

REPUBLIC OF SOUTH AFRICA

**EXPLANATORY NOTE FOR THE**

**DRAFT REGULATIONS ON THE CARBON OFFSET**

**PUBLISHED IN TERMS OF SECTION 20(b) OF THE DRAFT CARBON TAX BILL,  
2015**

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## BACKGROUND

Government published the Draft Carbon Tax Bill for public comments and further consultation on the 2<sup>nd</sup> of November 2015. The Draft Carbon Tax Bill includes the detailed and revised carbon tax design features as per the Carbon Tax Policy Paper of 2013, announcements in Budget 2014 and the Carbon Offsets Paper of 2014 and takes into account public comments received following extensive stakeholder consultations since 2011.

The overarching design of the carbon tax is informed by the administrative feasibility and practicality of covering most greenhouse gas (GHG) emissions and takes into account the need for a long and smooth transition to a low carbon economy in a sustainable manner. The significantly high level of tax-free allowances, recycling of revenues through a reduction in the electricity generation levy and energy efficiency savings tax incentive, and phased approach to the introduction of the tax will ensure that South Africa's competitiveness is not compromised and vulnerable households are protected.

The Draft Carbon Tax Bill gives effect to the design features of the carbon tax as outlined below, including the carbon offset allowance:

- An energy combustion tax-free allowance of 60 per cent;
- An additional tax-free allowance of 10 per cent for process emissions;
- An additional tax-free allowance of 10 per cent for fugitive emissions;
- A variable tax-free allowance for trade-exposed sectors (up to a 10 per cent maximum);
- A maximum tax-free allowance of 5 per cent for above average performance;
- A 5 per cent tax-free allowance for companies with a Carbon Budget;
- **A carbon offset allowance of either 5 per cent or 10 per cent;**
- The total tax-free allowances during the first phase (up to 2020) can be as high as 95 per cent.

This Regulation, which sets out the procedure for claiming the carbon offset allowance and for the use of carbon offsets by taxpayers to reduce their carbon tax liability, is developed in terms of Section 20 (b) of the Draft Carbon Tax Bill and is hereby published for public consultation.

### Policy Rationale for the Carbon Offset Scheme

Carbon offsets are investments in specific projects that reduce, avoid or sequester emissions. As defined in the 2014 Carbon Offsets Paper, a carbon offset is an external investment that allows a firm

to access GHG mitigation options at a lower cost than investment in its current operations. Under the carbon tax policy framework, firms will be able to reduce their carbon tax liability by using offset credits up to a maximum of 5 or 10 per cent of their total GHG emissions, depending on the sector within which the firm operates.

The carbon offset system serves a dual purpose that is as:

- A flexibility mechanism that will enable industry to deliver least cost mitigation, that is, mitigation at a lower cost to what would be achieved in their own operations, and thereby lower their tax liability; and
- A way of incentivising mitigation in sectors or activities that are not directly covered by the tax and/or benefiting from other government incentives, especially, transport, Agriculture, Forestry and Other Land Use (AFOLU) and waste.

The design of the carbon tax follows the design of carbon pricing schemes internationally that provide for the use of carbon offsets by firms to reduce their carbon tax liability. This includes schemes such as the European Union Emissions Trading Scheme (EU ETS) which allows for the use of offset credits generated by projects approved under the Clean Development Mechanism (CDM), as well as schemes in California and the Canadian Province of Alberta.

These carbon offset projects are likely to generate sustainable development benefits and employment opportunities in South Africa by encouraging investments in energy efficiency and renewable energy, rural development projects, and initiatives aimed at restoring landscapes, reducing land degradation and biodiversity protection.

### **Eligible standards**

During the initial stage of the carbon offset scheme, it is envisaged that the scheme will rely primarily on existing international carbon offset standards namely, the CDM, Verified Carbon Standard (VCS) and the Gold Standard (GS) and their associated institutional and market infrastructure.

To be accepted under the South African carbon offset scheme, the offset projects will need to be approved by one of these accepted international standards. An allowance will be made to evaluate the robustness of existing domestic standards for eligibility to be used within the carbon offsets scheme.

The offset project approval process is specific to each standard. In the case of the CDM, a validation of the offset project by a Designated Operational Entity (DOE) is followed by registration of the project by the CDM Executive Board. Under the VCS standard, a validation/verification body (VVB) validates the project and the VCS Association is responsible for the registration of the project. Under the GS, a DOE validates and the GS registers the project for the compliance market under the CDM while those projects developed for the voluntary market could choose an accredited verification body. The offset project developer is responsible for ensuring this external validation and the registration.

This will be complemented by requirements specific to the South African scheme pertaining mainly to additionality criteria and the administration of the scheme whilst drawing extensively on the modalities and rules that govern the international standards.

### **Carbon offset project eligibility criteria**

In addition, all approved standards, both international and domestic, will also have to meet the South African specific requirements of the carbon offsets scheme. The main eligibility criteria will be:

- At the initial stage, only projects located in South Africa will be eligible under the carbon offset scheme in order to support mitigation in South Africa.
- Projects should occur outside the scope of activities that are subject to the carbon tax to prevent double counting of the carbon emission reduction benefit. The carbon offset scheme will focus on technologies from activities that are not included in the carbon tax liability net, which includes the transport, waste and AFOLU sector activities.

### **Administration of the scheme**

To facilitate the development of carbon offset projects and a credible carbon offset scheme, appropriate technical infrastructure is required such as a programme administrator; carbon offsets registry; and possible third party verification by accredited third party verifiers identified in the Carbon Offsets Paper.

The Designated National Authority (DNA), within the Department of Energy (DoE) which was established to support the development and implementation of CDM projects under the Kyoto Protocol of the United Nations Framework Convention on Climate Change (UNFCCC), will be responsible for administering the carbon offset scheme.

Currently, a project is being undertaken by the DoE to assist with the implementation of the administrative framework for the carbon offset scheme. The main output from the project includes setup of a framework for administering the carbon offsets scheme which includes an initial assessment of the capacity and skills requirements to enhance the human resource capacity of the DNA, the development of a Standards and Operating Procedure Manual for administering the carbon offset scheme and a preliminary design of the administration IT system.

South Africa is also a participant in the Partnership for Market Readiness (PMR) project, administered by the World Bank, which provides technical assistance to countries to support the implementation of carbon pricing policies. Building on the current project by the DoE, further technical work will be undertaken through the PMR to assist with the establishment of the carbon offset system. This

includes options for the establishment of a registry; capacity building through further training and secondment of international experts; and compilation of a technical guideline for project developers.

## **PART I: DEFINITIONS**

### **Definitions: Regulation 1**

This section provides an explanation of the main definitions that inform the establishment of the carbon offset mechanism.

**Administrator** means the Designated National Authority within the Department of Energy appointed in terms of regulation 5.

An emissions offsets means an (external) investment through which a firm can access additional GHG mitigation options that are cheaper than what can be achieved by investment in its own operations. Emissions offsets are project-based that is, involve specific projects or activities that reduce, avoid, or sequester emissions, and are developed and evaluated under specific methodologies and standards.

**Approved project** means a CDM project, VCS project or GS project (as defined below) or a project that complies with another standard approved by the Minister of Energy or a delegated authority which also meets the South Africa specific additionality criteria and is listed on the positive list.

**Clean Development Mechanism Project** means a project registered in terms of paragraph 36 of the Modalities and procedures for a clean development mechanism as contained in the Annex to Decision 3/CMP.1 in Part Two of the Addendum to the Report of the Conference of the Parties serving as the meeting of the Parties to the Protocol to the United Nations Framework Convention on Climate Change means a CDM Project as defined in regulation 1.

Emission offsets are also guided by a variety of principles, which need to be fulfilled for a project to be awarded a carbon credit under a specific standard which is metric tons of CO<sub>2</sub>-equivalent (tonne CO<sub>2e</sub>) as defined in the Draft Carbon Tax Bill, 2015.

In addition, a CDM project will be issued with a letter of approval as contemplated in regulation 7(3) of the National Environmental Management Act, 1998 Regulations for the establishment of a designated national authority for the Clean Development Mechanism (Government Notice No. R.721 published in *Government Gazette* No. 27788 of 22 July 2005).

**Gold Standard Project** means a project that complies with the requirements set out in "Revised Annex C: Guidance on Project Type Eligibility" issued by the Gold Standard and Certification Body, a non-profit organisation established in 2003.

## **Offset**

Offset means a measurable avoidance, reduction or sequestration of carbon dioxide (CO<sub>2</sub>) equivalent GHG emissions, constituted as set out in regulation 3.

**Offset registry** means the offset registry established by regulation 8.

**VCS** means the non-profit non-governmental association, the Verified Carbon Standard.

**VCS project** means a greenhouse gas reduction program voluntarily entered into that is registered on the VCS project database in respect of which a verified carbon unit is issued.

**VCS project database** means the central VCS project database to which the VCS registry system is able to connect.

**VCS registry system** means the platform where offsets are assigned unique serial numbers for the purposes of tracking the VCS project in respect of that offset.

**Verified carbon unit** means a reduction or removal of one ton of carbon dioxide equivalent (CO<sub>2</sub>e) from the atmosphere. This applies to a VCS project defined above.

## **PART II: ELIGIBILITY**

### **Allowances of carbon offset in respect of an approved project against carbon tax liability: Regulation 2**

This section specifies the eligibility criteria for the offset projects in line with the Carbon Offsets Paper of 2014.

1. To encourage the development of locally based projects and GHG-mitigation in South Africa, only South African-based credits will be eligible for use within the carbon offsets scheme.
2. Projects that generate carbon offset credits must occur outside the scope of activities that are subject to the carbon tax. This is to prevent double counting of the carbon reduction benefit should a carbon offset project be implemented on an activity that is liable to the carbon tax.
  - This includes projects that would be developed inside the carbon tax net, as potential double counting of financial benefits from GHG mitigation could increase distortions in the carbon market due to an entity generating the credits being able to potentially sell the credits to other entities for lower prices than projects in sectors that are not covered by the tax.
  - Offsets originating within taxable activities (scope 1 emissions) will be excluded, i.e. only activities not liable for the carbon tax can be used to implement projects and sell carbon credits.

3. In addition, *projects registered prior to the implementation of the carbon tax* will have to meet the following conditions to be eligible under the scheme:

- *Registered projects*: offset credits issued prior to the implementation of the carbon tax which have not yet been retired will be eligible, provided they are transferred from an international registry to the South African registry within 12 months of the implementation of the tax.
- Projects that are currently under development and which will be registered before the start date of the tax, credits issued following the introduction of the carbon tax will have to be transferred from an international registry to the South African registry within 6 months of their issuance.

An eligible projects list would include project areas that, in addition to carbon mitigation, also have sustainable development benefits and contribute to meeting South Africa’s developmental priorities. Based on an analysis of the mitigation potential of different sectors, table 1 below provides an indicative positive list, as envisaged in the Carbon Offsets Paper.

**Table 1: Indicative positive list**

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

It is important that this standardised approach is sufficiently flexible and accepts additional methodologies, thus not limiting projects that can be added once the offset scheme is implemented. This indicative positive list could therefore be expanded as the programme matures to allow new project types to be included should they meet the required criteria.

### Offset duration period: Regulation 3

This section specifies the crediting period for which generated offsets will be valid. During the initial phase, eligible carbon offset projects will be based mainly on the three approved international standards and the rules and modalities for these programmes including duration of the offset crediting period will apply, even when offsets are cancelled and transferred from the international standard registry to the South African registry and retired for purposes of the carbon tax.

To address the issue of permanence pertaining to certain offset projects, crediting period for carbon offset projects will require periodic reviews to ensure, most importantly, that the baseline assumptions for the project are still valid. Table 2 below shows the applicable offset crediting duration periods for offset projects developed under the different standards. These range from 7 years with options for renewal to 10 year crediting periods with no option for renewal. In the case of the VCS, the crediting periods are further defined specifically for AFOLU and non-AFOLU projects.

**Table 2: Offset Duration Period for International Standards**

ELIGIBLE STANDARD	OFFSET / CREDITING DURATION PERIOD
1. CDM	Once-off 10 year crediting period with no option for renewal or 7 year crediting period (Renewable twice, for 21 years in total).
2. GS	Same as CDM - Once-off 10 year crediting period with no option for renewal or 7 year crediting period (Renewable twice, for 21 years in total).
3. VCS	Two times 10 years for all non-AFOLU projects, other than AFOLU projects or ALM (Agricultural Land Management) <sup>1</sup> projects focusing exclusively on N <sub>2</sub> O, CH <sub>4</sub> or fossil-derived CO <sub>2</sub> ;
	For all other AFOLU projects, the project crediting period shall be <ul style="list-style-type: none"> <li>• a minimum of 20 years up to a maximum of 100 years</li> <li>• renewed at most four times</li> <li>• renewal of baseline every 10 years.</li> </ul>
4. Project approved under other standards	The offset crediting period for SA specific projects will be specified and approved by the Minister of Energy or a delegated authority.

Source: Adapted from different international standards.

<sup>1</sup> The methodology quantifies the GHG emission reductions of sustainable land management practice activities that enhance aboveground, belowground and soil-based carbon stocks of agricultural areas. This methodology is applicable to projects that introduce sustainable management practices to an agricultural landscape where the soil organic carbon would have remained constant or decreased in time without the intervention of the project.

ALM includes soil nutrient management, tillage and residue management, agronomic practices, integrated pest management, agroforestry, soil and water management and improved livestock management. ALM involves generating carbon credits by building organic matter in agricultural soils

## **PART III: NON-ELIGIBILITY**

### **Limitation on allowance: Regulation 4**

This section specifies carbon offset projects that are not eligible for use in the South African carbon offsets scheme.

*Projects benefiting from other government incentives* are excluded as this could result in a double counting of the emission reduction benefits and financial incentives for the project. The incentive programmes will include, but are not limited to, projects registered for the Energy Efficiency Savings Tax Incentive (in terms of section 12L of the Income Tax Act, 1962) and the Renewable Energy Independent Power Producers Procurement Programme (REIPPPP).

In summary, the non-eligible list of activities covers:

- 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 Energy Efficiency Savings Tax Incentive (section 12L of Income Tax Act No. 58 of 1962);
- Renewable energy projects developed under the REIPPPP (under section 35(4) of the Electricity Regulation Act, 2006); and
- Industrial gas destruction projects, including trifluoromethane (HFC-23) and nitrous oxide (N<sub>2</sub>O) from adipic acid production.

Further discussions will be held with the REIPPPP offices on the scope of the current programme, and eligibility criteria used to evaluate projects. This will help to identify specific renewable energy projects types that might qualify and not benefit from the REIPPPP such as small and medium-sized renewable energy projects. However, these could qualify under the envisaged standards and could therefore be classified as offsets under the Carbon Tax Policy regime.

However, should a sector be outside the tax net in the first phase of the carbon tax (and therefore eligible to generate offsets), be included in the carbon tax net in subsequent phases, those projects would be allowed to generate offset credits up to the original sunset date.

## Part IV: ADMINISTRATION

### Designation and functions of administrator: Regulation 5

This section specifies the administrator of the carbon offsets scheme and envisaged functions. The Designated National Authority (DNA) within the Department of Energy will fulfil this oversight role and expand its current functions to enable the implementation of the offset scheme. The responsibilities of the carbon offsets administrator and details on the envisaged institutional framework are elaborated on below.

### Responsibilities of the Carbon offsets administrator: Regulation 6

This section specifies the administrative duties of the carbon offsets administrator. The duties of the Administrator will include but are not limited to:

- pre-screening of project ideas to ensure they comply with eligibility criteria prior to their implementation or transfer to local registry
- registering carbon-offset projects; and
- issue offset certificates, cancelling and retiring carbon credits.

The DNA as the administrator of the mechanism will oversee the programme, functions related to project screening based on the defined sustainable development eligibility criteria, approve the issuance of offset certificates and perform duties, as outlined in table 3 below.

**Table 3: Envisaged Functions and Activities of the DNA as Administrator**

<b>Function</b>	<b>Activities</b>
<b>Institutional framework</b>	Definition of the rules and procedures for the offset scheme, including <ul style="list-style-type: none"><li>• pre-screening;</li><li>• overview of the transaction log; and</li><li>• issuance of carbon offset certificates.</li></ul>
<b>Project cycle</b>	<ul style="list-style-type: none"><li>• Approval of CDM projects, including issuance of letters of approval (LoA);</li><li>• Pre-screening of international projects i.e. CDM, VCS, and GS for local eligibility and transfer to SA registry including issuance of extended letters of approval (ELoA);</li><li>• Issuance of credits into the SA registry and registering credits in the transaction log;</li><li>• Issuance of carbon-offset certificates; and</li><li>• General support to the project developers.</li></ul>
<b>Operation of the scheme</b>	The DNA will be responsible for the overarching data management system and transaction log <ul style="list-style-type: none"><li>• Pre-screen projects for eligibility;</li><li>• Evaluate independent verification reports;</li></ul>

	<ul style="list-style-type: none"> <li>• Issue carbon credits;</li> <li>• Maintain transaction log of projects registry;</li> <li>• Manage the administration IT system – website and others; and</li> <li>• Establish a database of approved verifiers/ verification bodies (link to SANAS database).</li> </ul>
<b>DNA Steering Committee</b>	<p>The NEMA regulation requires that the DNA establishes a Steering Committee which provides supervision and advice on the operations of the DNA. This committee is chaired by a representative of the Department of Energy. The regulation provides for the establishment of an expert advisory committee who could be the envisaged independent expert committee (see below).</p> <p>Although the duties of the DNA steering committee are currently focused on the CDM, these will be expanded to include other approved international and domestic standards, as these are developed over the medium to long term.</p>
<b>Independent Expert Committee (expert advisory committee)</b>	<p>The Steering Committee will facilitate the establishment of the independent expert committee (IEC) envisaged under the carbon offsets paper within these structures as the expert advisory committee.</p>

### *Steering committee*

The NEMA regulation also establishes a Steering Committee for the DNA which provides supervision and advice with regards to the operations of the DNA. It is made up of ten members representing the following National Departments:

- Energy;
- Mineral Resources
- Environmental Affairs;
- Water Affairs and Sanitation;
- International Relations and Cooperation;
- Trade and Industry;
- Agriculture, Forestry and Fisheries;
- Transport;
- National Treasury;
- Science and Technology; and
- Health.

The chairperson of the Steering Committee is a representative of the Department of Energy and members of the Committee and an alternate to that member from among the officials in the respective departments are appointed by the Directors General of each of the Departments. The Steering Committee must establish a terms of reference for its operations which will address the following matters:

- Meetings of the Steering Committee;
- Decisions of the Steering Committee;
- Establishment of subcommittees, and an Expert Advisory Committee, and
- Powers and duties of Sub-committees and the Expert Advisory Committee.

Although the duties of the DNA steering committee are currently focused on the CDM, these will be expanded to facilitate the establishment of the IEC within these structures as an expert advisory committee. Also, given the focus of the carbon offsets policy, the composition of the steering committee must reflect the current departmental arrangements.

*Independent Expert Committee (expert advisory committee)*

The IEC is expected to work with the administrator of the scheme to develop and assess new methodologies. In line with all other international standards, there is need to incorporate a technical committee into the offset administration structure and the establishment of IEC technical subcommittees could play that role.

This panel could be similar to the SANEDI Expert Review Panel which assists with the evaluation of the EES tax incentive projects. The IEC technical sub-committees will work on the development of South African specific methodologies or standards for projects not well-catered for by the international standards. Thus, project developers can also propose new methodologies for assessment and consideration by the IEC technical sub-committees. Thus the IEC technical sub-committees will play a role in the management and updating of the positive list and associated design and approval of methodologies. The sub-committees would:

- Publish proposed methodologies for public review and comment;
- Approve new methodologies; and
- Include new methodologies in the positive list.

The IEC should be maintained as an independent committee / panel to develop, approve new methodologies as well as assist the DNA with complex project approvals, as needed. The sectoral sub-committees of the IEC for specific sectors will be representative of the following sectors: energy, waste, transport and AFOLU. The IEC technical sub-committees could be composed of experts from relevant departments (including the Departments of Energy, Environmental Affairs, Transport, Science and Technology, Agriculture, Forestry and Fisheries and National Treasury) as well as scientific research institutions (for example, SANAS, SABS, SANEDI and CSIR), independent industry experts or industry associations, non-governmental organisations (NGOs) and relevant academic institutions.

Currently, the DEA is responsible for the National GHG inventory and the development of methodologies for calculating emissions and emissions removals from the atmosphere. Further work is also underway by the DEA to develop emission methodologies for the AFOLU sector and to consider the monitoring, reporting and verifications systems implemented internationally for offset

schemes. Therefore the DEA would be best placed to chair the IEC and support the offset programme administrator.

The NEMA regulation for the DNA steering committee provides for the establishment of an expert advisory committee which could be used to establish the IEC and technical sub-committees, as needed. The relationship between the DNA steering committee and the IEC needs to be conceptualised and discussed further. This will also require development of the terms of references to establish the different IEC technical sub-committees.

Therefore, since the main duties of the DNA will be expanded, as discussed above, and the composition and mandates of the steering committee are likely to change, this may require an amendment to the NEMA regulation to allow for the expanded mandate of the DNA.

#### *Data Management and IT system*

The offset administrator should maintain oversight of the data management and administration IT system. A large amount of data on the underlying projects and on the carbon credits and their corresponding offset certificates will be generated under the offset scheme.

Currently, a project is being undertaken by the DoE to assist with the implementation of the carbon offset scheme. The main output from the study includes setup of a framework for administering the carbon offsets scheme. This includes an initial assessment of the capacity and skills requirements to enhance the human resource capacity of the DNA, the development of a Standards and Operating Procedure Manual for administering the carbon offset scheme, and a preliminary design of the administration IT system.

South Africa is also a participant in the Partnership for Market Readiness (PMR) project, administered by the World Bank, which provides technical assistance to countries to support the implementation of carbon pricing policies. Building on the current study by the DoE, further technical work will be undertaken through the PMR to assist with the establishment of the carbon offset system. This includes options for the establishment of a registry; capacity building through further training and secondment of international experts; and compilation of a technical guideline for project developers.

#### **Procedure for claiming allowance: Regulation 7**

This section specifies the procedure that the taxpayer must follow for registering an offset, with the administrator, that will be used to reduce their carbon tax liability.

#### *Transfer of carbon credits and generation of carbon-offset certificates*

A description of the envisaged process for the transfer, cancellation and retirement of the offsets generated under the different international standards and issuance of offset certificates to be used in the scheme is provided below.

1. Once emission reductions are verified, the developer may request issuance of carbon credits (Certified Emission reductions (CERs) under the CDM, Verified Carbon Units (VCUs) under the VCS and GS credits under the GS).
2. Upon approval by the issuing bodies, the credits are deposited into the project developers' account in the relevant registry (CDM, VCS or GS).
3. For the credits to be used to offset a tax liability under the South African carbon tax scheme, offset developers or entities responsible under the carbon tax will have to request credits to be cancelled in the international registry and then transferred into SA registry.
4. This will be a mirror system where one tonne CO<sub>2</sub>e is transferred as such into the SA registry. These carbon credits will have to meet the local eligibility criteria and then are registered in the South African registry only after the Administrator has attestation to the fact that the same credits have been cancelled in the respective international registry. Offset developers or entities must obtain a carbon-offset certificate from the administrator of the scheme.

The modalities of transfer, cancellation/retirement and general management with respect to registry systems of different carbon offset standards are being finalised.

#### *Exchange trading platform*

Before their final use, carbon credits are likely to be traded by market participants. Trading of project-based emissions reduction credits is done through various channels, with a distinction between compliance and voluntary carbon-offset credits.

Secondary CERs (CDM) that are traded for compliance in the European Emissions Trading System (EU ETS), by far the largest market for the CDM, are mostly traded through established exchanges. Most of the trading of voluntary carbon credits is done over-the-counter and additionally through auctioning.

However, there are some international trading platforms such as the ICE or CarbonTradeXchange (CTX), that operate spot exchanges for carbon credits of different standards (e.g. CDM, GS, VCS) which aim to bring more liquidity to the voluntary market, which is still relatively small. There has been experience with trading carbon as a commodity on the Johannesburg Stock Exchange which was successfully done in March 2015.

It remains to be assessed whether South African credits could be effectively traded under one of these existing platforms, or whether developing a South African trading platform would be more appropriate. The latter could also take the shape of an auction platform. The need for and type of trading platform will be influenced by the registry that will be put in place and the modalities of transfer of credits. Private sector actors have expressed interest in developing a trading platform in South Africa. National Treasury envisions that these actors will lead this activity but will provide inputs during the process to ensure that an adequate regime is put in place.

## Offset Registry: Regulation 8

A registry will be crucial to avoid double-counting of emission reductions and ensure credibility of the scheme. A large amount of data on the underlying projects and on the carbon credits and their corresponding carbon-offset certificates will be generated under the carbon offset scheme. Also, carbon credits and offset certificates will be transacted, from their issuance (or before) to their use under the carbon tax. Appropriate tools to collect and manage the data and the transaction of offsets are necessary.

This section outlines the requirements of a suitable registry for the South African carbon offsets scheme which includes:

- Record ownership and facilitate transfers of ownership in an accurate and auditable way;
- Ensure administrative efficiency;
- Provide access to specified users in the required way, such as via the internet;
- Keep transaction costs low;
- Ensure timeous execution of transfers;
- Ensure very low risk of fraud; and
- Provide adequate administrative support.

Most carbon trading systems operating globally rely on multiple registries. An in-depth assessment is required to understand which type of data management and registry tool(s) are appropriate for the South African offset scheme and how to best roll these out.

This assessment will need to address a number of issues such as the linkages with international registries and standards as well as linkages with the broader data management and Monitoring Reporting and Verification systems being developed to support the implementation of the carbon tax.

Table 4 below provides further details on these linkages and envisaged activities.

**Table 4: Assessment for Registry Establishment**

Linkages	Assessment
<i>International registries and standards</i>	<ul style="list-style-type: none"> <li>• Assessment of possibility and modalities of transferring of credits issued under one of the eligible international standards to the South African registry.</li> <li>• Modalities for the cancellation of international credits.</li> <li>• Options for conversion of international credits into domestic carbon-offset certificates.</li> <li>• Impact on the legal nature of the credits.</li> <li>• Assessment of possible double-counting issues and guarantees of double counting prevention.</li> </ul>
<i>Other tools used under the carbon offset scheme and the carbon tax</i>	<ul style="list-style-type: none"> <li>• Interaction of the data management tool and the registry (which could be two separate systems, or different modules of the same system)</li> <li>• Interaction of the registry with the broader data management and MRV tools, including the South African Air Quality Information System (SAAQIS) and the National Atmospheric Emissions Inventory System (NAEIS) as well as the SANAS-accredited verifiers' database</li> <li>• Availability of public information related to the offset scheme.</li> </ul>

Development of a South African specific registry system is envisaged in the medium to long term but interim arrangements could include outsourcing this component to:

- Markit;
- APX;
- Markit and APX;
- JSE – Strate; or
- Other domestic platform.

The above decision will depend on the costs of administering such a system. Follow up with international registries such as MARKIT and APX on the feasibility of using their systems in the interim or feasibility of a local system will be undertaken in the latter half of the year. The likely cost structure will then be derived from such engagements so an informative decision can be made. Further work will be undertaken through the PMR to support the implementation of the offset scheme including options for the establishment of the national registry.

### **Obtaining a certificate: Regulation 9**

This section specifies procedures to be followed by a taxpayer to obtain an offset certificate specifying the emission reductions to offset their carbon tax liability.

As a preliminary step, project developers would apply to the administrator, DNA, for a pre-screening letter that a proposed project would be eligible against the domestic eligibility requirements of the carbon tax. The project developers apply for an Extended Letter of Approval (ELoA) from the DNA to confirm domestic eligibility approval before a project is undertaken. The project is then undertaken under the rules and modalities of the international offset standard (CDM, VCS, or GS) or an approved methodology for South African specific projects and then issued with credits under the respective standard. The project developer would then request for the international program credits to be transferred into the domestic registry.

The DNA would assess each request for transfer against the domestic eligibility criteria<sup>1</sup> and would either accept the transfer and issue corresponding domestic carbon offset into the nominated account of the transferee in the domestic offset registry or reject the transfer. The units issued into the domestic registry could be either linked to the specific CER, if this is a CDM project, or simply represent an undifferentiated CER held in the national account. Therefore all CERs within the account are all of equal tax compliance value.

Entities liable to the carbon tax are responsible for surrendering their carbon offset credits to SARS should they wish to use the offset credits to reduce their carbon tax liability. If SARS decides to carry out an audit of a specific carbon tax liable entity, the administrator of the offset scheme will work with the SARS to provide information on the offsets credits used by an entity to reduce the tax liability. This

will be achieved through providing SARS access to the offset registry/database which should contain proof of retirement of the carbon offsets.

It needs to be finalised whether the actual carbon credits will be required to be retired in the registries of the respective international standards (CDM), or that a linkage between registries can be established in order to transfer the credits (VCS and GS) into the domestic registry where they will be retired once utilised. Entities should keep the offset certificate and related documentation for at least 15 years for auditing purposes.

### **Content of certificate: Regulation 10**

The offset certificate will be issued by the offset administrator, i.e. the DNA, and offset credits surrendered by the taxpayer to the SARS to claim a deduction against its carbon tax liability but the entity keeps the offset certificate for auditing purposes. This information will also be stored on the South African carbon credits registry. The information on the certificate will include:

- a unique number that must be allocated for each offset that is registered by the administrator;
- the geographical location of the activity undertaken in respect of which the offset is created;
- the name of the manager of the activity in respect of which the offset is created;
- the methodological basis in respect of which the approved project is developed;
- the date of the commencement of the activity in respect of which the offset is created;
- an indication of whether the offset is utilised for the first time for the purposes of these Regulations or whether the offset is extended; and
- the offset credit duration period.

### **Short title and commencement: Regulation 11**

This section specifies the name and commencement date of the Regulations on carbon offsets.