

CARBON TAX POLICY UPDATE AND OVERVIEW OF THE OFFSETS REGULATIONS

National Treasury Carbon Offsets Workshop
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Outline

- Background
- Carbon Tax Design Overview
- Objectives of the carbon offset mechanism
- Overview of the Draft Offset Regulation
 - Eligible project criteria
 - Ineligible project criteria and limitation on allowances
 - Proposed administration and institutional arrangements for offset mechanism

Introduction and Policy Context

- South Africa recently ratified the Paris Agreement in April 2016 and endorsed the Nationally Determined Contribution (NDC - previously the Intended Nationally Determined Contributions).
 - The NDC requires that **emissions peak in 2020 to 2025, plateau for a ten year period from 2025 to 2035 and declines from 2036 onwards.**
 - GHG emissions expected to range between **398 and 614 MT CO_{2eq}**
- The **Paris Agreement** will require sizable reductions in energy-related carbon dioxide (CO₂) in large emitters, including in developing economies. As part of South Africa's submission of the NDC, the **carbon tax** was noted as an important component of the country's **mitigation policy** strategy to lower greenhouse gas emissions.
 - The carbon tax policy forms an integral part of the **climate change** response policy package under the National Climate Change Response Policy (NCCRP) of 2011, and is recognised as an important instrument to ensure cost effective greenhouse gas (GHG) mitigation in the **National Development Plan.**
- **Carbon pricing** is environmentally effective. Pricing carbon increases the prices of carbon intensive goods and services and thereby promotes and strikes the **efficient balance** across the entire range of mitigation opportunities.

South Africa's National Climate Change Response White Paper, 2011

- South Africa's response to climate change has two objectives:
 - Effectively manage inevitable climate change impacts through interventions that build and sustain South Africa's social, economic and environmental resilience and emergency response capacity.
 - Make a fair contribution to the global effort to stabilise greenhouse gas (GHG) concentrations in the atmosphere at the level that avoids dangerous anthropogenic interference with the climate system within a timeframe that enables economic, social and environmental development to proceed in a sustainable manner.
- One of the elements in the **overall approach to mitigation is: The deployment of a range of economic instruments to support the system of desired emissions reduction outcomes, including the appropriate pricing of carbon and economic incentives, as well as the possible use of emissions offset or emission reduction trading mechanisms ...**

Carbon tax policy process

Environmental
Fiscal Reform
Policy paper
(2006)

Carbon Tax
Discussion
Paper
(Dec 2010)

Carbon Tax
Policy Paper
(May 2013)

**Carbon Offsets
Paper (April
2014)**

Legislative
Process &
Technical
Alignment
(2015 -2017):
**Publication of
the Carbon
Offset
Regulations
(June 2016)**

Carbon Tax
Implementation
(2017)

CARBON TAX DESIGN FEATURES: Rate, Tax-free Allowances and Recycling Measures

Tax Design

Carbon tax at R120 per ton of CO₂e from 2017

60% basic tax-free threshold

Max of 10% tax-free allowance for trade exposure

10% tax-free allowance for process and fugitive emissions

Up to 5% performance allowance

5% tax-free allowance for complying with carbon budgets information requirements

5 or 10% allowance for Carbon Offsets – to reduce the carbon tax liability

- Tax-free allowances of **60-95%** - effective tax rate of

R6 - R48 t/CO₂e

- No impact on electricity prices until 2020

- Tax-free thresholds phased down after 2020

Revenue Recycling

Energy Efficiency Savings tax incentive

Credit against Eskom's carbon tax liability for the renewable energy premium built into the electricity tariffs

Credit for the electricity levy

Support for the installation of solar water geysers

Enhanced free basic electricity / energy for low income households

Improved public passenger transport & support for shift of freight from road to rail



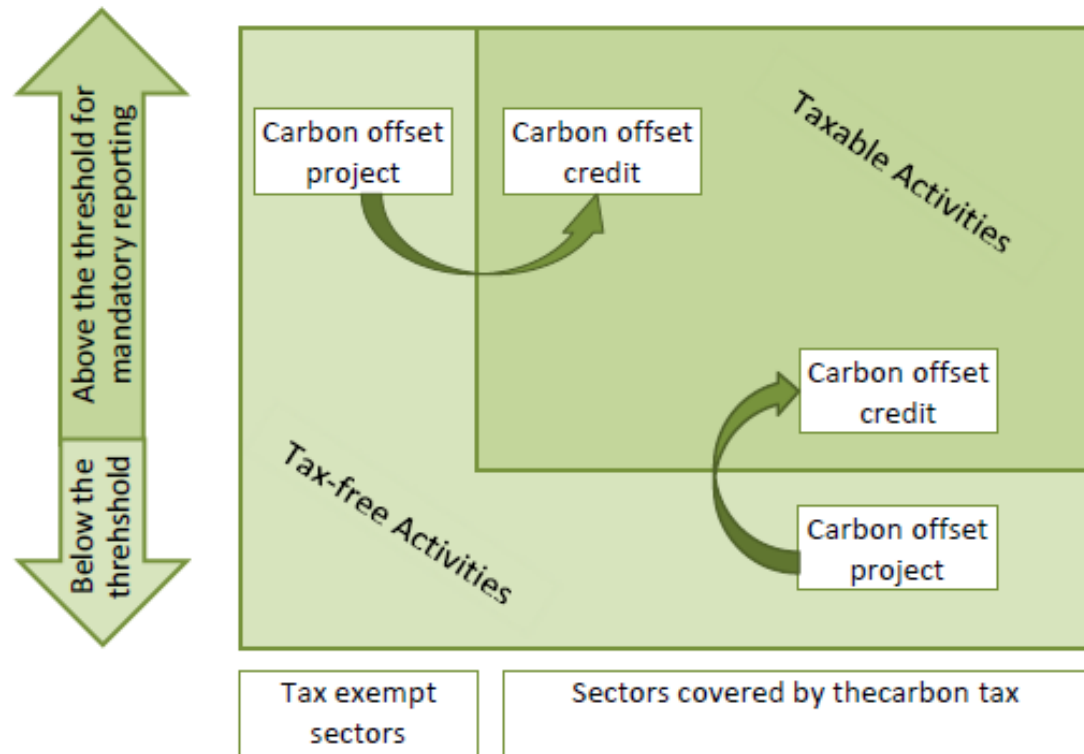
Offset Allowance

- The use of carbon offsets to assist sectors to reduce their carbon tax liability was generally supported by stakeholders and is seen as a cost-effective measure to incentivise GHG emissions reduction in sectors not covered by the tax.
- **The Draft Carbon Tax Bill makes provision for the carbon offset allowance in terms of Section 13 and 20(b).**
 - This provides for firms to reduce their carbon tax liability by using offset credits of up to a maximum of 5 or 10 per cent of their total greenhouse gas (GHG) emissions, as specified in Schedule 2 of the draft Carbon Tax Bill.
 - The Draft Carbon Offset Regulations was developed jointly by the National Treasury, the Department of Energy and the Department of Environmental Affairs.
- **The offsets are limited to either 5 or 10 per cent so as to ensure that firms make real efforts to mitigate their own emissions.** Limitations on offsets are common in most carbon pricing schemes for this very reason.
- The principles of **'real, additional and permanent'** are pivotal to ensuring the credibility of carbon offset projects.
- **Draft Regulations published on June 20th 2016 for public comments.**
 - About 65 written comments received

Policy intent of carbon offsets scheme

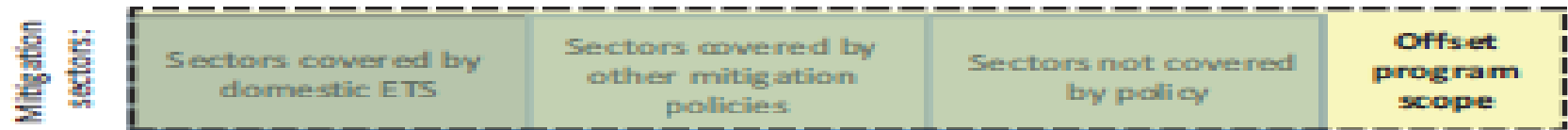
The **carbon offset component of the carbon tax** has a dual purpose:

- To serve as a flexibility mechanism that will enable industry to deliver least cost mitigation, i.e. mitigation at a lower cost to what would be achieved in their own operations, and thereby lower their tax liability; and
- 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.

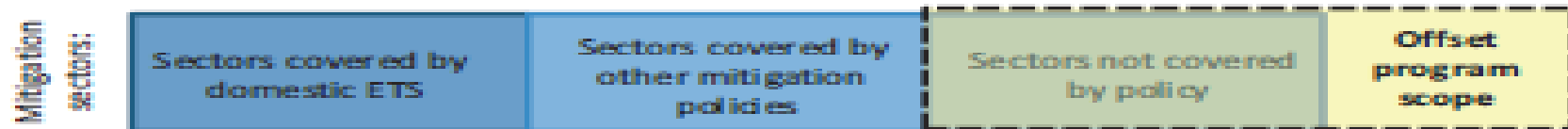


Scope of Offset programmes (PMR Technical Note 2015)

Broad scope of eligibility of project types in offset program



Selective scope of eligibility of project types in offset program



<i>Offset programs with broad scope</i>	<i>Offset programs with selective scope</i>
<ul style="list-style-type: none"> • Few eligibility restrictions • International scope • Bottom-up • Limited standardization • Additionality determination is mostly project based 	<ul style="list-style-type: none"> • Eligibility restricted to a few project types • Limited geographic scope • Top-down • Increased standardization, especially for additionality determinations
Examples: CDM, JI Track 1, CCER, JCM, GS, and VCS	Examples: AU CFI, CA COP, Québec, and CAR

Overview of Carbon Offsets Regulation

- This Regulation sets out the procedure for claiming the offset allowance and for the use of carbon offsets by taxpayers to reduce their carbon tax liability
- **Outline of regulations:**
 - **Preamble**
 - **Part I: Definitions**
 - **Part II: Eligibility**
 - Allowance of offset in respect of an approved project against carbon tax liability
 - Offset duration period
 - **Part III: Non-Eligibility**
 - Limitation on allowance
 - **Part IV: Administration**
 - Designation and functions of administrator
 - Responsibilities of the Administrator
 - Procedure for claiming the allowance
 - Offset Registry
 - Obtaining a certificate
 - Content of certificate

Carbon offsetting under the carbon tax

- It is proposed that initially carbon credits developed under certain internationally recognised carbon offset standards be permitted. These could include:
 - Clean Development Mechanism (CDM),
 - Verified Carbon Standard (VCS),
 - Gold Standard (GS).
- A potential domestic standard would primarily cover the types of projects that are not well catered for under international standards.
- A specific set of **eligibility criteria for carbon offset projects** has been devised to ensure effective implementation of the offset mechanism:
 - Projects that generate carbon offset credits 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 and within a specific timeframe.

Ineligible project types

- **Projects within the scope of taxable activities and benefiting from other government incentives should also be excluded.** These would include:
 - Energy efficiency projects implemented on activities that are owned or controlled by companies that are covered by the carbon tax.
 - Cogeneration of renewable energy projects implemented on activities that are owned or controlled by companies that are covered by the carbon tax.
 - Fuel-switch projects implemented on activities that are owned or controlled by companies that are covered by the carbon tax.
 - Projects that benefit from the **Section 12 L Energy Efficiency Savings Tax Incentive**.
 - Renewable energy projects developed under the **Renewable Energy Independent Power Producer Programme (REIPPP)**.

Administration of the Carbon Tax

- The carbon tax will be implemented by the South African Revenue Service (SARS).
- **Regulations for mandatory reporting of GHGs and the Technical Guidelines** have been developed and published. The DEA will maintain a mandatory GHG inventory database.
- **Central Energy Database and Energy Efficiency Target Monitoring System.** The Department of Energy (DoE)'s reporting on energy use data will also be incorporated into the National Atmospheric Emissions Information System (NAEIS) maintained by DEA.
 - SARS will liaise with DEA and will be able to access the GHG inventory and the NAEIS.
- **The DoE currently hosts the Designated National Authority (DNA), which will be responsible for administering the carbon offset scheme.**

Administration of the Offset Mechanism – Designated National Authority (DNA)

- **Designated National Authority (Department of Energy)**
 - the DNA already conducts pre-screening and tracking of projects for eligibility under the CDM. Issuance of the Certified Emissions Reductions (CERs) is done by the CDM Executive Board.
 - The capacity has been developed within the DNA to assess CDM projects for eligibility and its institutional capacity will be utilised to issue certificates to be used under the carbon tax regime.
- **Functions**
 - For the **carbon-offsets projects developed under the specified, internationally recognised carbon-offset standards** to become eligible under the carbon tax regime, it is **proposed that the projects obtain a certificate** stating the CO₂e reduction achieved.
 - It is proposed that the **DNA expands its functions to include issuance of certificates stating the CO₂e reduction**

Administration of the Offset Mechanism – Designated National Authority (DNA) (2)

- **Overall Function:**

- Acceptance of project ideas in line with SA eligibility criteria;
- Facilitate international credit cancellation, transfer and retirement;
- Maintain transaction log and / or registry; and
- Issue offset certificates to be surrendered against tax liability.

Partnership for Market Readiness Project

- The National Treasury leads this project in partnership with the Departments of Environmental Affairs and Energy.
- South Africa was approved funding in March 2015 aimed at refining the design of the carbon tax policy and enhancing the administration system to support implementation of the tax.
- There are **4 components of the PMR work**:
 - **Component 1: Refinement of the design of the carbon tax**
 - **Component 2: Monitoring Reporting Verification of the Carbon Tax**
 - Modification of the National Atmospheric Emissions Information System (NAEIS) and inclusion of the GHG emissions reporting (Led by DEA)
 - Enhancement of the Central Energy Database and the Energy Efficiency Targets Monitoring System (DoE)
 - **Component 3: Development and Implementation of the Carbon Offset System**
 - Further work will be undertaken to review and refine the COAS, consider options for the hosting of the registry, and capacity building.
 - **Component 4: Communications and Stakeholder Engagement and Project Administration Support**

Thank you.