

CARBON OFFSETTING UNDER THE CARBON TAX ACT

CARBON TAX IMPLEMENTATION IN SOUTH AFRICA
2020: STAKEHOLDER CONSULTATIONS



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



CARBON TAX POLICY CONTEXT

- South Africa voluntarily committed (at COP 15 in 2009) to curb GHG emissions by 34% by 2020 and 42% by 2025 below the BAU trajectory subject to support from developed countries - climate finance, capacity building & technology transfers.
- South Africa **ratified** the Paris Agreement in November 2016 and **endorsed** the submission of its Nationally Determined Contribution (NDC) which requires that **emissions peak in 2020 to 2025, plateau for a ten year period from 2025 to 2035 and declines from 2036 onwards.**
- **South Africa's emissions by 2025 and 2030 will be in a range between 398 and 614 Mt CO₂-eq, as defined in national policy.**
- **Paris Agreement** will require sizable reductions in GHG emissions by large emitting countries, including in developing economies. The NDC noted **carbon tax** as an important component of our **mitigation policy** strategy to lower GHG emissions.
- Carbon tax forms an integral part of **climate change** response policy package under the National Climate Change Response Policy (NCCRP) of 2011, and in **National Development Plan (NDP)** as an important cost-effective instrument.
- **The Carbon Tax Bill gives effect to the polluter-pays-principle** and helps to ensure that firms and consumers take these costs into account in their FUTURE production, consumption and investment decisions. Assists in reducing GHG emissions and ensuring SA will meet its NDC commitments as part of its ratification of the 2015 Paris Agreement.

DESIGN OF THE CARBON TAX

- Business entities that engage in activities that produce direct greenhouse gas emissions are required to report under the 2017 National Greenhouse Gas Emission Reporting Regulations of the Department of Environment, Forestry and Fisheries (DEFF).
- The carbon tax design is aligned to this mandatory emissions reporting to DEFF and any natural or juristic persons who exceed the DEFF thresholds for reporting, which also functions as the carbon tax threshold, are subject to the carbon tax.
- The carbon dioxide equivalent of greenhouse gas emissions of a taxpayer in respect of a tax period resulting from fuel combustion, industrial processes and fugitive emissions are taxed at a rate of R120/tCO₂e for 2019 and R127/tCO₂e for 2020.
- The gradual implementation of the tax provides for the first phase from 1 June 2019 to 31 December 2022 and the second phase from 2023 to 2030. The carbon tax rate increases annually by inflation plus 2 per cent until 2022 and annually by inflation thereafter.
- Significant tax-free emission allowances ranging from 60 per cent to 95 per cent will result in a modest effective carbon tax rate ranging from R6 to R48/tCO₂e to provide current significant emitters time to transition their operations to cleaner technologies through investments in energy efficiency, renewables, and other low-carbon measures.
- A review will be conducted of the impact of the carbon tax three years after implementation by 2022. Adjustments to the tax design beyond this first phase will depend on the economic circumstances at that time and how effective the tax will have been in mitigating emissions.

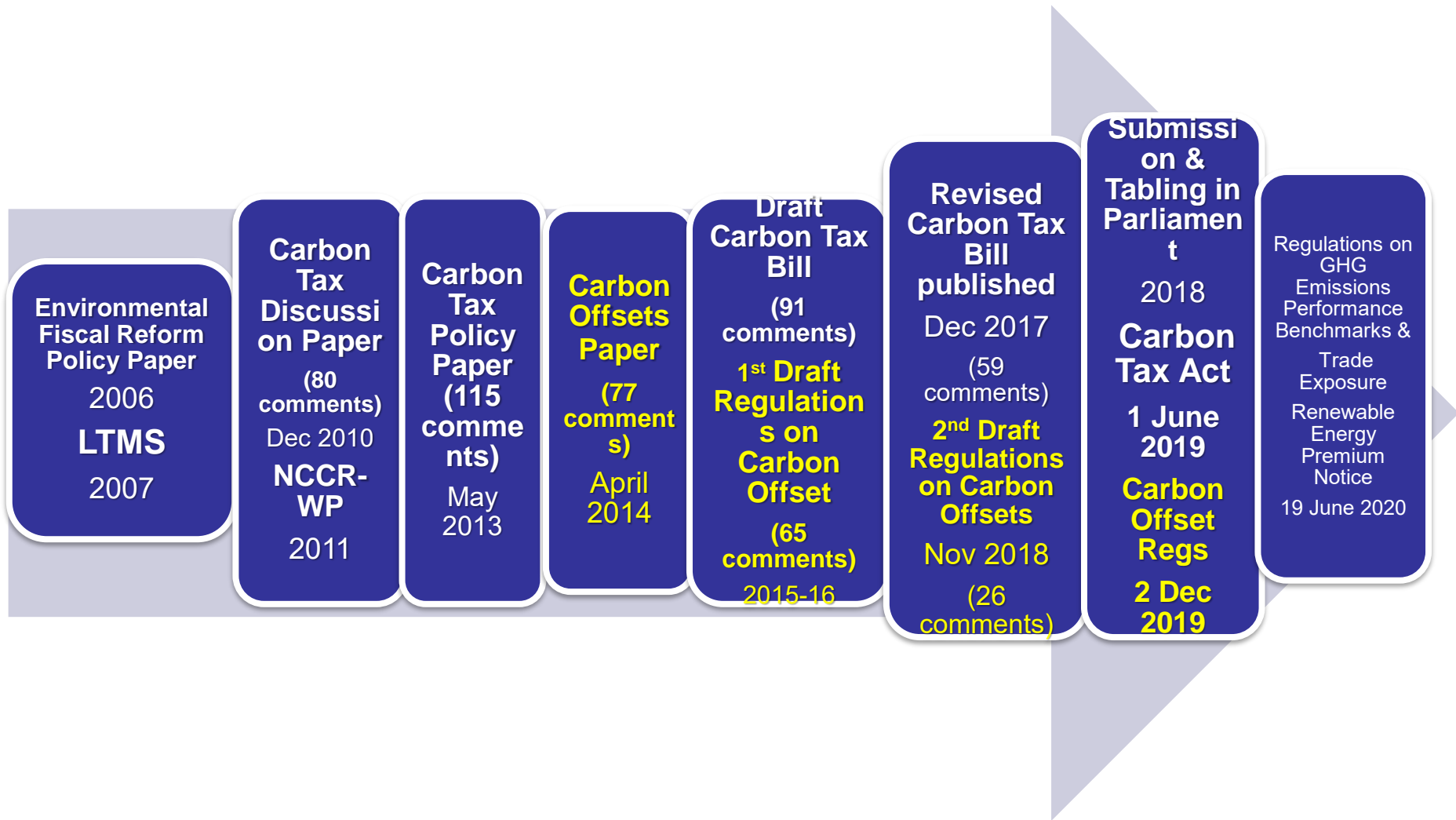
CARBON TAX DESIGN: TAX-FREE ALLOWANCES

	<u>GHG Emissions</u>			
	Combustion	Process	Fugitive	
<u>Tax free allowances</u>				
Basic	60	60	60	
Process emissions	n/a	10	n/a	
Fugitive emissions	n/a	n/a	10	
Trade exposed	10	10	10	Max = 10
Performance based (Z - factor)	5	5	5	Max = 5
Carbon budget	5	5	5	
Offsets	10	5	5	
Total	90	95	95	

GHG INVENTORY, 2015 – DEFF

2015 GHG Inventory (Estimates) – Categories	Emissions - CO2 Eq (Gg)	Emissions - CO2 Eq (Gg)	Total Emissions - CO2 Eq (Gg)	Percentage Contribution
1 - Energy			424104	83%
A - Fuel Combustion Activities			395139	77%
1.A.1.A - Electricity		224 009		44%
1.A.1.B - Petroleum Refining		3 388		1%
1.A.1.C - Manufacture of Liquid Fuels (Synfuel)		31 299		6%
1.A.2 - Manufacturing Industries and Construction		36 704		7%
1.A.3 - Transport		51485		
Civil Aviation	4 258			
Road Transport	46 676			9%
Rail Transport	551			
1.A.4 - Other Sectors		48 254		9%
B - Fugitive emissions			28 965	6%
2 - Industrial Processes and Product Use			35875	7%
2.A - Mineral Industry		6179		
Cement production	5 205			
Lime production	860			
Glass Production	114			
2.B - Chemical Industry		Not disclosed		
2.C - Metal Industry		37 513		
Iron and Steel Production	14 094			
Ferroalloys Production	13 416			
Aluminium production	2 186			
3 - Agriculture, Forestry, and Other Land Use			(48 890)	(10%)
4 - Waste			22 211	4%
Total National Emissions and Removals			512383	100%
International Bunkers	5		11599	

CARBON TAX CONSULTATION PROCESS - TIMELINE



POLICY INTENT OF CARBON OFFSETS SCHEME UNDER THE CARBON TAX

The carbon offset component of the carbon tax has a dual purpose:

- To serve as a flexibility mechanism that will enable industry to invest in mitigation projects at a lower cost to what would be achieved in their own operations, and thereby lower their tax liability (i.e. seek out delivery least cost mitigation).
- To incentivise mitigation in sectors or activities that are not directly covered by the tax and/or benefiting from other government incentives, especially, transport, AFOLU, waste.

CARBON OFFSETS - RATIONALE AND PRINCIPLES

- It is proposed that initially carbon credits developed under certain internationally recognised carbon offset standards be permitted (**gatekeeping**);
- Projects developed under three different carbon offset standards in South Africa, including Clean Development Mechanism (CDM), Verra's Verified Carbon Standard (VCS), & Gold Standard (GS) be permitted during the 1st phase;
- A potential domestic standard primarily to cover the types of projects that are not well catered for under international standards – framework guidance under development.
- The principles of '**real (demonstrable and quantifiable), additional and permanent**' are pivotal to ensuring the credibility of all carbon offset projects credits.

CARBON OFFSETTING UNDER THE CARBON TAX

- In 1st phase, permitted carbon credits should be developed under:
 - Clean Development Mechanism (CDM);
 - Verified Carbon Standard (VCS); and
 - Gold Standard (GS).
- Allowance for potential domestic standard to cover project types not well catered for under international standards e.g. AFOLU.
- Specific **eligibility criteria for carbon offset projects** for effective implementation of the offset mechanism in South Africa includes:
 - Project activities must occur **outside the scope of activities subject to the carbon tax**.
 - **Only South African based credits** will be eligible for use within the carbon offset scheme.
 - **Carbon offset projects registered and / or implemented before the introduction of the carbon tax** regime will be accepted subject to certain conditions.
 - Projects should not be on the **negative list** to be eligible.

INDICATIVE POSITIVE (ELIGIBLE) PROJECT LIST

Sector	Eligible projects
Energy	
<i>Energy Efficiency (except projects claiming the energy efficiency tax incentive / 12L)</i>	<ul style="list-style-type: none"> • Energy efficiency in the residential and commercial sector • Energy efficiency in buildings • Community-based and municipal energy efficiency and renewable energy • Fuel-switching projects • Electricity transmission and distribution efficiency • Small-scale renewable energy projects
Transport	<ul style="list-style-type: none"> • Public transport • Transport energy efficiency
Agriculture, forestry and other land use (AFOLU)	<ul style="list-style-type: none"> • Restoration of sub-tropical thicket, forests and woodlands • Restoration and management of grassland • Small-scale afforestation • Biomass energy • Anaerobic biogas digesters • Reduced tillage
Waste	<ul style="list-style-type: none"> • Municipal waste projects

INDICATIVE NEGATIVE (INELIGIBLE) PROJECTS LIST

- Projects that receive benefits from other government incentives;
- Energy efficiency for projects that benefit from the Energy Efficiency Savings Tax Incentive, (Section 12L of the Income Tax Act);
- Cogeneration of renewable energy and fuel switch projects for operations controlled or owned by companies that are covered by the carbon tax;
- Renewable energy projects developed under the Renewable Energy Independent Power Producers Procurement Programme (REIPPPP) before May 2013 (Bid 1 and Bid 2 windows);
- Destruction of industrial gases from adipic acid production (HFC-23 & N₂O)
- Nuclear energy;
- Geological carbon dioxide capture and sequestration;
- Temporary CDM CERs.

CARBON OFFSET REGULATIONS (GAZETTE NO. 42873)

- Objective - A regulatory framework for the development and administration of the carbon offset scheme under the carbon tax.
- Structure of the draft Regulations:
 - Part I: Definitions
 - Part II: Eligibility
 - Part III: Non-eligibility
 - Part IV: Administrator
 - Part V: Offset registry
 - Part VI: Claiming of allowance
 - Part VII: Requirements for documents
 - Part VIII: Miscellaneous

ISSUES FOR CLARIFICATION (1)

- **Part II - Eligibility:**

- 2. Allowance of offset in respect of an approved project against carbon tax liability**

Clarify period of use of existing or in the pipeline offsets;

- 3. Offset utilisation period**

Clarify period of use of offsets from project activities that become taxable in the future;

- **Part III - Non-eligibility**

- 4. Limitation on allowance**

Clarify inclusion of renewable energy projects – >15 MW with cost equal to or lower than R1.09 / kWh otherwise <15MW, all in.

ISSUES FOR CLARIFICATION (2)

- Part IV – Administrator

5. Designation of administrator – **DMRE DG**

- Part V – Offset registry

6. Creation of offset registry – **functioning registry system**

7. Maintaining, overseeing of offset registry and access to offset registry – **offset registry with different levels of access for stakeholders.**

- Part VI – Claiming of allowance

8. Procedure for claiming allowance by taxpayer – **ELoA; Attestation of voluntary cancellation, Offset certificate processes.**

ISSUES FOR CLARIFICATION (3)

9. Duties of administrator for purpose of claiming of allowance by taxpayer – ELoA, listing of offsets, offset transfers, retirement processes.

- **Part VII – Requirements for documents**

10. Requirements for extended letter of approval – documents required.

11. Content of certificate – copy of draft certificate.

12. Retaining of certificate – period of retention, non-transferability, applicable to stipulated tax period.

13. Short title and commencement

CARBON OFFSET ADMINISTRATION SYSTEM

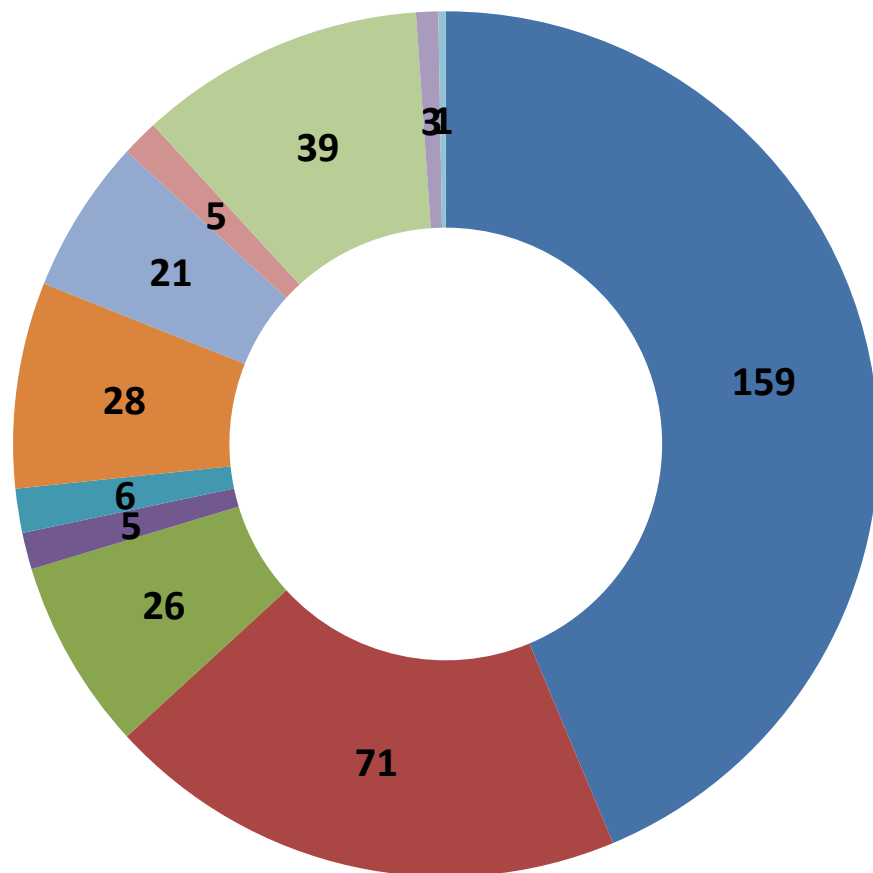
1. Pre-screening of approved project ideas from different standards to ensure they comply with the carbon offset criteria for the South African carbon tax;
2. Issuance of an Extended Letter of Approval (ELoA) to the project owner if they meet all the South African requirements;
3. Credit owner requests attestation or certificate of voluntary cancellation from the international market and request listing into local registry;
4. Administrator lists credits in South African Ownership Repository and issue listing confirmation to credit owner;
5. Credit owner can issue a transfer instruction request for credit ownership transfer to facilitate change in ownership details;
6. Taxpayer issues a retirement instruction to the carbon offsets administrator when ready to utilise the carbon offsets to reduce carbon tax liability;
7. The administrator retires through deactivating the credits in the South African Ownership Repository and issues the taxpayer with a carbon offset certificate;
8. Taxpayer surrenders carbon offset certificate to SARS to mitigate carbon tax liabilities.

CARBON OFFSET PROJECTS IN SOUTH AFRICA



- South Africa has been participating in the carbon markets:
 - **53 potential projects with credits in the CDM;**
 - **22 projects registered through the Gold Standard (2013);**
 - **15 VCS potential projects with credits through Verra (former VCS);**
 - The 2015 National Terrestrial Carbon Sinks Assessment quantifies **carbon offset potential within the AFOLU sector** at 275 MtCO₂e over 20 years.
- Pilot trades of CERs and VCUs were done on the Johannesburg Stock Exchange in early 2015 using existing South African commercial infrastructure for commodities.

CDM PROJECTS IN SOUTH AFRICA – SECTORAL CLASSIFICATION



- Renewable energy
- Energy efficiency
- Cogeneration
- Bio-fuel production
- Industrial process
- Fuel switch
- Methane recovery and flaring
- Nitrous Oxide
- Waste management
- Transport
- Afforestation

NEXT STEPS IN CARBON OFFSETS POLICY

Framework to guide development of local standards being developed through the PMR to cater for:

- concerns regarding the high costs and bureaucratic processes associated with international standards;
- small-scale and micro-community projects and unlock mitigation potential in the agriculture, forestry and other land use sectors which are not well covered by international standards; and
- creation of jobs and develop capacity within local institutions, and reduce reliance on international standards beyond the first phase of the carbon tax.

Outsourcing registry – finalising the project before procurement of services process starts.

- **Offsets** policy create potential market instrument, platform for market infrastructure development forming the basis for engagements with the international market (**Article 6 of the Paris Agreement**).