



Biodiversity & Fiscal Reform: A summary of Fiscal Tools for Biodiversity to Date

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March 2009**

SECTION A: OVERVIEW

A.1. Background of BFR

In 2007, DEAT commissioned the Botanical Society of South Africa to develop specific incentive proposals on biodiversity, protected area management and related issues. The Biodiversity & Fiscal Reform project was initiated at an inception meeting held in July 2007 with DEAT, Treasury, SANBI and the Botanical Society. A steering committee has been established and a Project coordinator was appointed and began work on the project in November 2007. C.A.P.E., a bioregional programme within SANBI, has since provided additional funding to the BFR project. The BFR currently reports quarterly to CAPE Biodiversity Economy Task Team and to DEAT.

DEAT, with the support of Treasury, also commissioned work to develop an overarching framework and suite of proposals for all proposed environmental management fiscal instruments¹, including pollution levies, biodiversity management incentives and incentives for mitigation activities for developments. This resulted in the document Fiscal Frameworks for Sustainable Development, submitted to DEAT in late 2007.

A.2. Introduction

The leading threat to biodiversity in South Africa is habitat loss. In response to this, two main strategies exist, a) to expand our protected area estate, and b) to manage threatened ecosystems sensitively and with production systems that are compatible with retaining biodiversity.

The aim of the Biodiversity and Fiscal Reform project is to identify and develop a range of fiscal mechanisms that incentivise the uptake of these two strategies beyond the purchase of land or environmental regulations. The BFR has also sought to identify and address perverse incentives acting against the expansion of the PA estate

The National Environmental Management: Protected Areas Act (Act 57 of 2003) (PAA) and the National Environmental Management: Biodiversity Act (Act 10 of 2004) (NEMBA) provide a sound legal basis for the formal protection of biodiversity.

These Acts, amongst other things, establish a planning framework which targets only the most important biodiversity areas, and makes provision for partnership agreements for conserving biodiversity on private and communal land.

The two Acts allow for a number of partnership agreements, varying in the level of biodiversity protection. These are:

- A Biodiversity Management Agreement (provided for under NEMBA);
- A Protected Environment (provided for under PAA); and
- A Nature Reserve or National Park (provided for under PAA).

The latter two agreements also require formal declaration and restrictions on their land.

In order to be as effective as possible, the above declarations and agreements are being implemented with additional contracts, which outline agreed upon management plans for the land, and stipulate time frames. These time frames and management requirements are aligned with the degree of protection of biodiversity. For example, a Biodiversity Management Agreement would typically have limited management requirements, allow a number of other activities on the land, and would extend for a relatively short period of time, such as five to ten years. At the other end of the spectrum, a Nature Reserve is more likely to be long term, such as 99 years or in perpetuity, with more substantial restrictions on the use of the land.

¹ DEAT (2007): A Fiscal Framework for Sustainable Development

These agreements are currently being implemented through organised stewardship programmes developed within provincial conservation agencies. These programmes target biodiversity priority areas, provide an extension service to participating landowners, draw up and manage the above mentioned contracts, assist the declaration process and audit the agreements. There is a role for other agencies, such as NGO's, to become involved in this process. However, effective stewardship programmes are relatively resource heavy, and collaboration between agencies in order to assist the process would be most effective.

Beyond the expansion of protected areas and statutory conservation, there remains a need to maintain the integrity of biodiversity across landscapes. This contributes not only to the sound functioning of protected ecosystems and linkages between ecosystems, but also provides ecosystem services and supports livelihoods beyond protected areas.

The term 'Fiscal' refers to government revenue and expenditure. In the case of fiscal tools for biodiversity, the BFR has focused predominantly on property rates and tax based mechanisms, with some consideration towards payments for ecosystem services (PES). These mechanisms are outlined in Section B below.

There is no single tool, fiscal or other, that will address the wide range of scenarios across the landscape, or achieve the spread of conservation outcomes envisaged in national policy. Instead, the aim is to develop a suite of tools that encourage conservation outcomes in different landowner situations, as well as achieve different degrees of biodiversity conservation, both statutory and non-statutory.

SECTION B: FISCAL INCENTIVES

B.1.TAX

Introduction

Tax based incentives were promulgated in the Revenue Laws Amendment Act 60 of 2008, and will be written into the Income Tax Act 58 of 1962. The incentives will be effective from the 2009/2010 tax year.

The incentives are designed to address only statutory conservation. Furthermore, they are dependent on the existence of a contract with a specified duration for the agreement. Specifically:

A Biodiversity Management Agreement	->	Contract of a minimum 5 years
A Protected Environment, Nature Reserve or National Park	->	Contract of a minimum 30 years
A Nature Reserve or National Park	->	Contract of a minimum of 99 years.

In response to the commitments of landowners to secure biodiversity on their land, National Treasury has recognised that:

- A. Landowners have forgone use rights to their land, which have inherent value, and
- B. Landowners often incur substantial costs in managing their land under these agreements.

As a result, a number of fiscal mechanisms have been developed to support what is essentially a cost carried by an individual for the public good.

The tax mechanisms are outlined below.

Biodiversity Management Agreement, with a minimum contract of 5 years

All conservation and maintenance expenses incurred in terms of a Biodiversity Management Agreement are to be treated as expenditure incurred in the production of income and for purposes of trade. Examples of these expenses could be rehabilitation expenses, alien clearing or burning fire breaks. However, expenses are only deductible if the activity is reflected in the management plan connected to the Biodiversity Management Agreement.

The taxpayer may only make these deductions from income generated from the land subject to the Biodiversity Management Agreement, or land in the immediate proximity. The Act does not define 'immediate proximity', but it is taken to mean neighbouring, or within a few kilometres of the land under the BMA.

The deduction may not exceed the income of the taxpayer derived in the year of assessment. However, the amount by which the deduction exceeds the income will be deemed to be expenditure incurred by the taxpayer in the following year of assessment. In other words, a roll-over of deductions into the next tax year is allowed.

Farmers entering into Biodiversity Management Agreements are subject to the same deductions, with the only difference being the deductions are allowed for under paragraph 12(1A) of the First Schedule. This portion of the Income Tax Act deals specifically with all allowable deductions made by farmers.

The deductions are limited to income derived by the taxpayer from farming activities on the land or within the immediate proximity of the land.

Recoupment Clause

If the taxpayer is in breach of the agreement, the amount of the deductions previously allowed in the five years preceding the contravention would be recouped².

Protected Environment, Nature Reserve, National Park, with a minimum contract of 30 years

All conservation and maintenance expenses are deemed to be Section 18A deductible donations. This means that expenses related to the management of the land, as required by the Management Plan, can be deducted from the taxpayer's taxable income³. Activities not required in the management plan are not deductible.

18A Deductions

An '18A deduction' refers to deductions from taxable income allowable under Section 18A of the Income Tax Act 58 of 1962 (Chapter II, Part I, Section 18A).

This Section allows the taxpayer to deduct from their taxable income donations made in cash or of property made in kind to Public Benefit Organisations, which includes Government Departments.

NB: An 18A deduction may not exceed 10% of the taxpayer's taxable income.

Recoupment Clause

If the taxpayer is in breach of the agreement, he/she will be subject to a recoupment of the deductions previously allowed in the five years preceding the contravention.

Nature Reserve, National Park, with a minimum contract of 99 years

The value of land is deemed to be a Section 18A deductible donation. This means that the taxpayer may deduct the value of the land from their taxable income. This deduction must follow some prescribed guidelines, outlined below. Taxpayers under this agreement are still entitled to deduct management expenses from their income, as outlined above. However, both these deductions, combined, must fit under the 10% cap referred to in the box above.

Calculating the Value:

- The landowner may deduct 10% p.a. of the value of the land over ten years, starting on the year of declaration.
- The deductible amount does not include portions of the land over which the taxpayer has right of use. For example, the residential footprint of a house or commercial lodge included in the reserve or park.
- The deductible amount is initially equal to 10% of the lesser of:
 - the cost to purchase the land, or
 - the market value of the land
- This 10% amount must then be multiplied by the ratio of the market value of the declared land reduced by the right of use as that amount bears to the value of the declared land as if that declared land had been donated full, as depicted in the formula below:

² SARS would recover the money by including it in the amount owed to them in the tax year in which the breach arose

³Gross income – exemptions = Income

Income – Deductions + Taxable Capital Gains = Taxable Income

10%	x	Lesser of cost or market value declared	x	Market value of land declared
				Market value of land declared if there had been no right of use retained

Duration of Deduction

The taxpayer may deduct the amount in the year of declaration, and again in each of the following nine years. This means that by the end of the ten year period, the full base value (cost or market value as the case may be, reduced to take account of any right of use that was retained), may have been deducted. There is no allowance for a roll-over of deductions into the following year, should there be no or insufficient income from which to make the deduction in any given year.

Summary: Tax Incentives

Under certain conditions, the tax mechanisms described above will provide a strong incentive for land to be formally protected. In other conditions, they will at least provide land owners who are already willing to conserve their land with some form of compensation for their expenses. However, it must be noted that the tax mechanisms are only effective with land owners who are generating enough income to make the biodiversity-related deductions significant.

The tax legislation providing biodiversity incentives was only promulgated in 2008. These innovative mechanisms have yet to be tested. It is expected that, over the next few years, guidelines and practise notes will develop as uptake of the tax incentives grows.

B.2. PROPERTY RATES

Introduction

Property rates have the potential to significantly affect land use decisions. In the past, land owners outside of urban areas were not subject to property rates. Under the new Municipal Property Rates Act 6 of 2004 (MPRA), municipalities are now able rate rural properties within their jurisdiction. In some cases, land owners who were not required to pay rates before may now be facing prohibitively high rates - high enough to stimulate a change in land use behaviour in order to lessen the rates burden. This provides an opportunity to encourage sound land use behaviour through property rates. It also requires that we be cognisant of rates policies that inadvertently have negative affects on biodiversity (perverse incentives).

Property rates have the potential to positively impact biodiversity at two levels. At the national level, MPRA stipulates that certain protected areas are excluded from paying property rates.

At the local level, municipalities are required to develop their own property rates policies, within the bounds of the MPRA. Municipalities are also responsible for ensuring the valuation of properties, upon which rates are based. This provides an opportunity for municipalities to develop specific rates-based incentives to maintain biodiversity, or secure a particular ecosystem service.

Property Rates: Important Terms and Definitions

Exclusions: The Municipal Property Rates Act defines categories of land types that should be subject to rates exclusions.

Exemptions and Rebates: Applies for categories of properties or land owners and is determined by municipal rates policy in accordance with the MPRA

Property Valuations: Conducted by municipalities and can be applied to categories of land or individual properties

National Property Rates Act: Incentives and Perverse Incentives

Rates exclusion for National Parks and Nature Reserves

The MPRA Section 17 (1) (e), states that special nature reserves, nature reserves and national parks are excluded from paying property rates. While this is progressive fiscal policy for protected areas, the exclusion only applies to those portions of the land that are not used for commercial, business, agricultural or residential purposes. It is important that municipalities administer this allowance in the intention of the law, which is to rate only the actual improved areas of the activity. This is best illustrated with an example of nature reserve with a lodge, and game drives. The lodge should be liable for property rates, but the remainder of the nature reserve, including the land over which game drives are taken, should not be rated.

Property Rates for Eco-tourism and Game Farming

Currently, the MPRA, Section 1(b), defines game farms and ecotourism activities as commercial activities, by specifically excluding them from agricultural activities. As a result, eco-tourism and game farms are liable for up to eight times greater property rates to the local municipality compared to what would be levied on the land if it was agricultural land. This may motivate landowners to convert game farms, which could be providing a corridor or maintaining biodiversity, to intensive agriculture.

This issue has been raised by the BFR with National Treasury while in the process of amending the MPRA. However, it has not resulted in any changes to the Act. DEAT may decide to take the matter further with the Department of Provincial and Local Government.

Local Property Rates Policies

Municipal Rates policies are governed by the MPRA. Municipalities are responsible for developing their own rates policies in accordance with the Act. These policies are subject to annual review, and may be amended. They are also responsible for ensuring all properties are valued. Apart from properties excluded from paying rates, the valuation of a property has a direct impact on the rates a land owner is liable for.

As national parks and nature reserves are already excluded from paying rates, a biodiversity based local rates policy should focus on non-statutory conservation, particularly around the provision of ecosystem services. Within the bounds of the MPRA, municipalities have the opportunity to use the rates policy to achieve objectives related to natural systems. For example, fire mitigation by encouraging the clearing alien invasive plants; flood mitigation through maintaining natural systems such as wetlands; or securing sections of greenbelts on private land.

Rebates and Exemptions

Under the MPRA, local municipalities are entitled to offer rebates or exemptions for defined categories of properties within their jurisdiction. Through this mechanism, local municipalities are able to provide an incentive to landowners to manage the biodiversity

on their land effectively. This would be done through a contractual agreement between the land owner and the municipality, requiring certain management actions on the land, and/or placing certain restrictions on the land.

The complexity and degree of land owner's commitment can be dependent on the capacity and objectives of the municipality. Certain metropolises have used their rates policies to incentivise local biodiversity stewardship agreements. Nelson Mandela Bay Municipality, for example, will offer rates rebates and exemptions to land owners within high biodiversity priority areas who have signed a contract with the metro specifying land use restrictions and responsibilities.

Beyond the relatively well resourced metro's, few municipalities have the capacity to implement biodiversity stewardship programmes. However, more discrete goals could be reached through contracts with land owners requiring more simplified actions. For instance, a single ecosystem service, such as water provisioning through maintaining natural grasslands, could be managed through a contract between the land owner and the municipality, with subsequent rates rebates. Other examples of ecosystem services that could be provided by land owners for municipalities in return for rates rebates or exemptions include fire mitigation through alien clearing, flood control through the maintenance of wetlands, etc.

Environmental Servitudes and Property Valuation Reductions

Property valuation reductions allow the municipality to reduce the rates paid by the land owner by reducing the valuation of the property on the valuation roll. While there may be arguments for not interfering with the valuation mechanism, it is well known in many international jurisdictions that revaluations can be altered to reflect an inability to develop or realise the "highest and best use" of a property or to encourage sound environmental management. Valuation reductions may be a more simple and acceptable tool in the administration of the municipality.

Land valuation reductions could be used specifically for land units that are important for environmental management or biodiversity, in which the local municipality would like the land to remain undeveloped, or cannot be developed due to National Legislation or international agreements, e.g. National Environmental Management: Biodiversity Act (Act 10 of 2004) section 43, Ramsar Convention on Wetlands of International Importance; Bonn Convention on Migratory Species. One method of implementing this would be through declaring an 'environmental' or 'biodiversity' servitude on a portion of the land, and then revaluing the property according to the reduced development rights. Once again, this provides a formal and binding agreement on the land in return for fiscal incentives.

In terms of the MPRA, municipalities are specifically prohibited from providing ad hoc rate exemptions or rebates to categories of properties or individuals if the criterion is not catered for in their Rates Policies. They are also required to record exemptions and rebates as expenditure in the budgets, which is a perverse incentive designed to minimise the use of these mechanisms. However, a property valuation reduction can be applied to an individual property that does not fall within an identified category if the value is reasonably reduced through a limitation on the title deed or the declaration of an environmental servitude in favour of conservation.

This reduction in rates through a reduced property valuation is not reflected in the annual financial statements as expenditure. The decreased valuation of the property is not directly linked to the market value of the property.

B.3. PAYMENTS FOR ECOSYSTEM SERVICES

Currently, Payments for Ecosystem Services (PES) markets in South Africa around carbon and water are being investigated by various government and non-government agencies⁴. However, there remains a need for greater understanding around PES. Some of these key gaps in knowledge are outlined below.

- There is currently insufficient understanding of suitable institutional models for PES to operate effectively in South Africa.
- Complementarities between carbon markets, water markets and biodiversity need to be better understood. In some instances, a carbon market will automatically benefit the natural vegetation from which the carbon credits are gained. Similarly, some water markets might correlate highly with intact natural ecosystems. However, there will be instances where neither a carbon nor water based PES model will benefit biodiversity. Complementarities should be identified spatially.
- The biodiversity sector needs to determine whether biodiversity based PES (unrelated to carbon or water PES) is a viable option in South Africa. If it is, is it more beneficial to sell biodiversity units as a 'bundled' good (i.e. buyer purchases 'biodiversity units'), or should discrete ecosystem services be sold, which result in sound biodiversity management?
- There is a need for more thought around linkages between PES and sustainable development. It is quite possible that, implemented correctly, PES could be a very powerful tool for poverty reduction, particularly in communal areas where other fiscal incentives for conservation are likely to be ineffective.

⁴See, for example, *Maloti Drakensberg Transfrontier Project (2007) Payments for Ecosystem Services: An Ecosystem Services Trading Model for Mweni/Cathedral Peak and Eastern Cape Drakensberg Areas*. Mander (ed) INR Report IR281. Development Bank of Southern Africa, Department of Water Affairs and Forestry, Department of Environmental Affairs and Tourism, Ezemvelo KZN Wildlife, South Africa.

SECTION C: SUMMARY

C.1. Applicability of Fiscal Incentives

Table 1 (below) illustrates the wide range of applicability of fiscal incentives for biodiversity explored by the BFR. Tax incentives, in their current form, link directly to statutory conservation. Property rates and PES have the potential to span statutory and non-statutory biodiversity conservation.

Across the landowner spectrum, tax- and rates-based incentives are expected to be more effective with private land owners, and particularly on land of high commercial value and with landowners generating income (not necessarily from the land). However, these incentives are likely to be of little value on communal land where communities do not pay rates, or with landowners generating marginal income (as the tax deductions will be limited). In contrast, a PES programme, if implemented wisely, has the potential to incentivise biodiversity conservation while addressing poverty.

C.2. Progress to Date

The tax incentives outlined in this document have been developed and promulgated. However, there is a significant need for these tax mechanisms to be fully understood and taken up by the implementing agencies in order to be effective. The BFR has conducted some training on the use of tax incentives with agencies involved in stewardship. The project is also working on unravelling some of the complexities of relevant tax legislation, to ensure more efficient uptake of the tax incentives.

Property rates work at the level of the Municipal Property Rates Act has largely been completed. There is still a need for high level engagement around national guidelines for municipal rates policies for biodiversity. BFR continues to provide ad hoc support to individual municipalities, in particular City of Cape Town and Nelson Mandela Bay Municipality.

Formal work on PES has not yet begun, although BFR has been involved in discussions and learning events around PES. It is felt that a primary focus within the biodiversity sector should be identifying the linkages between water, carbon and biodiversity PES markets, both spatially and institutionally, and to focus attention on understanding the implementation requirements for PES and the perverse incentives or obstacles preventing them being deployed. The market for water and carbon have substantially greater potential than biodiversity markets. Bundling biodiversity with a carbon or water market, and possibly including social benefits, will achieve much desired triple dividends.

TABLE 1: Fiscal Incentives Outline

Fiscal Incentive	Biodiversity targeted	Level of protection	Landowner Beneficiary Type
Tax Based Incentives			
Deductibility of management expenses for Biodiversity Management Agreements	Threatened Ecosystems	Biodiversity Management Agreements under the Biodiversity Act, minimum contract duration 5 years.	The tax mechanisms preferentially benefit individuals and other legal entities generating larger incomes
Deductibility of management expenses for Protected Environments	NPAES target areas, Provincial biodiversity priorities, Threatened Ecosystems, important catchments, and other biodiversity priority areas	Protected Environment, minimum contract of 30 years	
Deductibility of management expenses for Nature Reserves and National Parks	NPAES target areas, Provincial biodiversity priorities, Threatened Ecosystems, important catchments, and other biodiversity priority areas	Nature Reserve, minimum contract of 30 years National Park, minimum contract of 30 years	
Deductibility of land value for Nature Reserves and National Parks	NPAES target areas, Provincial biodiversity priorities, Threatened Ecosystems, important catchments, and other biodiversity priority areas	Nature Reserve, minimum contract of 99 years National Park, minimum contract of 99 years	
Property Rates			
Municipal Property Rates Act: Rates exclusion for national parks and nature reserves <i>This provision already exists in the MPRA. The task is to ensure that it is taken up by municipalities.</i>	NPAES target areas, Provincial biodiversity priorities, Threatened Ecosystems, important catchments, and other biodiversity priority areas	National parks and nature reserves under the Protected Areas Act Aimed at portions of PA's not used for commercial, residential or industrial purposes.	Landowners paying property rates
National Property Rates Act: Removal of perverse incentives	Corridors, important catchments, landscapes outside of Protected Areas. The perverse incentives related to ecotourism and game farming, which provides an alternative land use to activities that would require land	Informal conservation, e.g. non-contractual stewardship and conservancies	Land owners paying property rates Predominantly aimed at removing perverse incentives on land used for ecotourism or game farming.

	transformation		
Local property rates policies and property valuations: conservation biodiversity and other ecosystem services	Local high biodiversity areas can be protected through agreements between land owner and municipalities Could also apply to ecosystem services, such as water quality and quantity, fire mitigation, erosion, etc.	Predominantly informal conservation	Land owners paying property rates
Local property rates policies and valuations: Avoiding perverse incentives	Areas of local or national biodiversity significance with development restrictions placed upon them Land where specific threats to biodiversity have been addressed, e.g. AIP control	Informal conservation	Land owners paying property rates
Market based			
PES	Predominantly landscapes that offer carbon and/or water benefits with biodiversity benefits.	Formal and Informal conservation	Any landowner, however, PES could significantly benefit impoverished communities and communities in communal areas, where other fiscal incentives would not be effective