



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA STATEMENT

Gazetting of the Carbon Offsets Regulations in terms of the Carbon Tax Act and related draft regulations for public comment

The Carbon Tax Act (Act No. 15 of 2019) was signed into law by the President in May 2019 and came into effect from 1 June 2019. In terms of section 19(c) of the Carbon Tax Act, the Carbon Offsets Regulation was gazetted on Friday 29 November 2019 (Gazette No. 42873) and is available on the National Treasury website (www.treasury.gov.za).

The National Treasury has published for public comment two further sets of regulations, namely Draft Regulations for the Trade Exposure Allowance for purposes of section 10 and Draft Regulations for the Greenhouse Gas (GHG) Emissions Intensity Benchmarks for purposes of section 11 in terms of section 19(b) and (a) of the Act, respectively.

This follows on an extensive stakeholder consultation process on the design of the carbon tax and tax free-allowances since the publication of the Carbon Tax Policy Paper in 2013 and the 2015 version of the Carbon Tax bill. The National Treasury will ensure that the final regulations are gazetted by the first quarter of 2020 to be aligned with the greenhouse emissions reporting period of the Department of Environment, Forestry and Fisheries.

The carbon tax is an integral part of Government's package of policy measures to mitigate climate change as outlined in the National Climate Change Response Policy, National Development Plan and its Nationally Determined Contribution commitments under the 2015 Paris Agreement. It provides for the introduction of the carbon tax in a phased manner at a relatively low rate initially to allow businesses time to make the necessary structural adjustments to their production processes and practices and to ensure a just transition to a low carbon, climate resilient economy.

To ensure a cost effective transition, the design of the tax provides for the recycling of revenues through the electricity generation levy credit and energy efficiency savings tax incentive, and significant tax free-allowances of up to 95 per cent of the total greenhouse gas emissions to firms, consisting of a basic tax free allowance of 60 per cent for direct, scope 1 emissions and allowances for sectors that are trade exposed up to a maximum of 10 per cent and a performance allowance up to a maximum of 5 per cent. The trade exposure allowance aims to assist companies that potentially face competitiveness pressures whilst the performance allowance seeks to encourage firms to reduce the carbon intensity of their production processes relative to their peers and promote the competitiveness of local products.

The Draft Regulations and a detailed summary of the regulations are available on the National Treasury (www.treasury.gov.za) website. Written comments on the 2019 Draft Regulations must be submitted to carbontax@treasury.gov.za by **close of business on 17 January 2020**.

Carbon Offset Regulations

The Carbon Offset Regulations was developed jointly by the National Treasury, the Department of Minerals Resources and Energy and the Department of Environment, Forestry

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and Fisheries. It outlines the eligibility criteria for offset projects and sets out the procedure for claiming the offset allowance. Companies are allowed to use carbon offsets of either 5 or 10 per cent of their total GHG emissions to reduce their tax liability.

The Carbon Offset Regulation has been gazetted after extensive consultations on the Carbon Offsets Paper of 2014, 1st Draft Carbon Offsets regulations which was published in June 2016 and 2nd draft regulation published in November 2018, due to the substantive changes made to the initial version of the regulations. About 26 written comments were submitted on the 2nd draft regulation and a stakeholder workshop was held in March 2019 for clarification of comments and finalisation of the regulations.

The main comments from stakeholders were on the inclusion of renewable energy, eligibility of projects and credits generated prior to the implementation of the carbon tax and eligibility of electrical efficiency projects, and technical comments on the alignment of the regulations with the language used in carbon markets. The following amendments were made to the gazetted regulations:

- *Inclusion of renewable energy*

After stakeholder consultations on the 1st draft regulation, which excluded all renewable energy projects from the offset mechanism, the regulations were amended in consultation with the Department of Energy to allow Renewable Energy Independent Power Producers Procurement Programme (REIPPPP) projects approved from bidding window 3 and other renewable energy projects up to 50 MW installed capacity to be eligible for offsets. During the consultation on the second draft regulation, there were strong views from stakeholders on the environmental and financial “additionality” of the projects, arguing that including renewables (especially REIPPPP projects) will provide a double financial benefit to these projects which already benefit under the bid programme and could crowd out the development of new projects. The final regulation was amended to take into account stakeholder comments and provide for the inclusion of renewables as follows:

- All small scale renewable energy projects up to 15 MW contracted and installed capacity respectively for both REIPPPP (from bid window 3 i.e. signed on or before 9 May 2013) and non- REIPPPP projects are eligible as carbon offsets to provide an incentive for the uptake of such projects;
- For projects greater than 15MW, REIPPPP projects from the third bidding window and non-REIPPPP projects, except for technologies with a cost less than R1.09/ kWh, will be eligible as carbon offsets. This is based on the average tariff for the 4th bidding window of the REIPPPP and takes into account that certain renewable based electricity generation is cost competitive with fossil fuels.

- *Eligibility of electrical efficiency projects*

Stakeholders were of the view that some electrical efficiency and on site co-generation projects should be eligible as offsets as they reduce indirect (scope 2) and not direct (scope 1) emissions covered by the tax, thereby improving efficiency. The regulation has been amended to only allow electrical efficiency and co-generation projects which “do not co-produce useful thermal energy implemented on activities that are covered by the carbon tax resulting in reduced fuel consumption” as eligible offsets.

- *Clarification of eligible projects and the use of credits generated prior to the implementation of the carbon tax*



The regulation has been amended to clarify that projects and offsets issued for a specific monitoring period up to 31 May 2019 will be eligible for offsets. Further, for project activities that are covered under the carbon tax, these offsets must be used within the first phase of the carbon tax up to December 2022, except for qualifying renewable energy projects. For project activities not covered by the carbon tax in the first phase, these offsets can be used until the end of the crediting period as stipulated under the relevant standard.

- *Administration of the carbon offsets*

The DMRE has developed a carbon offset administrative system (COAS) which is being finalised following an extensive consultation process during 2016 and 2017. The regulations specify the duties of the administrator and the procedure to be followed by taxpayers for claiming the offset allowance, subject to required approvals by the administrator. As part of the development of the COAS infrastructure, a process will be initiated for the outsourcing of the registry to a credible third party under the oversight of the administrator.

- *Framework for development of local standards*

To address stakeholder concerns regarding the high costs and bureaucratic processes associated with international standards, a framework to guide the development of local standards and methodologies is currently being developed through the Partnership for Market Readiness project of the World Bank. The developed framework will also be used to pilot test existing and in the pipeline local standards. This will help cater for 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. A domestic standard will help create jobs and develop capacity within local institutions, and reduce reliance on international standards beyond the first phase of the carbon tax.

- *Other Technical Amendments* include the exclusion of temporary credits, clarification that offset certificates are non-transferable, specifying the tax period for which the offset will be used, and that the offset certificate should be retained for the duration of the project or 15 years, whichever is longer.

Draft Trade Exposure Allowance Regulations

Section 10 of the Carbon Tax Act sets out the methodology for calculating the trade intensity of a sector which informs the level of the trade exposure allowance that a sector or subsector will qualify for, as determined by the Minister of Finance by Regulation.

In the 2013 Carbon Tax Policy paper the trade exposure allowance was initially designed as a company based allowance. Following consultations on the 2015 Draft Carbon Tax Bill, the proposals from business were accepted and the allowance was changed from a company to a sector based allowance. Stakeholders were of the view that a sector based allowance will be more equitable and simpler to administer than the company based approach. In collaboration with Business Unity South Africa, the allowance was redesigned and key industrial sectors such as mining and iron and steel are likely to qualify for the full trade exposure allowance of 10 per cent, mitigating possible adverse impacts due to the carbon tax. There were also proposals for an alternative qualitative approach to determine the allowance for taxpayers that may not qualify for a certain level of allowance.



The Draft Regulations for the Trade Exposure Allowance gives effect to the sector based allowance and provides a list of sectors and subsectors and their respective trade exposure allowances and outlines an alternative approach to calculate the trade exposure allowance for companies.

Draft GHG Emissions Intensity Benchmarks

Section 11 of the Carbon Tax Act sets out the formula to be used by taxpayers to calculate the applicable performance allowance. For a tax period, taxpayers that perform better than an approved sector or subsector emission intensity benchmarks will qualify for a performance allowance.

In 2015, the National Treasury requested that stakeholders develop benchmark proposals for purposes of the performance allowance. To help facilitate the development of greenhouse gas emission intensity benchmarks, the National Treasury commissioned a study through the World Bank and a report entitled “Emissions intensity benchmarks for the South African carbon tax” was published in 2014 followed by a stakeholder consultation workshop.

During 2016 to 2019, benchmark proposals were developed by the liquid fuels, gas and coal to liquid fuels, mining, cement, iron and steel, paper and pulp, ferroalloys, titanium, chemicals (nitric acid), sugar and clay brick sectors. Fourteen benchmark proposals, mainly based on the average emissions performance of a sector, were submitted to the National Treasury. The Draft GHG Emissions Intensity Benchmark Regulations sets out the emissions intensity benchmarks for these sector and subsectors.

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