



**Attention: Hayley Reynolds**

National Treasury  
Republic of South Africa  
Church Square  
Pretoria  
0001

**Per electronic mail:** [Hayley.Reynolds@treasury.gov.za](mailto:Hayley.Reynolds@treasury.gov.za);  
[2022AnnexCProp@treasury.gov.za](mailto:2022AnnexCProp@treasury.gov.za)

7 February 2022

Dear Hayley,

**Re: Sasol’s submission on the Discussion Document: “What is the Most Appropriate Tax Regime for the Oil and Gas Industry”**

In response to the call for comments on the “Discussion Document: What is the Most Appropriate Tax Regime for the Oil and Gas Industry”, we attach Sasol’s response. In addition, Sasol foresees additional engagements on the issues raised in this document and kindly requests an opportunity to discuss directly with you. Our response is structured to provide some high-level positions supported by a detailed comments section.

The following specific areas have been covered in our response:

1. the impact of climate change on the Oil and Gas sector;
2. commentary on the proposals relating to the Upstream Oil and Gas tax regime, including recommendations on how the tax system should treat future fossil fuel investments; and
3. a summary of Sasol’s recommendations.

**Sasol Limited** 1979/003231/06

Sasol Place 50 Katherine Street Sandton 2146 South Africa | Private Bag X10014 Sandton 2196 South Africa  
Telephone +27 (0)10 344 5000 | Facsimile +27 (0)11 788 5092 | [www.sasol.com](http://www.sasol.com)

Directors: SA Nkosi (Chairman) FR Grobler (President and Chief Executive Officer) MJ Cuambe (Mozambican) MBN Dube M Flöel (German)  
KC Harper (American) VD Kahla (Executive) GMB Kennealy NNA Matyumza ZM Mkhize MEK Nkeli PJ Robertson (British and American)  
S Subramoney P Victor (Chief Financial Officer) S Westwell (British)

Group Company Secretary: M du Toit

## **1. Impact of climate change on the Oil and Gas sector**

### **1.1 Strategic role of gas in the short to medium term**

Gas has been shown to play a key role as a transitional measure in South Africa's decarbonisation journey to 2040 and a future with no additional gas is likely to lead to more cumulative emissions in the long run across the key economic sectors in the country. This is largely due to the potential continuation of higher emitting coal and diesel usage in the absence of additional gas or lower cost sustainable alternatives. This could in turn put the emission reduction targets underpinning South Africa's latest Nationally Determined Contribution (NDC) in support of the Paris Agreement at risk (NBI/BUSA Climate Pathways Study: The role of gas in South Africa's path to net-zero, 2022, available at: <https://www.nbi.org.za/climate-pathways-and-a-just-transition-for-south-africa/#explore>).

South Africa consumes ~180 Petajoules per annum (PJ/a) of gas. This gas is utilised predominantly in the synfuels sector (110 PJ/a) and the industrial sector (70 PJ/a), which supports up to 56 000 jobs across the value chain generating up to R215 billion in taxable revenue and contributing ~1–2% to Gross Domestic Product (GDP) (NBI/BUSA Climate Pathways Study, 2021, available at: <https://www.nbi.org.za/climate-pathways-and-a-just-transition-for-south-africa/#explore>).

By and large, the Pande-Temane gas fields in Mozambique supply South Africa ~160 Petajoules per annum and are declining. Supply is therefore expected to be constrained from the mid to late 2020s, presenting a supply risk if additional gas cannot be sourced at an affordable price. This poses a risk to the decarbonisation ambitions of key sectors in the South African economy, which currently and in future, rely on gas as a transition fuel or low-carbon feedstock.

South Africa's potential future gas demand will be driven by four key sectors with proven use cases for gas as a transition fuel or lower emission feedstock (NBI/BUSA Climate Pathways Study: The role of gas in South Africa's path to net-zero, 2022, available at: <https://www.nbi.org.za/climate-pathways-and-a-just-transition-for-south-africa/#explore>):

1. Power: use gas in gas-to-power (GTP) plants to enable a high penetration of renewable energy in the power system by providing the flexible capacity to manage the long-duration intermittency, which battery storage cannot address.

2. Synfuels: introduce additional gas to enable the phase-out of significantly more carbon-intensive coal feedstock in the production of synthetic liquid fuels.
3. Industry: phase out higher emitting coal, and to a lesser extent diesel, with additional gas as an energy source for industrial heat generation and other processes.
4. Transport: use gas as an alternative to diesel, albeit at a smaller scale, for heavy-duty (predominantly >15 tonne) commercial road transport in the short-term while alternative greener technologies mature and become economically viable.

A case in point is Sasol's decarbonisation ambitions, which includes gas as a transitional measure to ~2040, while the cost of green hydrogen is prohibitive. Hence, we are reliant on the use of transition gas in the short to medium term and will likely be one of the largest consumers of a potential upstream oil and gas sector. Today, we are a significant emitter of greenhouse gases (GHG) in the South African economy and are also greatly impacted by a changing climate. In terms of these two high risk dimensions for the company, we are mitigating both transitional risks in relation to a global move away from fossil fuels and adapting our operations to physical changes in the climate.

Within the ambit of transitional risk mitigation, the Paris agreement has put into motion the global move to reduce fossil fuel usage and curb exposure to climate change impacts. Countries and companies like ours are required to contribute to meet these global reduction requirements, with differences anticipated in the reduction trajectory and timing depending on national circumstances. In South Africa these trends, while slightly delayed, are also playing out and companies including Sasol are responding positively to the global need to reduce emissions and climate change risk exposure. As a result, Sasol has committed to playing its part in the country's transition to a low-carbon and more climate resilient economy.

Last year we launched our Future Sasol strategy detailing our decarbonisation roadmaps and GHG emission reduction targets, i.e. a 30% reduction in scope 1 and 2 emissions by 2030 and a net-zero emission ambition by 2050. A key component of our decarbonisation lies in utilising gas. Despite this, we are already progressing opportunities to leverage some of the country's greatest endowments, including wind and sun for energy, platinum group metals, our mining expertise and relatively young population – to successfully transition to a more sustainable energy future including green hydrogen for South Africa. In parallel to our gas ambitions, we are also investing

in green and brown fields green hydrogen projects that will deliver social and economic value for the country, e.g. Boegoebaai and Sasolburg green hydrogen pilot project.

We believe greater use of gas for Sasol and the economy is a critical step in the transition away from coal and a bridge to more sustainable feedstocks. However, we are acutely aware that fossil gas is quickly falling out of favour, particularly in light of the International Energy Agency's (IEA) Net Zero report and the Intergovernmental Panel on Climate Change (IPCC) 6<sup>th</sup> Assessment Report both in 2021, as well as the 26<sup>th</sup> Conference of Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC). These reports have shone a spotlight on the importance of reducing short-lived GHG methane emissions in this decade. That said, for highly carbon intensive coal-based economies like South Africa, transitioning using gas is still critically needed, both as a feedstock and in the power sector. Sasol supports similar sentiments included in the discussion document regarding the significant GHG reduction potential that can be achieved from feedstock switching.

## **1.2 Competitiveness**

The upstream oil and gas sector in South Africa is a frontier area and to monetise discovered assets at the pace and scale needed to transition as well as still attract the necessary funding, will require an enabling policy environment, which is currently limited. A further complication is that South Africa will be competing with other more established and frontier jurisdictions for upstream investments. At the same time, the world is moving towards a more fossil-fuel restricted future. Therefore, there is a need for speed and agility in the development and review of an appropriate regulatory landscape to allow for any upstream resources to be exploited and utilised before they are in danger of becoming stranded.

As a result, further investment in the upstream oil and gas sector is a critical enabler to help the country transition to greener alternatives, as well as provide a potential additional revenue stream. Securing additional gas does however come with constraints, primarily being market affordability to implement gas solutions at scale and timing.

From a timing perspective, a realistic estimate from exploration to first production is between 8 to 10 years, which is largely dependent on the complexity of the geology and the development plan. Whilst the production of domestic gas will be complex, the alternative for South Africa is the import

of gas which has a direct implication on the country's balance of accounts. This complexity is brought about by deep-water assets in under-explored areas (e.g. ER236 and Brulpadda) requiring significant upfront costs to deal with this high level of risk. Onshore opportunities such as shale in the Karoo also remains a possibility, however, this type of investment will likely lead to a high cost base and is associated with resources not directly linked to markets. Smaller onshore options such as coal bed methane, require material re-investment to sustain production off a low baseline in comparison to Southern Mozambique, for example. The implication is that, if South Africa were to rely on domestic gas to meet its decarbonisation agenda, licensing and fiscal terms will have to be more attractive for investors to work within the closing window of opportunity for hydrocarbon investment. In light of this, exploration needs to start in 2022 for the capital to be recovered by 2040. Sasol therefore strongly recommends that government undertake a wider process to develop the requisite policies and measures, including incentives to transition and consider more flexibility in awarding licenses compared to what global benchmarking may suggest.

With regards to affordability, South Africa's gas industry is largely dependent on supply from Southern Mozambique, which is available at prices far below liquified natural gas (LNG) parity on an energy basis. As gas consumption in South Africa will need to increase across all sectors to meet our decarbonisation ambitions, markets will need to adapt to a higher feedstock cost. It is not clear the extent to which this will be possible considering costs to supply the molecules and develop infrastructure, which will be capital intensive with long lead times to payback. From an oil and gas exploration and production perspective, it should be expected that developers will seek flexibility on government take, recovery of past costs and royalty tax. We have included further commentary on this issue later in the submission.

Gas developments are market and infrastructure led. South Africa does not have infrastructure that could unlock gas developments at scale. This infrastructure is capital intensive with long lead times to payback. In addition to this, market affordability remains a challenge. The consequence of this is that if a condition precedent on the oil and gas sector is domestic utilisation; careful consideration (e.g. concessions) also needs to be given to gas infrastructure (e.g. pipelines) and although not the purpose of this document, regulation of pricing. In the absence of in-country infrastructure, exports could be considered for gas from either on or offshore facilities. In the absence of industries that can utilise any condensate yield, the cost of exporting this to alternate

markets needs to be considered.

The existing policy environment is limited with a few policies and measures currently in place to effectively incentivise the industry. Fair and equitable returns for upstream companies and the country must be ensured. Beyond the current discussion document and its focus on the Upstream Petroleum Resources Development (UPRD) Bill, further policies and measures are needed, such as green funds, tax breaks (extension of existing ones such as Income Tax Act 12L and introduction of new ones), and clarity on the alignment of the carbon tax with the carbon budget instruments to name a few.

Sasol is strongly of a view that particularly in the climate change policy environment, the industry needs incentives to achieve National Treasury's three objectives of attracting investment, generating an appropriate level of government revenue and meeting our climate change commitments. Incentives offered to the industry today will benefit the country in the long term in the form of economic growth, job creation, downstream monetisation and localisation to mention a few.

## **2. Commentary on the proposals relating to the Upstream Oil and Gas tax regime**

### In response to section 8.4.a: Royalties for oil and gas

A production sharing regime can be onerous for contractors and for a country with limited oil and gas resources, high geological risk and an under-developed upstream industry. A concessionary royalty tax regime is recommended.

Government's proposal to move to a flat rate of 5% on gas/oil produced from a sliding scale royalty tax of a minimum 0.5% capped at 5% depending on profitability, will secure government revenue as these will be linked to produced resources and not profitability. Whilst the flat tax rates provide transparency to all parties and allows for easier budgeting and administration, it is unlikely to be well received by the oil and gas sector. Even once developments are complete and production starts, it could be the case that operators and contractors view such an arrangement as non-ideal, stalling re-investment, which could be exacerbated by the fact that the geology is largely unproven.

It is fair to point out that flat rate royalty taxes are common in many African and European countries with most tax rates starting from 5% and reaching highs of 40% i.e. Germany. Countries like Mozambique, Nigeria and Ghana which have either a hybrid fiscal regime or production sharing contracts (PSC) have rates of 6% to 10% for Mozambique, 0% - 20% in Nigeria and 3% - 12.5% in Ghana to name a few. We must however bear in mind that these countries have a far more mature exploration and production sector than South Africa, and therefore we should rather focus on how these tax regimes have evolved over the years to ensure investor interest and grow the industry.

Given the fact the South Africa has a nascent oil and gas sector, it is plausible that oil and gas investors would expect a risk adjusted royalty rate that accounts for risk capital and speed of implementation as well as for it to be linked to shallow water vs. deep-water and gas vs. oil.

In terms of this proposal, Sasol is in favour of a more balanced approach that encourages investment with speed and is not supportive of a fixed flat rate of 5% on gas/oil produced.

In response to section 8.4.b: Capital Allowances

Capital allowances have remained unchanged with a 200% capital allowance on Exploration and Appraisal (E&A) and 150% on development costs.

At this point Sasol is unable to make a definitive conclusion on this proposal and recommends further testing of the proposed capital allowances within the context of a narrowing window of opportunity and increasing global competition.

In response to section 8.4.c and d: Petroleum Resources Rent Tax

No changes to the withholding tax and Petroleum Resource Rent Tax have been observed. The introduction of more taxes would be unfavourable from an upstream investor standpoint which is supported.

In response to section 8.5: Proposal for overall package

Government has proposed an increase to government's stake of 20% shareholding with a 100% carry through E&A with no/part recovery. Detailed commercial modelling on proxy assets is required to unpack the mechanics of the proposal. In addition, it is critical to also determine the extent to which the proposal could pose a challenge for investment, particularly as material discoveries are

expected to be high risk and capital-intensive, with a likely expectation of some form of recovery from government. Therefore, we are of the view that government needs to provide further incentivisation for this sector to grow with speed.

In response to section 8.6: Stability Agreements

In an effort to provide oil and gas investors with certainty on the tax treatment of future revenues, the Minister of Finance may enter into a fiscal stability agreement (FSA) with an oil and gas company. The contract binds the government and guarantees provisions of the Tenth Schedule and the Mineral and Petroleum Resources Royalty Act of 28 of 2008 (MPRRA) from the date the contract is concluded.

For the past 7 years, government has not approved any fiscal stability agreements and hence considering previous Budget announcements, government intends to review all incentives to broaden the tax base and lower the corporate tax rate. In this regard, feedback has been requested on whether FSAs should continue to be part of the fiscal regime.

In Mozambique for example, additional fiscal stability clauses introduced in 2017 demonstrate the governments prioritisation of the industry and their provision of incentives to the entities operating in the sector. This clearly illustrates that there are contractual arrangements with the government that supersede the general tax legislation applicable in this industry, thereby providing certainty. Likewise, in Qatar and other Middle Eastern countries, at least 10 years of tax holidays are granted to support exploration and share the risk with oil and gas companies.

Similarly, in South Africa the provision of certainty through the continuation of FSAs (which is consistent with world-wide practice) and tax exemptions should extend, as a minimum, to the following areas:

- corporate income tax;
- obligation to withholding tax on dividends;
- management and consulting fees paid to foreign partners;
- contractors, sub-contractors and suppliers under the Contract of Engineering, Procurement and Construction shall be exempted from tax;



- the company's import of goods, materials, substances, supplies and equipment, as well as spare parts required for maintenance, repair or any future investments related to the project which are not needed by the project, shall be exempted from import duties;
- customs duties and general customs duties and related fees on the exportation of petroleum and related fuel products;
- salary tax for expatriate personnel; and
- VAT exemption across the value chain to improve cash flows.

It is recommended that South Africa include the provision of FSA's in the current fiscal regime as this will encourage investment and ensure competitive terms for the oil and gas sector.

#### In response to section 8.8: Sovereign Wealth Fund

Sasol acknowledges National Treasury's short discussion on a sovereign wealth fund (SWF) and that further consideration of such a fund is underway. We are however reticent on how a SWF would be useful today as the oil and gas sector is nascent with no meaningful revenue streams.

We believe it to be more prudent for National Treasury to undertake urgent work on an enabling policy framework, focusing on requisite incentives to accelerate the growth of this sector while we still have the opportunity to do so. It is also important that the work include benchmarking from emerging economies in Africa, inclusive of the advantages of a SWF. In this way a holistic win-win approach for both the government and the investor can be ensured.

Sasol is keen to collaborate with the department on this important area to achieve both the country's and our own climate change ambitions.

### **3. Summary of Sasol's recommendations**

As detailed above, due to increasing climate change challenges and the need to transition the energy industry, a limited and closing window of opportunity exists for the development and utilisation of upstream assets globally. In order for South Africa to take advantage of this window of opportunity, and earn a desired revenue stream from these assets, it is recommended that government consider a more attractive investment regime and increasing flexibility in the conditions linked to the awarding of licenses.

It is also recommended that additional modelling work be undertaken on the following key areas to further inform decision-making:

- explore a dual fiscal regime for gas vs oil given the capital intensity and the implication on recovery of capital against an uncertain energy transition;
- risk adjusted royalty mechanism that accounts for risk capital, speed of implementation and whether it is linked to shallow water vs. deep-water and gas vs. oil (Sasol is not supportive of a fixed flat rate of 5% royalty on oil and gas produced as it will more than likely discourage investment);
- understand the impact of the proposed 20% government shareholding at 100% carry with no/part recovery in a high risk and capital-intensive sector and whether there is a more attractive alternative;
- test whether the proposed capital allowances of 200% on E&A and 150% on development costs make South Africa a sufficiently attractive destination for investments;
- explore tax incentives and fiscal certainty through FSAs to ensure economic viability for both business and economy, inclusive of job creation and skills development; and
- investigate further flexibility in the proposed fiscals to attract investments given a closing window of opportunity for South Africa.

To reiterate, Sasol welcomes the opportunity to comment on this important discussion document and sees this as part of an ongoing consultation process with your department. We look forward to engaging at your earliest convenience.

Yours sincerely,

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**Paul Victor**

Group Chief Financial  
Officer

[Paul.Victor@sasol.com](mailto:Paul.Victor@sasol.com)

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**Priscillah Mabelane**

Executive Vice President  
Energy Business

[Priscillah.Mabelane@sasol.com](mailto:Priscillah.Mabelane@sasol.com)

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**Vuyo Kahla**

Executive Vice President  
Strategy, Sustainability &  
Integrated Services

[Vuyo.Kahla@sasol.com](mailto:Vuyo.Kahla@sasol.com)