the M&V body and have been approved by the SANEDI 12L evaluation panel for the assessment year in question.

The tax incentive will be applicable for a period of 12 months of savings – there is some uncertainty on whether the baseline is applicable only within the assessment year or for a calendar years' worth of savings. The end date is any year of assessment that is after 31 December 2020 (there is a sunset clause to the benefit).

[1] The process of quantifying EE savings or the impacts by determination of actual consumption and relevant energy-governing factors, and to develop baselines and baseline adjustments (SANS 50010 definition – SABS).

In order to claim the tax from SARS, applicants will have to follow the process below:

1. Establish a baseline in terms of energy use;

2. Register with SANEDI (SANEDI will evaluate viability of project at **no cost**);

3. Once the project is approved it goes through an assessment process. The assessment must be carried out by SANAS accredited M&V body and this is sent back to SANEDI for final sign off (after being signed by M&V body);

4. SANEDI will then issue an Energy Efficiency tax certificate once the assessment is complete;

5. Tax certificate can be sent to SARS for the tax relief.

To date, over 74 projects have been submitted nationwide. Of these, 7 of the projects have been activated.

This process is estimated to be carried out over an 18 month period prior to the tax benefit being realised.

Sector	No of Applications	Comments
Mining	28	Mainly large projects awaiting baseline submissions
Agriculture	3	Awaiting baseline submissions
Industrial	20	Large projects, awaiting baseline submissions
Commercial	21	Mainly lighting & air-conditioning retrofits in commercial buildings, including hotels and two possible cogeneration projects
Transport	2	One logistics fleet and one mining/ haulage project
Total	74	

Brief summary of submitted projects to date, 2015 (June, 2015)

Projects that will be considered are as follows:

1. Greenfield projects (required constructing the baseline from comparable data in the relevant sector).
2. Projects that improve the energy conversion efficiency.
3. Where the project is an energy conservation project that does not reduce the energy conversion efficiency of the activity, but maintains the same level of activity output and boundary conditions, as determined by SANS 50 010 (Measurement & Verification Standard).

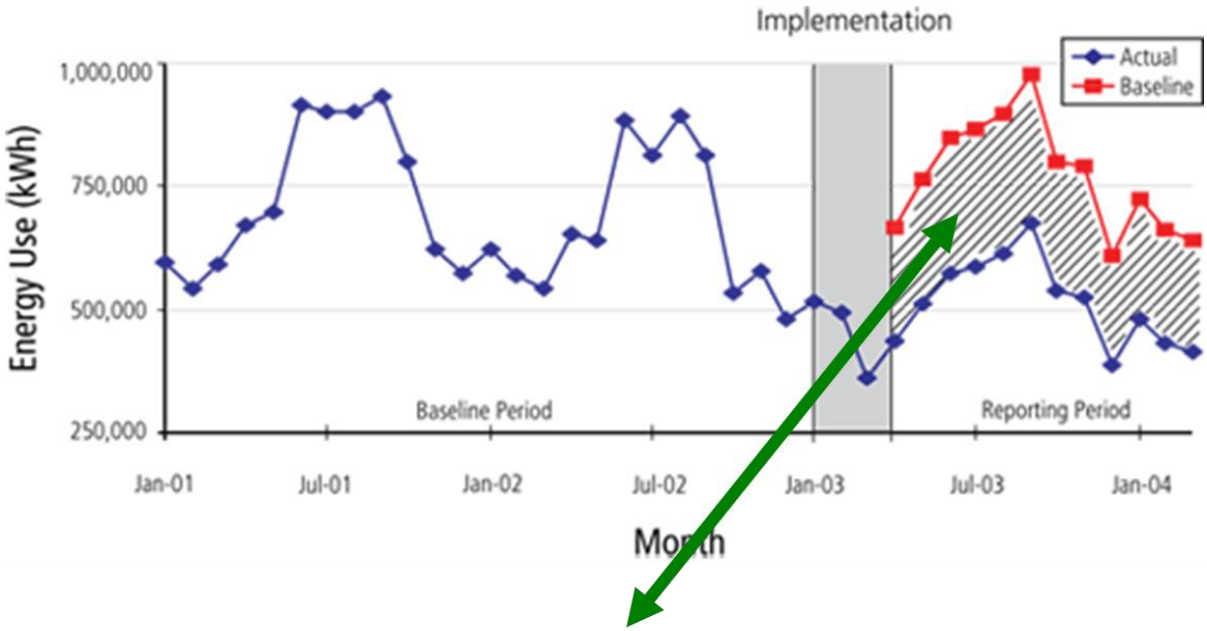
4. The project uses underutilised energy generated from an industrial process, e.g. waste heat recovery[2].
5. Co-generation projects.

Projects that will not be considered are the following:

1. Renewable sources are 'generally' excluded. Captive Power Plants, where the 'conversion efficiency' of the energy generated is less than 35% of the requirements for the facility, subject to the renewable energy sources specified above.

All forms of energy are included. Examples are electricity, gas, diesel, waste heat etc. captive power plants (CPP) can claim a benefit if "kWh or the equivalent kWh of energy output of the captive power plant" i.r.o. an assessment year is "more than 35% of the kWhs or the equivalent kWh of energy input in respect of that year of assessment".

Below is an example of how an application will be assessed in calculating what the claimed "energy efficiency saving" is for the given assessment year by an M&V body:



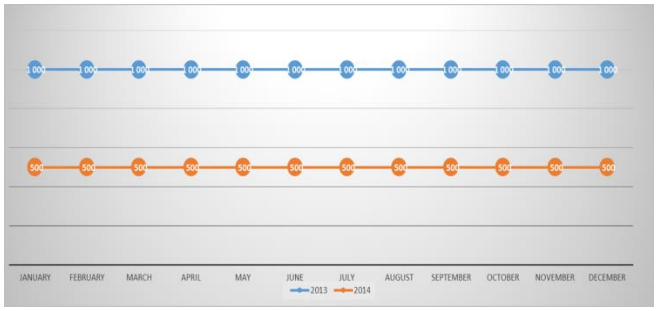
kWh Saved for Assessment Year

Example:

1. Assume a Plant that operates 24/7/365 and has a constant usage of 1 000 kWh per month.
2. The annual baseline usage will be 12 000 kWh
3. Assume an intervention where there is a 50% reduction in usage to 500 kWh per month

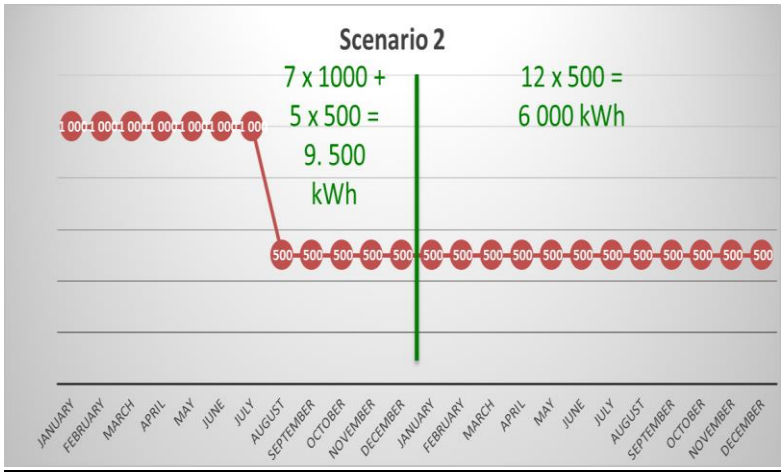
[2] Waste heat recovery is defined as "utilising waste heat or underutilised energy generated during an industrial process"

Scenario 1



Verified kWh Savings = 12 000 – 6 000 = 6 000 kWh

Scenario 2



Year 1 = 12 000 – 9 500 = 2 500 kWh

Year 2 = 9 500 - 6000 = 3 500 kWh

Verified kWh Savings: 2 500 kWh + 3 500 kWh = 6 000 kWh

Therefore, the verified data on the kWh energy efficiency savings that SANEDI will be the final arbitrator on, will be used to calculate the total deductions against taxable income i.e. (verified kWh * 45c) which will form the basis to calculate the estimated tax revenue forgone by the government.

In the case of company this will be Verified kWh * 45c * 28% and in the case of unincorporated businesses Verified kWh * 45c * the marginal PIT rate, e.g. 40%. The marginal rate for unincorporated businesses is the same as for individuals and varies between 18% and 40%.

In the example above, the total tax allowance benefit will be as follows:

1. **Treatment under 45c/kwh tax allowance**

For a company with a marginal tax rate of, say, 28%, this translates into a foregone revenue for SARS of 6000 x R 0.45 x 28% = R 756 for that given assessment year.

Currently in force

2. **Treatment under 95c/kwh tax allowance**

This translates into a foregone revenue for SARS of 6000 x R 0.95 x 28% = R 1596 for that given assessment year.

Proposed in 2015

This highlights that there is a stronger incentive for businesses under the proposed 95c/kWh tax allowance as seen in the example above, i.e. R840 which is more than double the current benefit of 45c/kWh.

This also suggests that the incentive is much stronger for large scale project that will result in higher verified kWh savings, e.g. 1 MWh and higher. In a project that will generate over 1 000 000 kWh, the forgone tax revenue can be as high as R 126 000 (1 000 000 x R 0.45 x 28% = R 126 000). In the latter case, if a company has a net profit of R 2 000 000 that is to be taxed then under the company tax regulations, the company tax would have been R 560 000 (0.28 * 2 000 000). The forgone tax would have been R 126 000, meaning the final tax payable would be R 560 000 – R 126 000 = R 434 000. This example clarifies the first point that the incentive is practical for projects with high enough kWh savings. Under the 95c/kwh saving, this tax saving is pushed up to R 266 0000, meaning a final tax payable amount of R 294 000 against the net profit.

Implications for Businesses when considering registering a project under 12L

Companies will need to carefully consider the viability of this incentive for two main reasons. The first of these is that there is an additional cost burden implied by the M&V body (this can be as high as 10% of the project costs in some cases). The Act does not stipulate how these charges are set and therefore are left at the discretion of that specific M&V body. However it must be highlighted that

the Council of Measurement and Verification (CMV) is starting to monitor the costs charged by the accredited M&V bodies more strongly (please refer to the SABS:SANS 50010:2011 for the M&V Standard for 12-L Tax Incentives). The proposed fee structure offers a guidance ±5% of project cost, but could be anything dependent on the project scope, complexity and additional benefits.

There are currently 5 accredited M&V bodies in the country, of which two of these are in Western Cape universities, namely, University of Stellenbosch and University of Cape Town.

The other consideration to be made is the financial viability of registering a project under the 12L or against another state-led incentive such as the MCEP as the 12L regulations does not make provisions for concurrent consumption-related benefits. Meaning that projects that have applied for other tax-related incentives such as the MCEP will not be able to register a project under 12L. A rule of thumb is that if your project received a higher benefit under a different tax incentive then it would not justify registration under 12L.

Applicability

The Revised 12L allowance of 95c/kwh is not yet law. It is not included in the Regulations, but will be part of the 2015 tax bills that are only likely to become law by the end of the year or early next year.

Presently, the existing 12L applications are assessed based on the 45c/kwh allowance. Tax incentives are currently offered for one (1) assessment year of kWh savings and are only applicable to registered businesses.