

14 December 2018  
Dr Memory Machingambi  
Senior Economist  
Environmental & Fuel Taxes  
The National Treasury  
Government of South Africa

**Subject: Response to Updated Draft Regulations: Carbon Offsets**

Dear Dr Machingambi,

**South Africa's Proposed Carbon Tax Offset Scheme: Comments from Climate Neutral Group**

Climate Neutral Group welcomes the opportunity to provide comments on the National Treasury's November 2018 Updated Draft Regulations for Carbon Offsets. We acknowledge the fact that accommodating stakeholders impacted by the proposed Carbon Tax is a difficult task. Therefore, it is with pleasure that we would like to provide suggestions, hoping to alleviate the challenge that the National Treasury is being tasked with in developing these offset regulations.

We believe that the Draft Regulations made in terms of Clause 19(c) of the Draft Carbon Tax Bill, as of 12 November 2018 are covering the crux of the proposed mechanism to provide for a flexibility mechanism for taxpayers as well as an incentive for activities not subject to carbon tax. We do feel however that some clarification is required especially when reading the Regulations with the Explanatory Note for the Draft Regulation on the Carbon Offset.

**Introduction**

Climate Neutral Group (CNG) is a leading international provider of carbon management and offset solutions. Since our founding 15 years ago we have commissioned over one million tonnes of carbon credits from more than 50 projects in 20 countries. We are member of the International Carbon Reduction and Offset Alliance (ICROA), now part of the International Emissions Trading Association (IETA), thereby helping to set standards for the carbon industry. Through our National Business Initiative (NBI) membership we engage with business leaders in shaping a low carbon future in South Africa.

**Comments on National Treasury's Updated Draft Regulations on Carbon Offsets**

Climate Neutral Group wishes to express concern regarding perceived discrepancy between the Draft Regulations Made in Terms of Clause 19(c) of the Draft Carbon Tax Bill (hereinafter referred to "The Regulations") and the Explanatory Note for the Draft Regulation on the Carbon Offset (hereinafter referred to as "Explanatory Note"):

### 1) Lack of crystal-clear definition of concepts

The Regulations distinguish two types of activities: 1) activities in respect of which the carbon tax is imposed; 2) activities in respect of which the carbon tax is not imposed.

The Explanatory Note uses a number of concepts interchangeably including: “sectors covered by carbon tax”; “companies covered by carbon tax”; “activities covered by carbon tax”; “activities included in the carbon tax net”; “projects that occur outside the scope of activities that are subject to the carbon tax”; “projects in sectors that are not covered by the tax”; etc. We understand that these terms all refer to the same concept, referred to in The Regulations as *activities in respect of which the carbon tax is either imposed or not imposed*. We believe that a crystal-clear understanding of what is sometimes referred to as “carbon tax net” is essential for good reading, understanding and application of The Regulations, read with the Explanatory Note.

We suggest that The Regulations include in “Part I: Definitions”, the concept “*activities*” and that in the Explanatory Note concepts are used consistently and resemble those used in The Regulations. From both The Regulations and the Explanatory Note, we understand that the “carbon tax net” is established by *the activities in respect of which the carbon tax is imposed*. These activities are those listed in Schedule 2 of the Carbon Tax Bill with a basic tax-free allowance of less than 100% and that are not marked as “NA” in the third column of the same Schedule. The objective is for each potential tax-payer as well as offset provider to make crystal clear which activities are taxable and which activities are not.

### 2) Liquidity of the nascent carbon offset market

Climate Neutral Group appreciates the mechanisms within The Regulations that allow for offsets generated prior to the carbon tax to be utilised by taxpayers. This for initial demand of offsets to be met. Although The Regulations do not imply that any such mechanism could evoke double counting, the Explanatory Note suggests otherwise by explaining that provision has been made to allow all existing projects with credits generated from activities within the tax net to be eligible as carbon offsets during the first phase of the carbon tax (Explanatory Note; Section 1(c); page 8). We strongly recommend eliminating this provision from the Explanatory Note. Firstly, as there is no mention of such provision in the actual Regulations, and secondly this is contradictory to the explanation provided by the Explanatory Note; Section 1(b), page 8 “*to prevent potential double counting*”.

We believe that mechanisms applied to improve market liquidity should focus on the supply-side of the market. An option could be to allocate carbon tax revenue to developers of eligible

carbon offset projects to help these entities overcome initial high investments related to external validation and verification processes involved with the registration of offset-projects.

We have grouped our remaining comments into the categories outlined in the Draft Regulations and associated Explanatory Note:

**a) Part I: Definitions**

- **“attestation of voluntary cancellation”** – the definition implies that the CDM, VCS or Gold Standard must specify on their respective attestation of cancellation that the reason for cancellation is “being used in the South Africa carbon tax offset scheme”. This could potentially imply that attestations of cancellation that do not contain this specification may be rejected by the administrator as per Regulation 9(e)(ii). Climate Neutral Group wishes to recommend that Regulation 9(e)(ii) is extended with the following text: “and that it specifically provides that the reason for cancellation is to be used in the South African carbon tax offset scheme”.
- **“offset registry”** - It is imperative that the correct terms and appropriate language are in line with the international carbon market and used consistently throughout the Final Regulations and Explanatory Note. These updated draft Regulations are certainly an improvement on the first draft regulations in terms of using correct terms and language. However, we would suggest that the term “*offset registry*” is changed to “*SA offset registry*” to allow for the differentiation between the international registries of the CDM and Markit (for VCS and GS) with the yet to be established South African registry, in order to avoid confusion.

**b) Part II: Eligibility – Allowance of offset in respect of an approved project against carbon tax liability**

- Climate Neutral Group welcomes the inclusion of REIPPP projects from Round 3 onwards and up to 50MW. However currently this consists of 6 projects with a combined total of 159.5MW which will deliver approximately 200,000t CO<sub>2</sub> in offsets per year. A very small contribution to the overall demand projected of over 20 million tons per annum. Furthermore round 4 projects are all awaiting construction so none of these will likely deliver any carbon offset in phase 1. We suggest Treasury to consider increasing or removing the capacity-limit of these types of projects. This will alleviate carbon offset supply issues. Should the capacity-limit remain we recommend that the Explanatory Note provides explanation for the reason of a limit and how the value of 50 MW has been arrived at.
- Important supply is presented by existing South African landfill gas to energy CDM projects, and the potential for new waste handling projects in the country. Many of

these projects have been or will be developed by public sector entities, namely municipalities. For the offset scheme to tap into this supply, it must offer clear yet comprehensive guidance on how the emission reductions from these carbon offset projects can be developed and then utilised by taxpayers. Government orchestrated auctions are an option to be explored. Treasury could consider promulgating guidance then arranging for workshops and other capacity building programmes to ensure that municipalities do in fact participate in the offset scheme. This will strengthen the carbon tax programme and benefit entities liable for the carbon tax by ensuring they will have access to this important segment of supply. In addition, this will help South Africa to mitigate climate change thereby contributing to its national target for emission reductions.

- This aside, allowing landfill and other waste handling and disposal projects into the offset scheme is a strong point in Treasury’s proposal, as there is considerable offset experience available in this sector (and some 2 million credits from existing projects which may be used in the offset scheme). However, the proposed inclusion of the waste sector in phase 2 of the carbon tax regime, only 5 years after launching the scheme, is likely to discourage existing offset projects from joining the scheme. This short window of opportunity, given the significant time and cost required to register new projects, might act as a deterrent to the development of new projects in the waste sector. The crediting period needs to be long enough, and market conditions for offset credits healthy enough, for project developers to be willing to carry the upfront costs of submitting a project to the carbon registration cycle. Climate Neutral Group recommends that the inclusion of waste sector in the tax regime should not happen prior to 2025.

### c) Part II: Eligibility – Offset utilisation period

Climate Neutral Group is concerned that two concepts, namely: “Offset utilisation period” and “Offset crediting period” are being mixed up. The crediting period reflects the time-period from start of the crediting period to the end as is determined by the carbon standard under which an eligible offset credit can be generated. The crediting period is not linked to the offset duration period, because the offset duration period determines the period during which the offset can be utilised under the carbon tax. In other words, and if understood correctly, the offset duration determines the time-period for offsets listed in the SA offset registry to be *utilised* under the carbon tax. Whereas the crediting period determines the time-period during which an offset can be *generated*. Climate Neutral Group is concerned that Table 1: Offset Crediting Period for International Standards, used in the Explanatory Note to provide clarity on Regulation 3 of The Regulations, could cause for confusion that the offset utilisation period is the same as the offset crediting period.

- For the purpose of completeness and alignment of the Explanatory Note, Climate Neutral Group recommends to elaborate in the Explanatory Note under the same section “Offset utilisation period: Regulation 3”, on the so-called “transitional activities” that are referred to in Regulation 3 of The Regulations: “activities in respect of which the carbon tax is not imposed but that become activities in respect of which the carbon tax is imposed”. Climate Neutral Group understands that this could be the situation for activities listed in Schedule 2 of The Regulations that are currently enjoying a 100% basic tax-free allowance, but as a result of future revisions of the Carbon Tax Bill, this basic tax-free allowance may be reduced to below 100%. The Regulations make provision for utilisation of offsets generated by such activities; however, the Explanatory Note does not elaborate on this.

**d) Part III: Non-Eligibility**

- Climate Neutral Group does not have other suggestions with respect to the Non-Eligibility of activities in terms of generating offsets for use under the Carbon Tax than those mentioned above or in previous submissions of comments.

**e) Part IV: Administrator**

- Climate Neutral Group does not have other suggestions with respect to the Administrator than those mentioned above or in previous submissions of comments.

**f) Part V: Offset registry**

- Climate Neutral Group does not have other suggestions with respect to the Offset registry than those mentioned above or in previous submissions of comments.

**g) Part VI: Claiming of Allowance**

- Climate Neutral Group does not have other suggestions with respect to the procedures described for claiming of an allowance than those mentioned above or in previous submissions of comments.

**h) Part VII: Requirement for documents**

- Climate Neutral Group does not have other suggestions with respect to the Requirement for documents than those mentioned above or in previous submissions of comments.

i) **Part VIII: Miscellaneous**

- Climate Neutral Group does not have other suggestions with respect to the Short title and commencement of The Regulations.

Finally, Climate Neutral Group wishes to once again take the opportunity to emphasise that in order to ensure that a credible, diverse and liquid supply of carbon offset credits is available to the entities that will have tax liabilities as of June 2019, the ground rules and infrastructure needed to support an offset programme must be finalised and articulated by mid-2019, or sooner. Offset project lead times – from methodology development to project implementation and first verification of GHG reductions/removals – are lengthy and can take up to 2-3 years which should be considered at all times in the design of effective offset regulations for use under the Carbon Tax.

Thank you very much for taking the time to review our recommendations with respect to these issues.

Please do not hesitate to contact us should you have comments or questions on the views expressed above.

Yours Sincerely,



Franz Rentel  
Country Director – South Africa  
Climate Neutral Group