

CARBON OFFSETTING UNDER THE CARBON TAX

PMR PERSPECTIVES SERIES – EXTRA CREDIT: DESIGNING
DOMESTIC CREDITING MECHANISMS

Environmental and Fuel Taxes Directorate:
Dr. Memory Machingambi

21 April 2021



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 – currently under review in the NDC review.**
- **Paris Agreement** will require sizable reductions in energy-related greenhouse gas (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 Act 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.

SA RANKED 14TH IN ABSOLUTE GHG EMISSIONS – 2015 GHG INVENTORY (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			11599	

CARBON TAX DESIGN: TAX-FREE ALLOWANCES

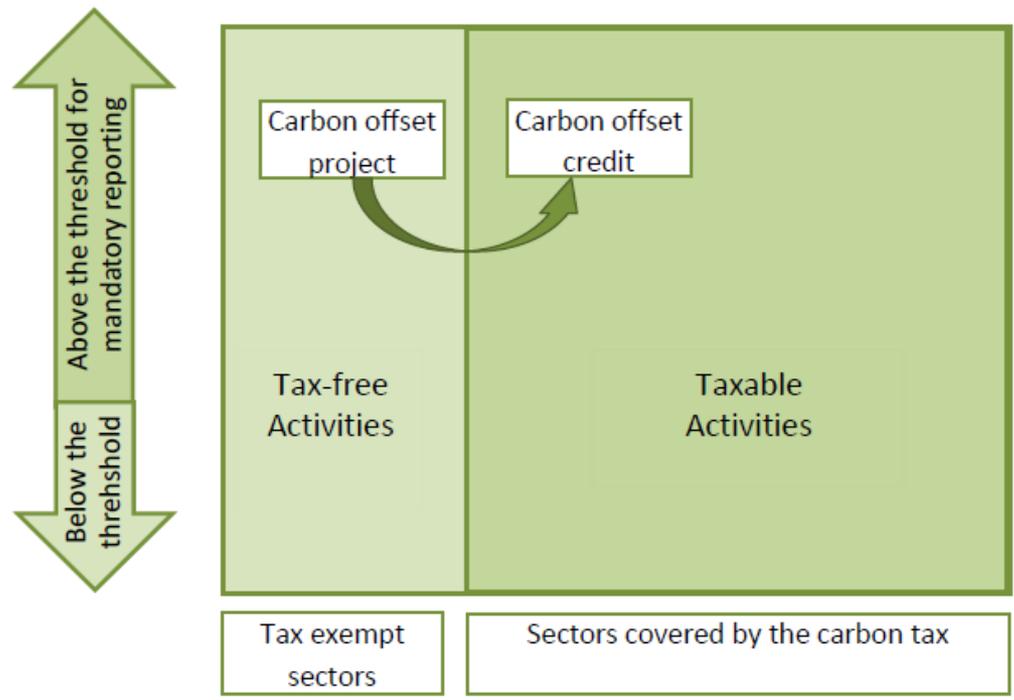
	<u>GHG Emissions</u>			
	Combustion	Process	Fugitive	
<u>Tax free allowances</u>				
Basic	60	60	60	
Process emissions	n/a	10	n/a	
Fugitive emissions	n/a	n/a	10	
Trade exposed	10	10	10	Max = 10
Performance based (Z - factor)	5	5	5	Max = 5
Carbon budget	5	5	5	
Offsets	10	5	5	
Total	90	95	95	

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.



The principles of 'real (demonstrable and quantifiable), additional and permanent' are pivotal.

CARBON OFFSETTING UNDER THE CARBON TAX

- First carbon tax phase, permitted carbon credits should be developed under:
 - Clean Development Mechanism (CDM);
 - Verified Carbon Standard (VCS);
 - Gold Standard (GS) ; and
 - Approved local standard.
- Framework to guide development of potential domestic standard to cover project types not well catered for under international standards has been developed and will be consulted on;
- A domestic standard will help create jobs, develop capacity within local institutions, reduce reliance on international standards, cater for small-scale and micro community projects and unlock mitigation potential in the AFOLU which are not well covered by international standards;
- 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.

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

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.

Thank you