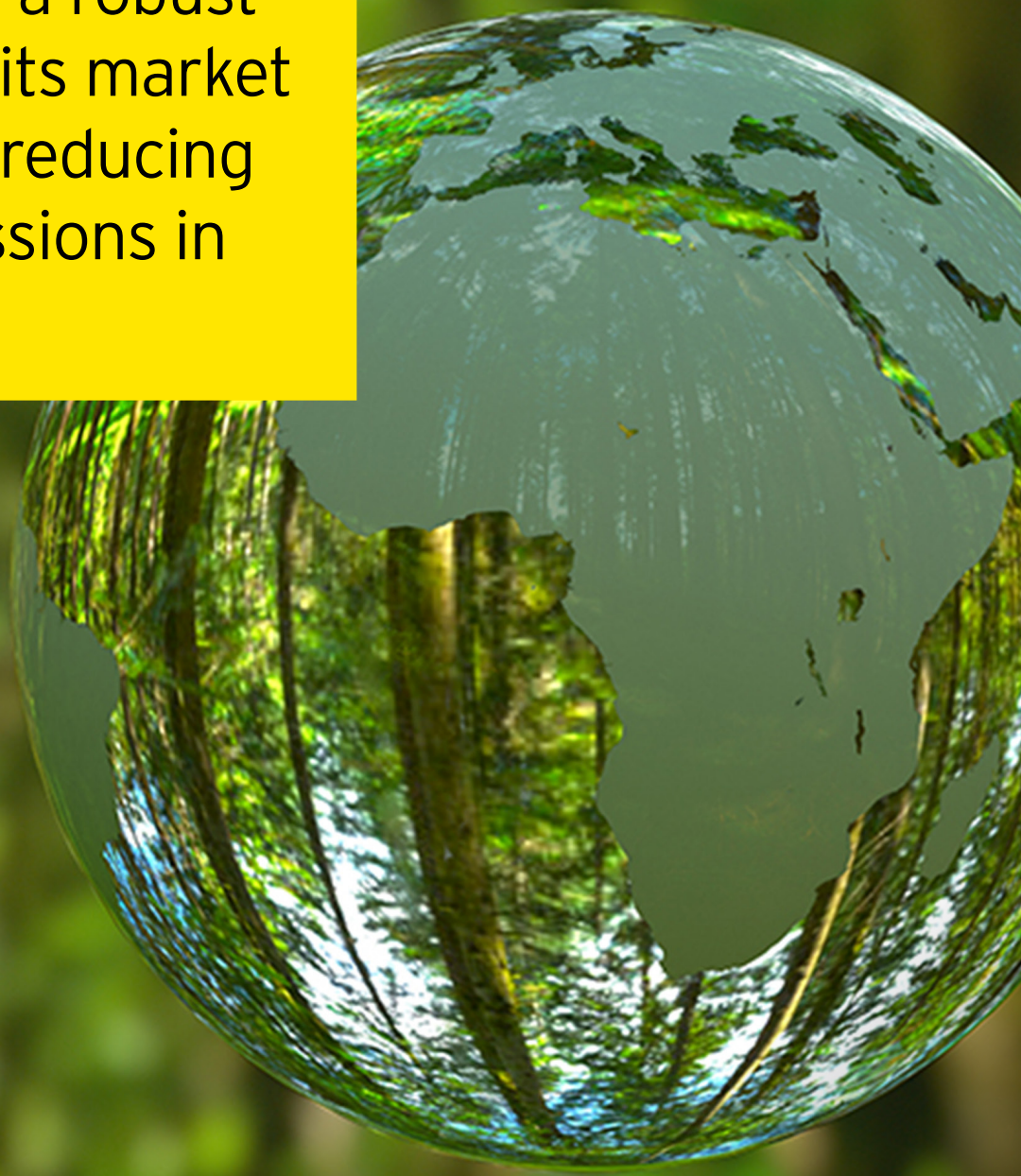
Establishing a robust carbon credits market is crucial to reducing carbon emissions in Zambia.



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Can the growing carbon credits market aid carbon reduction in Zambia?

Carbon markets have gained traction globally in the wake of the UN Climate Change Conference (COP26) and the recently held COP27. Countries have the option to establish compliance or voluntary markets for carbon trading. Unlike carbon allowances in a compliance market, where rules are set by national or international authorities, the voluntary carbon market (VCM) does not have any governance. The driving oversight for VCM is self-governed standards from independent globally recognized third-party verifiers (such as Verra and The Gold Standard). The carbon credits are purchased by multinational corporations (or individuals) voluntarily to meet its sustainability goals.

What distinguishes the voluntary carbon market from compliance markets is the ability to engage in VCM regardless of geographical location or business sector. Participants from different parts of the world can freely register their projects, sell, and buy carbon credits.1 For example, a private organization based in Australia can buy carbon credits that help preserve forests in Zambia.

Compliance markets are larger than the voluntary market in terms of volume traded and overall value. The value of traded global compliance market credits grew by 164% to a record US$851b last year, with the EU's Emissions Trading System (ETS) accounting for 90% of the global value.2 There are currently 68 carbon markets, including a carbon tax and ETS, with another 30 under development.3

The VCM market is still relatively small, with approximately US$1b of the total transacted volume of carbon offsets in 2021.4 However, the VCM market is primed for significant growth with increased interest in net-zero corporate commitments through carbon trading and concerns with price volatility within the compliance markets.

Spotlight on the Zambian market

Carbon credits will play an essential role in achieving Zambia's decarbonization commitments. Land-use change and the forestry sector contributed 60% to overall emissions in Zambia, followed by the agriculture (27%) and waste sectors (4%).5 Significant potential exists for government and private entities to generate carbon credits by preserving their forests, as around 60% of the total land area is forested. 6 Natural ecosystems can play a pivotal role in absorbing carbon emissions while getting monetized by governments and companies for conserving the environment.

Zambia is still at the embryonic stage of establishing a carbon trading system, although there is a growing appetite for a carbon market in recent years. The country has taken a results-based climate financing approach through its involvement as a pilot country in the Reducing Emissions through Deforestation and Degradation (UN-REDD) scheme. REDD projects remain the most popular in the Zambian voluntary carbon market, with the development of a national REDD strategy framework for forest carbon management to create carbon credits. Private organizations and NGOs in Zambia are working towards establishing carbon credits through ground-level water and land management projects, as well as portable solar light projects.

Carbon trading in Zambia is currently regulated by the Forest Act (Regulations 66) of 2021, but this does not comprehensively cover all aspects of carbon trading.7

A significant lacuna in the Zambian legislation sits under the Value Added Tax (VAT) Act, where carbon credits are not expressly provided for as a good nor qualified as a supply of a service. However, the VAT (Supply) Regulations8 define a supply of services as "anything done for a monetary consideration which not a supply of goods".

The operation of place of supply rules in the VAT Act means that if carbon credits are classified as goods, the export of the Carbon credits to non-resident buyers is zero-rated. However, the classification of Carbon credits as services means they are standard-rated and are subject to VAT at the rate of 16%. As the buyers are non-resident, the VAT imposed on the supply of Carbon credits is an additional cost. This makes it uncompetitive for non-residents to buy carbon credits from Zambia and has the potential to stifle the growth Carbon credits market and undermine the government's green agenda.

Despite the lack of clear guidance in the legislation, it is our view that carbon credits may be rightly regarded as goods for Zambian VAT purposes. As per the VAT Act, goods are defined to mean, "any article or substance of value, any immovable property and any interest in land …"[9]. **An "article or substance of value" can be said to imply any particular item with uniform properties that is useful and can be estimated in monetary worth. Our view is that as Carbon credits have uniform properties and are able to be expressed in monetary worth, they should rightly be classified as goods to that extent.**

Further, in light of the 'interest in land' aspect of the definition of goods in the VAT Act, local communities and carbon traders earn an equitable interest in the forest reserve lands which hold their carbon rights. This provides further scope for carbon credits to be classified as goods in the VAT Act.

Beyond the tax challenges highlighted above, we note that the 2023 National budget includes plans to develop guidelines to regulate the carbon market in line with the Kyoto Protocol on climate change.10 In December 2022, the Government formulated interim guidelines on carbon trading focused on the end-to-end management of the carbon market, including approval, implementation, and regulation of carbon projects in Zambia, until the enactment of the Climate Change Act (expected to be enforced by 1H23). [11] These initiatives are a positive outcome to support the carbon market as the Government takes greater accountability to develop a conducive environment.

Call for actions

Scaling up the focus on carbon credit generation from nature-based solutions

The Government should continue to focus on generating carbon credits within the forestry and agricultural sectors and leveraging the existing carbon pricing mechanisms, such as the REDD+ mechanism. Engaging rural communities with business partnerships, arranging crop-education programs for farmers, and extensive landscape management can help build a low-emission potential for the country through carbon offset opportunities.

In Zambia, the carbon fund business model facilitates the transaction of carbon credits from agribusiness that demonstrates emission reduction. For instance, Community Markets for Conservation (COMACO) and Shell recently verified 0.9 million tons of carbon credits and rewarded the nine chiefdom areas with US$3.1m for protecting their customary lands.12

Nature-based solutions could plug the gap until technology-based solutions (such as Biomass energy with carbon capture and sequestrations, Direct air carbon capture and sequestration, storage in the lithosphere, etc.) are ready for commercial deployment. The Government must also consider mandatory public disclosure by companies involved in carbon credit trading revenue and the share distributed to the relevant communities to increase transparency and build credibility.

Develop the technical expertise and skills of stakeholders

- Improving the technical knowledge and capacity to handle carbon credit projects, establishing stringent guidelines to ensure that the revenues from carbon offsets are declared, and proceeds shared with the relevant communities will help bolster the carbon trading market in Zambia.

- Private entities and the Government can consider investing in skills and technologies to determine the monetization of payouts on carbon finance projects. Cross-sector stakeholder coordination can help steer the Government to develop a clear vision, channel funds, and develop a conducive regulatory environment for skill development and R&D funding for a carbon market.

- Streamlined validation of the credibility of every participant in the carbon market, including standards, offset project proponents, and traders, and developing a standardized knowledge-sharing platform on carbon credit best practices will ensure optimal and transparent functioning of Zambia's carbon market.

Implement the best practices and learnings from policy experiences of the neighbouring countries

- To unlock the full potential of carbon trading, Zambia must consider exploring carbon pricing in the form of an ETS by proposing a tax incentive for companies operating a carbon trading exchange or a carbon tax. Countries such as Nigeria, Kenya, and South Africa have either established or are in the final stages of implementing laws related to carbon trading. Zambia may also consider extending the carbon taxes beyond motor vehicle surtax to other carbon-emitting sectors to propel the economy towards a more sustainable growth path.

- Zambia can apply the experience from Uganda by establishing a governance structure consisting of a multi-sectoral independent advisory committee on climate change, including communities on the climate consultation board, to take a holistic approach to designing a carbon market.

- The Africa Carbon Markets Initiative (ACMI), officially unveiled at COP27 by a consortium of African countries (Kenya, Malawi, Gabon, Nigeria, and Togo) and carbon credit experts, is a much-needed push to scale the VCM in Africa.13 ACMI aims to generate ~300 MtCO2e of carbon credits annually by 2030. While Zambia has thus far not officially committed to collaborating with ACMI, the initiative will provide the direction for the Zambian Government as they position carbon markets as a critical source of climate finance to unlock jobs and drive climate action.

Invest in digitization

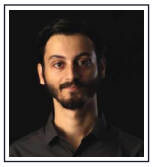
- Investing in digital technology, such as blockchain, to verify the transaction of carbon credits and regularly tracking a project's emission reduction impact can help streamline the measurement, reporting, and verification (MRV) of carbon credits.

- The Government can address data privacy concerns associated with digital technologies by formulating guidelines describing how sensitive emission information may be collected, used, and stored.

Authors

Towera Temba-Nkanza
Associate Director - Tax
Energy and Natural Resources Leader for Zambia

Manoj Chauhan
EY Knowledge Senior Mining & Metals Analyst



Utham Ganesh
EY Knowledge Mining & Metals Analyst

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