

DRAFT INTERPRETATION NOTE

DATE:

ACT : INCOME TAX ACT NO. 58 OF 1962

SECTION : SECTION 12L

SUBJECT : DEDUCTION FOR ENERGY-EFFICIENCY SAVINGS

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Preamble

In this Note unless the context otherwise –

- “**National Energy Act**” means the National Energy Act No. 34 of 2008;
- “**Regulations**” means the Regulations published under section 12L(5) by the Minister of Finance in Government Notice No. 10080 in *Government Gazette* No. 37136 of 9 December 2013 and amended by Government Notice No. R.186 in *Government Gazette* No. 38541 of 6 March 2015;
- “**SANEDI**” means the South African National Energy Development Institute established under section 7 of the National Energy Act;
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act No. 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance on the deduction for energy-efficiency savings under section 12L and the related Regulations.

2. Background

In response to South Africa ranking as one of the top 20 contributors of carbon dioxide in the world, it voluntarily announced during the 2009 United Nations Climate Change Conference in Copenhagen that it would act to significantly reduce domestic greenhouse gas emissions.¹ Consequently, environmental-related tax incentives have been introduced to address concerns related to global warming and energy security such as section 12K (exemption of certified emission reductions).

Another incentive is a deduction for energy-efficiency savings under section 12L. In an effort to encourage taxpayers to convert old technologies to newer, more energy-efficient technologies which may involve substantial amounts of capital and change behaviour related to energy usage, section 12L allows taxpayers to claim a deduction for most forms of energy-efficiency savings that result from activities performed in the carrying on of any trade and in the production of income. The deduction, when claimed, reduces the taxable income of a taxpayer and is not limited to the taxable income of a taxpayer. It can therefore create an assessed loss.²

Section 12L became effective on 1 November 2013 and applies up to years of assessment ending before 1 January 2020 (see **4.8** for further details).

For years of assessment commencing on or after 1 March 2015, the deduction is calculated at 95 cents per kilowatt hour (previously 45 cents per kilowatt hour).

¹ National Treasury Discussion Paper “Reducing Greenhouse Gas Emissions: The Carbon Tax Option” (December 2010) at 3.

² In case of a natural person claiming a deduction under section 12L, the provisions of section 20A which relates to the ring-fencing of assessed losses must, however, be taken into consideration. A company can only carry forward an assessed loss from a previous year if a trade is carried on in the current year of assessment. Refer to Interpretation Note No. 33 (Issue 4) dated 22 July 2014 “Assessed Losses: Companies: The ‘Trade’ and ‘Income from Trade’ requirements”.

3. The law

12L. Deduction in respect of energy efficiency savings.—(1) For the purpose of determining the taxable income derived by any person from carrying on any trade in respect of any year of assessment ending before 1 January 2020, there must be allowed as a deduction from the income of that person an amount in respect of energy efficiency savings by that person in respect of that year of assessment determined in accordance with subsection (2), subject to subsection (3).

(2) The amount of the deduction contemplated in subsection (1) must be calculated at 95 cents per kilowatt hour or kilowatt hour equivalent of energy efficiency savings.³

(3) A person claiming the deduction allowed in terms of subsection (1) during any year of assessment must obtain a certificate issued by an institution, board or body prescribed by the regulations contemplated in subsection (5) in respect of the energy efficiency savings for which a deduction is claimed in respect of that year of assessment containing—

- (a) the baseline at the beginning of the year of assessment;
- (b) the reporting period energy use at the end of the year of assessment;
- (c) the annual energy efficiency savings expressed in kilowatt hours or kilowatt hours equivalent for the year of assessment including the full criteria and methodology used to calculate the energy efficiency savings; and
- (d) any other information prescribed by the regulations contemplated in subsection (5).

(4) A deduction must not be allowed in terms of this section if the person claiming the allowance receives any concurrent benefit in respect of energy efficiency savings.

(5) The Minister of Finance, in consultation with the Minister of Energy and the Minister of Trade and Industry, must make regulations prescribing—

- (a) the institution, board or body that must issue the certificate contemplated in subsection (3);
- (b) the powers and responsibilities of the institution, board or body contemplated in paragraph (a);
- (c) the information that must be contained in the certificate contemplated in subsection (3) in addition to the information contemplated in that subsection;
- (d) those benefits that constitute concurrent benefits for the purpose of subsection (4); and
- (e) any limitation of energy sources in respect of which the allowance may be claimed.

4. Application of the law

4.1 Introduction

Section 12L allows any person who has a project which is registered with SANEDI to claim a deduction for energy-efficiency savings that are derived from activities performed in the carrying on of a trade.

³ Rate of 95 cents inserted by the Taxation Laws Amendment Act No. 25 of 2015 with effect from years of assessment commencing on or after 1 March 2015.

The term “energy efficiency savings” is defined in the Regulations as –

“the difference between the actual amount of energy used in the carrying out of an activity or trade, in a specific period and the amount of energy that would have been used in the carrying out of the same activity or trade during the same period under the same conditions if the energy-efficiency savings measure was not implemented”.

The term “person” is defined in section 1(1) and includes natural persons, juristic persons and trusts as well as an insolvent estate, the estate of a deceased person, and any portfolio of a collective investment scheme. A foreign partnership is, however, excluded from the ambit of the definition. The word “includes” is generally used in legislation as a term of extension. This means that the definition of “person” is not limited to only those individuals that are specifically mentioned but can also include other entities.

For instance, a real estate investment trust (REIT) is also a “person” for purposes of the Act. A REIT is a company listed on the JSE that owns and often operates income-producing property. A REIT or a controlled company (a subsidiary of a REIT) may therefore claim a deduction on qualifying energy-efficiency savings under section 12L.

The taxpayer must comply with certain requirements (see **4.4**) before a deduction can be granted under section 12L. Furthermore, the allowance can be claimed only from 1 November 2013 until years of assessment ending before 1 January 2020 (see **4.8** for more clarity on the effective date).

Section 12L must be read with the Regulations which prescribe, amongst other things, the following:

- The institution, board or body that must issue the energy-efficiency certificate to the taxpayer. For the purposes of section 12L, SANEDI is the designated institution (see **4.2**).
- The powers and responsibilities of SANEDI (see **4.2**).
- The information that must be included in the certificate in addition to the information required under section 12L(3) (see **4.6**).
- The determination of a baseline (see **4.7**).
- The benefits that constitute concurrent benefits (see **4.9**).
- Any limitation of energy sources for which the allowance may be claimed (see **4.3.2**).

4.2 South African National Energy Development Institute

SANEDI was established by the National Energy Act and its functions are contained in section 7 of that Act. These functions are based on various government policies, legislation and constitutional requirements. The role of SANEDI involves ensuring that South Africa will have the necessary information and planning support for a sustainable and secure energy future that will also satisfy the country’s economic, social and environmental needs. SANEDI is further tasked with influencing or

facilitating an immediate and critical change in the country's energy culture towards more considered and sustainable energy practises.⁴

In fulfilling its responsibilities⁵ under section 12L, SANEDI must –

- appoint suitably qualified persons to consider the reports submitted;
- consider, keep and maintain all reports submitted by taxpayers claiming the allowance;
- issue taxpayers with certificates containing the relevant information required by regulation 4;
- create and maintain a database of all issued certificates; and
- provide the Minister and the Commissioner with access to the reports and to the database.

Before a certificate is issued, SANEDI must also satisfy itself on the accuracy of the information contained in the report by investigating or causing to be investigated any energy-efficiency savings of the taxpayer.

This information must –

- comply with the standard (see **4.6**);
- be an accurate reflection of the energy-efficiency savings for which a deduction is claimed by the taxpayer during the year of assessment; and
- comply with the Regulations.

4.3 Activities that may or may not qualify for a deduction under section 12L

4.3.1 Activities that may qualify

The Regulations make use of the words “activity” and “project”. For the purposes of section 12L, these words encompass the planned undertaking by a business to reduce its energy usage. These projects must be conducted for the purposes of the taxpayer's trade.

The activities of a project that generates energy-efficiency savings by conserving energy while maintaining the level of activity output are considered to be eligible projects under section 12L and could qualify for a deduction under this section. Projects that generate energy from combined heat and power as well as those that involve the use of qualifying captive-power plants are also considered eligible. For a captive power plant to qualify, the kilowatt hours or the equivalent kilowatt hours of energy output in respect of a year of assessment should be more than 35% of the kilowatt hours or equivalent kilowatt hours of energy input.⁶

The term “captive power plant” is defined in the Regulations and means –

“where generation of energy takes place for the purposes of the use of that energy solely by the person generating that energy”.

⁴ Extracted from the South African National Energy Development Institute Strategic Plan (Version 9) 2012/13 – 2016/17 at 9.

⁵ See the **Annexure** – Regulation 3.

⁶ Regulation 6(3).

A deduction will also be allowed for energy that is generated from co-generation. In regulation 6(1), co-generation means “combined heat and power”. Combined heat and power means –

“the production of electricity and useful heat from a fuel or energy source which is a co-product, by-product, waste product or residual product of an underlying industrial process”.

BusinessDictionary.com states the following on a “co-product” and a “by-product”:⁷

“A co-product is a product manufactured along with a different product, in a process in which both are required in the production of another product. In comparison, a by-product is usually an undesirable product.”

“Waste product” is defined in the *Merriam Webster Dictionary* as follows:⁸

“[U]seless material that is produced when making something else <a hazardous waste product>.”

The term “residual product” is also defined in the *Merriam Webster Dictionary* and means a –⁹

“by-product <coke and coal tar from gasworks are *residual products*>”.

By applying the definition of “combined heat and power” it means that a deduction may be allowed if electricity or useful heat is generated from a derivative product which has been created by an industrial process other than the core product for which the industrial process was undertaken.

With energy-efficient machinery and equipment it may be possible for a lessee to claim a deduction under section 12L even though the lessee is not the owner of the machinery or equipment. As long as the lessee is actually carrying on a trade and the project from which the savings are generated are registered in such person’s name, a deduction may be claimable by the lessee (see **4.5**). The lessee will not, however, be able to claim other allowances in the Act which require the person claiming the allowance to be the owner of the machinery or equipment.

4.3.2 Activities that may not qualify

Section 12L(5)(e) makes provision for the limitation of energy sources for which the allowance may be claimed. These limitations are determined in regulation 6.

Regulation 6(2) states that a deduction under section 12L will not be permitted in the case of energy being generated from renewable sources (other than energy generated from combined heat and power). Savings emanating from energy that is, for example, generated through geothermal means or through the use of tidal energy generators are excluded from the ambit of section 12L.¹⁰

Projects that involve captive power plants in which the energy conversion efficiency of the plant is less than 35% will also not qualify for a deduction (see **4.3.1**).

⁷ www.businessdictionary.com/definition/coproduct.html [Accessed 18 February 2016].

⁸ www.merriam-webster.com/dictionary/waste%20product [Accessed 18 February 2016].

⁹ www.merriam-webster.com/dictionary/residual%20product [Accessed 18 February 2016].

¹⁰ See the definition of “renewable sources” in regulation 6(1).

4.4 Steps to be undertaken before claiming the allowance

Before claiming an allowance under section 12L, the taxpayer must take the following steps:

- Register the project on the SANEDI website (www.sanedi.org.za).
- Engage with a South African National Accreditation System (SANAS) – accredited measurement and verification body¹¹ who will measure, verify and provide a report on the energy-efficiency savings generated.
- Present the measurement and verification plan and project details to a SANEDI panel which will inform the taxpayer and the measurement and verification body whether the baseline has been approved.
- Implement the project if written confirmation is received from SANEDI.
- Submit a measurement and verification performance assessment to SANEDI for each year of assessment.

SANEDI will issue an energy-efficiency performance certificate (see **4.6**) if it approves the measurement and verification assessment. Once the energy-efficiency performance certificate has been issued, the taxpayer may claim an allowance under section 12L if all the requirements of the section have been met.

4.5 Registration of projects

Before a certificate can be issued by SANEDI and a deduction claimed under section 12L, taxpayers are required by regulation 2(a) to register the project from which the energy-efficiency savings will be derived with SANEDI. This registration can be done through the SANEDI website and each project that is registered will have a separate project-identification number.

A person, in the course of registering a project, will have to choose an accredited measurement and verification body from a list provided by SANAS. The names, technology, scopes and contact information of these bodies are also available on the SANEDI website. A project cannot be registered if a SANAS-accredited measurement and verification body is not appointed.

Furthermore, in the process of registering a project, a baseline (see **4.7**) must be submitted followed by a performance assessment to SANEDI who will then evaluate and approve or reject the assessment. Importantly, the baseline has to be approved by SANEDI before any activities take place.

Should the assessment be approved, an energy-efficiency performance certificate will be issued which allows the taxpayer to claim the deduction. Once the certificate is issued for the particular year of assessment, the project identification number will expire and a new project will have to be registered. This requirement will apply to a project that runs over several years. This means that a new project-identification number will have to be acquired for each year of assessment even if the same project is being undertaken. If the newly registered project operates within the same project boundary and if a measurement and verification body agrees, the last adjusted baseline may be used when submitting the assessment to SANEDI.

¹¹ See the **Annexure** for the definition of “measurement and verification body”. SANEDI refers to a measurement and verification professional as an M&V.

A taxpayer that is involved in more than one project must register each project separately. Those projects that have been completed or were in progress at the time that section 12L came into operation (1 November 2013) are excluded from the ambit of the section. In other words, only projects that commenced on or after 1 November 2013 will be eligible. Furthermore, a third party that is employed to manage a project cannot claim a deduction under section 12L. This right is limited to the person that is actually carrying on the trade, that is, the person under whose name the project is registered.

4.6 Energy-efficiency certificate

Section 12L(3) stipulates that an energy-efficiency performance certificate must be obtained from a prescribed institution, board or body which is currently SANEDI. This certificate does not have to be submitted to SARS but must be retained for audit purposes for a period of five years from the date of submission of the return of income in which the deduction was claimed.¹² In calculating the deduction available under section 12L, the taxpayer must use the amount reflected in the certificate as the savings for that particular year of assessment. This amount must be multiplied by the rate stipulated in section 12L(2).

The certificate must contain –¹³

- the baseline at the beginning of the year of assessment for which the allowance is claimed, derived and adjusted in accordance with regulation 5;
- the reporting period energy use¹⁴ at the end of the year of assessment for which the allowance is claimed;
- the annual energy-efficiency savings expressed in kilowatt hours or the equivalent of kilowatt hours for the year of assessment for which the allowance is claimed; and
- the difference between the kilowatt hours equivalent of energy input and the kilowatt hours equivalent of energy output of a captive power plant during a year of assessment. A captive power plant will qualify for the deduction only if the kilowatt hours of energy output for a year of assessment are more than 35% of the kilowatt hours of energy input (see **4.3.2**).

The baseline energy use, annual energy-efficiency savings and the energy output for captive-power plants must all be determined in accordance with the South African National Standard – “SANS50010:2011: Measurement and verification of energy savings” as published by the South African Bureau of Standards (SABS) Standard Division (the standard). This document provides a standard approach to the measurement and verification of energy savings and energy efficiency.

The certificate must also indicate the –

- initials and surname of the measurement and verification professional who compiled the report;

¹² Section 29 of the Tax Administration Act No. 28 of 2011.

¹³ See regulation 4.

¹⁴ “Reporting period energy use” is defined on SANS50010:2011 as the “application of energy for the reporting period after implementation of any energy-savings measure”.

- name and accreditation number of the measurement and verification body the professional belongs to;
- name and tax registration number of the person to whom the certificate is issued,
- date that the certificate was issued; and
- the certificate number.

Taxpayers involved in multiple projects must ensure that a separate certificate is obtained for each project and for each year of assessment.

Section 1(1) defines “year of assessment” as follows:

“ **‘[Y]ear of assessment’** means any year or other period in respect of which any tax or duty leviable under this Act is chargeable, and any reference in this Act to any year of assessment ending the last or the twenty-eighth or the twenty-ninth day of February shall, unless the context otherwise indicates, in the case of a company or a portfolio of a collective investment scheme in securities be construed as a reference to any financial year of that company or portfolio ending during the calendar year in question.”

The year of assessment of a person other than a company ends on the last day of February¹⁵ and a company’s year of assessment is its financial year.¹⁶

A certificate under section 12L(3) will thus have to be issued for the year of assessment in which the deduction is claimed. If the energy-efficiency savings span two years of assessment, a certificate will have to be obtained for each year of assessment.

A company that changes its year of assessment or any other information which would cause it to differ from the information on the certificate must notify SANEDI through its website.

4.7 Determining the baseline

The Regulations define “baseline” to mean “baseline as defined in the standard”. Paragraph 3.4 of the standard defines “baseline” as the –

“energy use representing conditions before the implementation of the energy-savings measures under a set of known energy-governing factors or relationships applicable at the time of the baseline measurement period to the activity in question, (or both)”.

Section 12L(3) provides that the energy-efficiency certificate must contain a baseline at the beginning of the year of assessment. This baseline is then compared to the consumption at the end of the year of assessment to determine the savings in energy usage for the year of assessment.

Depending on the type of project undertaken, specific methods of calculating the baseline are provided in regulation 5.

In the first year of assessment in which the allowance is claimed for a greenfield project, the baseline must be determined by taking into consideration comparable

¹⁵ Definition of “year of assessment” in section 1(1) read with section 5(1)(c).

¹⁶ Definition of “year of assessment” in section 1(1) read with section 5(1)(d).

data in the relevant sector. In this instance, comparable data is used because no standard practise has yet been specified on how to establish a baseline for a greenfield project.

The Regulations define “greenfield project” as –

“a project that represents a wholly new project which does not utilise any assets other than wholly new and unused assets”.

The word “new” was explained in ITC 672 as follows:¹⁷

“[T]he word ‘new’ means new in the sense of not having been used before by the particular taxpayer and in the sense of not having been acquired from somebody else and so second-hand.”

Therefore, projects that make use of any assets that have previously been used will not be regarded as “greenfield projects” as defined.

For other types of projects, the baseline must be determined from data collected during the year before the first year of assessment in which the allowance is claimed. Unlike “greenfield projects”, comparable data is not used. Rather, actual data that is specific to the project in question is used in the calculation.

Should a project run over several years, the baseline will have to be reset for every year of assessment. The same baseline that was calculated at the beginning of a particular year of assessment can therefore not be used in subsequent years of assessment. Instead the reporting period energy use at the end of a year of assessment will become the new baseline for the following year of assessment.

Example 1 – New baseline calculation

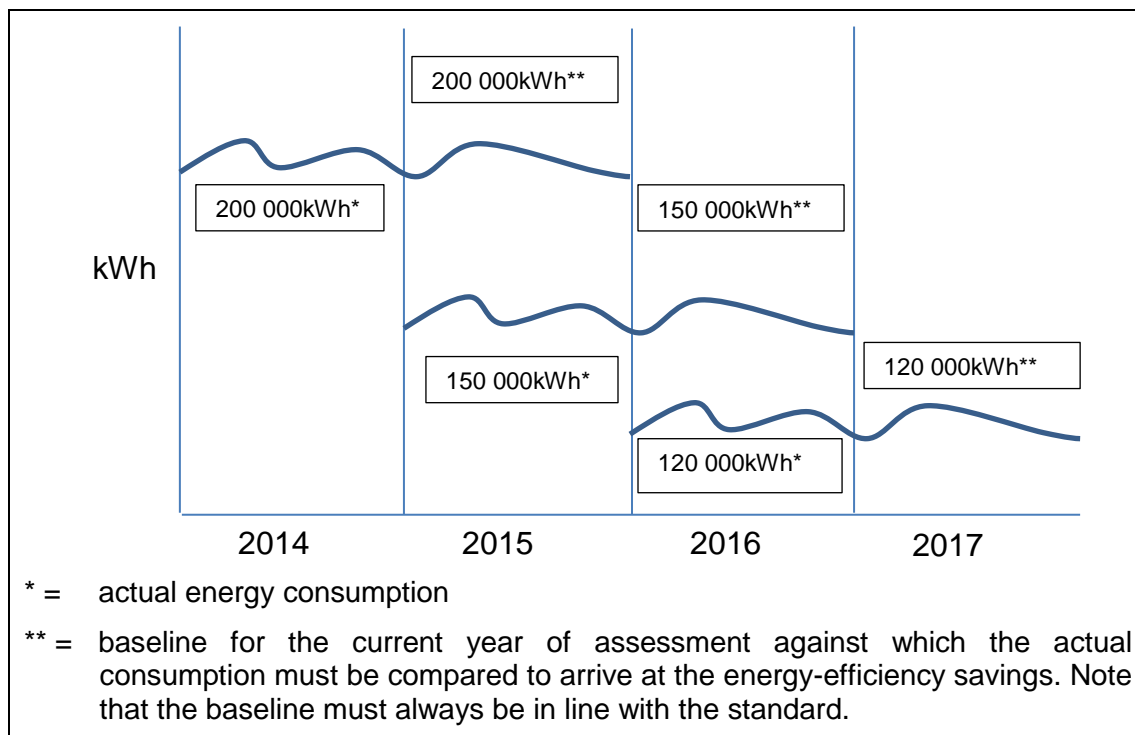
Facts:

During 2014 Global W Incorporated’s energy consumption amounted to 200 000 kWh. After implementing new technology that allowed for energy-efficiency savings, the energy consumption for 2015 was reduced to 150 000 kWh. The energy consumption for 2016 was 120 000 kWh.

Result:

The baseline is calculated by determining the sum of the monthly energy usage over a 12-month period. The actual consumption during 2014 is thus the baseline for 2015 and has to be compared against the actual consumption at the end of that year to arrive at the energy savings obtained. The energy consumption for 2015, that is, 150 000 kWh, is the new baseline for 2016. This method of calculation must be followed for every subsequent year of assessment in which the allowance is claimed. Note the registration requirements in **4.5**.

¹⁷ (1948) 16 SATC 227 (U) at 229.



4.8 Determination of the section 12L deduction under sections 12L(1) and (2)

4.8.1 The “trade” requirement and exempt income

A deduction can be claimed under section 12L from a person’s income derived from carrying on any trade during a year of assessment ending before 1 January 2020.¹⁸ The deduction allowable against the income from carrying on a trade in a year of assessment should be based on the energy efficiency savings generated for that year. Energy efficiency savings generated in a particular year of assessment cannot be carried forward and used to calculate the deduction in a following year.

As section 12L came into effect on 1 November 2013, a person carrying on a trade and generating energy-efficiency savings between the period of 1 November 2013 and the year of assessment ending before 1 January 2020, could be eligible to claim a deduction under section 12L. A taxpayer that generates energy-efficiency savings from a date preceding the effective date may claim only the portion relating to savings from 1 November 2013 (see **Example 3**).

The section 12L deduction can be claimed only if a taxpayer carries on a trade. Section 1(1) defines “trade” as follows:

“**[T]rade**’ includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature.”

The courts have interpreted “trade” as being neither exhaustive nor restrictive.¹⁹ It thus includes any activity in which a person risks something with the object of making a profit. Although “trade” has been given a wide meaning, it does not cover all the

¹⁸ Section 12L(1).

¹⁹ *Burgess v CIR* 1993 (4) SA 161 (A), 55 SATC 185.

activities that might produce income. For example, the watching over of investments²⁰ and the earning of interest on funds advanced by a holding company to its subsidiary²¹ do not constitute the carrying on of a trade. Therefore, when determining whether a trade is being conducted, the facts and circumstances of each case must be evaluated.²²

Section 1(1) defines “income” as follows:

“**[I]ncome**’ means the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II.”

The deduction under section 12L is allowed against the *income* of a person. “Income” consists of gross income²³ reduced by exempt income.

If a taxpayer did not generate any trade income in a year of assessment, but it can be substantiated that a trade was in fact carried on in that year, energy efficiency savings by the taxpayer in that year may still qualify for a deduction under section 12L (subject to all the requirements being met).²⁴

It may be possible for an entity to receive only exempt income as provided for under section 10. In such event there will be no “income” as defined against which the section 12L deduction can be claimed. Therefore, if an entity implements a project in a trade that produces exempt income, no deduction will be permissible. However, should this entity implement a project in a trade from which it also earns “income” as defined, a deduction may be possible in certain instances.²⁵

If a person implements a project which spans an entire building but operates two trades, namely, a trade from which exempt income is earned and another from which taxable income is earned, an apportionment must be made to limit any deduction for energy-efficiency savings to the portion of savings relating to the portion of the amount that constitutes income.

²⁰ ITC 1275 (1978) 40 SATC 197 (C).

²¹ ITC 496 (1941) 12 SATC 132 (U).

²² For more information on the “trade” requirement, see Interpretation Note No. 33 (Issue 4) dated 22 July 2014 “Assessed Losses: Companies: The ‘Trade’ and ‘Income from Trade’ Requirements”.

²³ “Gross income” is defined in section 1(1) in the case of a resident as the total amount, in cash or otherwise, received by or accrued to or in favour of the resident. In the case of a non-resident, the total amount in cash or otherwise received by or accrued to or in favour of such person from a source within South Africa, should be included in gross income. Amounts of a capital nature are excluded. All amounts listed in paragraphs (a) to (n) of the definition of “gross income” are specifically included, irrespective of the possible capital nature of the amount.

²⁴ Refer to Interpretation Note No. 33 (Issue 4) dated 22 July 2014 “Assessed Losses: Companies: The ‘Trade’ and ‘Income from Trade’ requirements”.

²⁵ In this regard, certain requirements relating to exempt entities have to be fulfilled. See the SARS *Tax Exemption Guide for Public Benefit Organisations in South Africa* (Issue 4) for more information on tax exempt entities and the rules pertaining to these entities.

Example 2 – Exempt income*Facts:*

Body Corporate ABC was incorporated to take responsibility for the enforcement of the rules and control, administration and management of the common property for the benefit of all owners in Greenhouse Estate, a residential development scheme. The body corporate carries on a trade and earns income in the form of levies, fees charged for the use of facilities and equipment such as squash courts, tennis courts and washing machines, and rental income from the letting of immovable property such as parking bays, servants' quarters and a demarcated area for a cell phone mast. For the 2016 year of assessment, the body corporate received levies amounting to R600 000. It also received R900 000 which related to fees charged for the use of facilities and equipment as well as rental income.

In an effort to make the Estate more energy efficient, the body corporate removed all electric geysers from the common property and replaced them with solar geysers in the 2016 year of assessment. Body Corporate ABC wants to claim a section 12L deduction for the energy-efficiency savings resulting from the conversion of the geysers.

Result:

The first aspect that has to be determined before a deduction can be granted under section 12L is whether the body corporate is carrying on a trade. In this regard, its specific activities have to be evaluated. If it is established that the body corporate is carrying on a trade, the exemptions provided for in section 10 have to be taken into consideration.

Section 10(1)(e)(i)(aa) states that a body corporate shall be exempt from normal tax on any levies received by or accrued to it. Therefore, the amount received for all levies, that is, R600 000 will be exempt from normal tax.

Section 10(1)(e)(ii) further states that any other receipts and accruals derived by a body corporate shall also be exempt, but up to a maximum of R50 000. In other words, if the receipts and accruals exceed this amount, R50 000 will be exempt and the remainder will be subject to normal tax. For the 2016 year of assessment, the body corporate received R900 000 in consequence of fees and rental income. Of this amount, R50 000 will be exempt. The balance of R850 000 (R900 000 - R50 000) constitutes "income" as defined and will be subject to normal tax.

Consequently, provided that Body Corporate ABC complies with all the requirements of section 12L, it will be allowed to claim a portion of the energy savings determined under section 12L in accordance with the percentage of income divided by gross income for the particular year of assessment ($R850\,000 / R1\,500\,000 = 56,67\%$). In the event that only exempt income is generated, Body Corporate ABC will not be allowed to claim any section 12L deduction.

4.8.2 The project cycle, the year of assessment and the application of the prescribed rates

Generally, a deduction under section 12L is granted for savings derived over a period of 12 consecutive months. Thus, the beginning of this period need not be the first day of a year of assessment or the first day of a calendar year. Since a deduction can be claimed only during the year of assessment in which the savings are derived, it may

be possible for a portion of the savings, for example, savings relating to four months, to be deducted in one year and the remaining savings for the subsequent eight months to be deducted in the next year. A certificate for the first four months as well as another for the remaining eight months will have to be obtained from SANEDI.

Under section 12L(2) the energy-efficiency savings for years of assessment commencing on or after 1 March 2015 must be calculated at 95 cents per kilowatt hour or kilowatt hour equivalent of energy-efficiency savings. The baseline as well as the marginal rate of tax must also be taken into consideration when calculating the energy-efficiency savings.

Example 3 – Year of assessment, the project cycle²⁶ and the calculation of the deduction

Facts:

Hothouse Ltd owns an industrial plant and has a financial year-end of 28 February. From 1 August 2015, Hothouse reduced its energy usage from 1 million kWh to 500 000 kWh per month through the use of more efficient technologies. In consequence of these savings, Hothouse wanted to claim a deduction under section 12L.

As part of the requirements of the section, Hothouse had to calculate baselines for the relevant years of assessment and submit it to SANEDI. Thereafter, the energy-efficiency savings had to be calculated by SANEDI in order for the deductible amount to be determined.

Result:

a) Baseline calculations

For the 2015 year of assessment, the energy usage was 12 million kWh (1 million kWh × 12 months). This was also the baseline for the 2016 year of assessment.

The energy usage for the 2016 year of assessment was 8,5 million kWh. This was also the new baseline at the beginning of the 2017 year of assessment.

This figure was calculated as follows:

- 1 000 000 kWh × 5 months = 5 000 000 kWh (energy usage *before implementation*, that is, 1 March to 31 July 2015)
- 500 000 kWh × 7 months = 3 500 000 kWh (energy usage *after implementation*, that is, 1 August to 28 February 2015)
- 5 000 000 kWh + 3 500 000 kWh = 8 500 000 kWh (energy usage for 2016 and new baseline for 2017)

The energy usage for the 2017 year of assessment was 6 million kWh (500 000 kWh × 12 months).

²⁶ SANEDI “Frequently Asked Questions” (11 March 2014).

b) Calculation of the energy efficiency savings and the deductible amount

For the period March 2015 to February 2016, Hothouse Ltd's savings were calculated by determining the difference between the baseline at the beginning of the 2016 year of assessment and the usage at the end of that year. Thus, the savings are 3,5 million kWh (12 million kWh – 8,5 million kWh).

For each year of assessment Hothouse's energy-efficiency savings must be multiplied by 95 cents per kilowatt hour.

The amount allowed to be deducted from the income of Hothouse Ltd for the 2016 year of assessment is R3 325 000 (3,5 million kWh × R0,95).

For the period March 2016 to February 2017 the savings are calculated by determining the difference between the baseline at the beginning of the 2017 year of assessment and the usage at the end of that year. Therefore, the savings are 2,5 million kWh (8,5 million kWh – 6 million kWh).

The amount allowed to be deducted from the income of Hothouse Ltd for the 2017 year of assessment will be R2 375 000 (2,5 million kWh × R0,95).

In the event that a project was implemented by Hothouse Ltd during the 2014 year of assessment, only the savings generated during November 2013 to February 2014 would be relevant since section 12L came into operation only on 1 November 2013. Furthermore, a rate of 45 cents would have had to have been applied when calculating the deductible amounts for the 2014 and 2015 years of assessment as the 95 cent rate was applicable only from years of assessment commencing on or after 1 March 2015.

4.9 Concurrent benefits

Under section 12L(4), a taxpayer that receives a concurrent benefit relating to the energy-efficiency savings will not be able to claim a deduction under section 12L.

Regulation 7 stipulates that a concurrent benefit will encompass any credit, allowance, grant, cost recovery agreement or other similar benefit that is awarded to a person for any energy-efficiency savings or for the sale and purchase of electricity by or through any –

- sphere of government;
- public entity that is listed in Schedule 2 or 3 to the Public Finance Management Act No 1 of 1999; or
- any power purchase agreement as defined in Electricity Regulations on New Generation Capacity made by the Minister of Energy under section 35(4) of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) published in Government Notice 721 of 5 August 2009 in respect of the IPP bid programme as defined in those regulations.

5. Conclusion

Section 12L provides a deduction to taxpayers for savings derived from implementing more energy-efficient methods of conducting their businesses. In claiming the deduction, attention should be paid to the –

- Regulations;
- method of calculating the baseline and the energy savings in multi-year projects;
- certificates that have to be obtained from SANEDI for each project and year of assessment;
- exclusions and limitations; and
- the effective date of section 12L.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE

Annexure – Regulations under section 12L of the Income Tax Act No 58 of 1962, on the allowance for energy-efficiency savings as published by the Minister of Finance in *Government Gazette* No 37136, Volume 582 on 9 December 2013 and amended by No. 38541, Volume 597 on 6 March 2015.

Definitions

1. In these Regulations, any word or expression to which a meaning has been assigned in the National Energy Act, or the Income Tax Act bears the meaning so assigned, and—

“**accreditation number**” means an accreditation number contained in a certificate of accreditation issued by the South African National Accreditation System under section 22(2)(b) of the Accreditation for Conformity Assessment, Calibration and Good Laboratory Practice Act, 2006 (Act No. 19 of 2006), to a measurement and verification body for the inspection, measurement, reporting and verification of energy efficiency savings;

“**allowance**” means the amount allowed to be deducted in respect of energy efficiency savings as contemplated in section 12L of the Income Tax Act;

“**baseline**” means baseline as defined in the standard;

“**captive power plant**” means where generation of energy takes place for the purposes of the use of that energy solely by the person generating that energy;

“**certificate**” means an energy efficiency savings certificate contemplated in section 12L(3) of the income Tax Act that is issued by SANEDI, comprising the content set out in regulation 4;

“**certificate number**” means a unique traceable number allocated to a certificate by SANEDI;

“**energy efficiency**” means energy efficiency as defined in the standard;

“**energy efficiency savings**” means the difference between the actual amount of energy used in the carrying out of any activity or trade, in a specific period and the amount of energy that would have been used in the carrying out of the same activity or trade during the same period under the same conditions if the energy savings measure was not implemented;

“**Income Tax Act**” means the Income Tax Act, 1962 (Act No. 58 of 1962);

“**measurement and verification**” means measurement and verification as defined in the standard;

“**measurement and verification body**” means a body that is accredited by the South African National Accreditation System in terms of section 22 of the Accreditation for Conformity Assessment, Calibration and Good Laboratory Practice Act, 2006 (Act No. 19 of 2006), for the purposes of inspection, measurement, reporting and verification of energy efficiency savings;

“**measurement and verification professional**” means a natural person who performs measurement and verification of energy efficiency savings under the auspices of a measurement and verification body;

“**National Energy Act**” means the National Energy Act, 2008 (Act No. 34 of 2008);

“**report**” means a measurement and verification report that—

- (a) contains a computation of energy efficiency savings in respect of a person for a year of assessment; and
- (b) is compiled by a measurement and verification professional in accordance with the criteria and methodology contained in the standard;

“**reporting period energy use**” means reporting period energy use as defined in the standard;

“**SANEDI**” means the South African National Energy Development Institute established in terms of section 7 of the National Energy Act; and

“**standard**” means the South African National Standard 50010 (SANS 50010, Measurement and Verification of Energy Savings), issued by the South African Bureau of Standards in terms of the Standards Act, 2008 (Act No. 8 of 2008).

Procedure for claiming allowance

2. A person that claims the allowance must, in respect of each year of assessment for which the allowance is claimed—

- (a) register with SANEDI in the form and manner and at the place that SANEDI may determine;
- (b) appoint a measurement and verification professional to compile a report containing a computation of the energy efficiency savings in respect of that person for that year of assessment;
- (c) submit the report to SANEDI; and
- (d) obtain a certificate from SANEDI.

Responsibilities of SANEDI

3. (1) SANEDI must appoint suitably qualified persons to consider reports submitted by a person claiming the allowance.

(2) If after consideration of a report SANEDI is satisfied that the information contained in a report—

- (a) complies with the standard;
- (b) is an accurate reflection of the energy efficiency savings of the person claiming the allowance in respect of the year of assessment for which the allowance is claimed; and
- (c) complies with these Regulations,

SANEDI must issue a certificate containing the information set out in regulation 4 to the person claiming the allowance.

(3) SANEDI may investigate or cause to be investigated any energy efficiency savings of a person contained in a report to be satisfied that the information contained in the report is an accurate reflection of the energy efficiency savings of the person submitting the report.

(4) SANEDI must—

- (a) keep and maintain all reports submitted for consideration;
- (b) create and maintain a database of all certificates issued by SANEDI in accordance with these Regulations; and
- (c) at all times provide the Minister of Finance and the Commissioner for the South African Revenue Service with ready access to—
 - (i) the reports contemplated in paragraph (a); and
 - (ii) the database contemplated in paragraph (b).

Content of certificate

4. The certificate issued by SANEDI as contemplated in regulation 3(2) must contain-

- (a) the baseline at the beginning of the year of assessment for which the allowance is claimed, derived and adjusted in accordance with regulation 5 and determined in accordance with the standard;
- (b) the reporting period energy use at the end of the year of assessment for which the allowance is claimed, determined in accordance with the standard;
- (c) (i) the annual energy efficiency savings expressed in kilowatt hours or the equivalent of kilowatt hours for the year of assessment for which the allowance is claimed, determined in accordance with the standard; and

- (ii) in case of a captive power plant, the difference between the kilowatt hours equivalent of energy input and the kilowatt hours equivalent of energy output during the year of assessment in accordance with the standard;
- (d) the initials and surname of the measurement and verification professional who compiled the report;
- (e) the name and accreditation number of the measurement and verification body under whose auspices the measurement and verification professional compiled the report;
- (f) the name and tax registration number of the person to whom the certificate is issued;
- (g) the date on which the certificate is issued; and
- (h) the certificate number.

Baseline calculation

5. (1) For the purpose of this regulation “greenfield project” means a project that represents a wholly new project which does not utilise any assets other than wholly new and unused assets.

(2) The baseline—

- (a) for the first year of assessment for which the allowance is claimed must—
 - (i) in the case of a greenfield project, be constructed from comparable data in the relevant sector; or
 - (ii) in any other case, be derived from data gathered during the year of assessment preceding the first year of assessment for which the allowance is claimed; and
- (b) must be adjusted for every year of assessment for which the allowance is claimed—
 - (i) in accordance with the methodology in the standard; and
 - (ii) by taking into account the reporting period energy use at the end of the immediately preceding year of assessment for which the allowance was claimed to compute the baseline for the beginning of the subsequent year of assessment for which the allowance is claimed.

Limitation of allowance

6. (1) For the purpose of this regulation—

“**co-generation**” means combined heat and power;

“**combined heat and power**” means the production of electricity and useful heat from a fuel or energy source which is a co-product, by-product, waste product or residual product of an underlying industrial process;

“**energy conversion efficiency**” means the difference between the useful heat and equivalent kilowatt hours of energy output and the equivalent kilowatt hours of input energy expressed as a percentage;

“**renewable sources**” means—

- (a) biomass;
- (b) geothermal;
- (c) hydro;
- (d) ocean currents;
- (e) solar;
- (f) tidal waves; or
- (g) wind;

(2) A person may not receive the allowance in respect of energy generated from renewable sources other than energy generated from combined heat and power.

(3) A person generating energy through a captive power plant may not receive the allowance unless the energy conversion efficiency of the plant is greater than 35 per cent.

Concurrent benefits

7. For the purposes of section 12L(4) of the Income Tax Act any credit, allowance, grant, cost recovery agreement or other similar benefit granted by or through—

- (a) any sphere of government;
- (b) any public entity that is listed in Schedule 2 or 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999); or
- (c) any power purchase agreement as defined in Electricity Regulations on New Generation Capacity made by the Minister of Energy under section 35(4) of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) published by Government Notice 721 of 5 August 2009 in respect of the IPP bid programme as defined in those regulations,

for any energy efficiency savings or the sale and purchase of electricity constitutes a concurrent benefit.

Short title and commencement

8. These regulations are called the Regulations in terms of section 12L of the Income Tax Act, 1962, on the allowance for energy efficiency savings and come into operation on 1 November 2013.