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DE BEERS GROUP OF COMPANIES

SUBMISSION TO THE PARLIAMENTARY PORTFOLIO COMMITTEE ON FINANCE
REGARDING THE DRAFT DIAMOND EXPORT LEVY BILL

1 NOVEMBER 2006

1. Introduction

- 1.1 De Beers welcomes the opportunity to comment on the recently published draft Diamond Export Levy Bill ("**the draft Bill**").
- 1.2 De Beers is supportive of government's goal of promoting local beneficiation of diamonds in South Africa, as reflected in the Diamonds Amendments Acts and the draft Bill.
- 1.3 De Beers recognises and appreciates the constructive approach that the National Treasury ("**Treasury**") has taken in its engagement with the downstream diamond industry in relation to the draft Bill and is pleased to note that most of De Beers' original concerns appear to have been taken into account in the draft Bill. We are left with only a few residual comments and concerns, which are set out below. Our more technical comments are set out in the annex to this submission.

2. Comments on the draft Bill

2.1 The definition of "*producer*"

- 2.1.1 The definition of "*producer*" in clause 1 of the draft Bill specifically includes persons that "*form part of the same consolidated group (for the purposes of generally accepted accounting practice) as a producer*" and which "*sell diamonds purchased from, or on behalf of, that producer*". According to the Explanatory Memorandum, the term "*producer*" was extended in this regard to "*reflect the economic reality of group operations, which often separate extraction from their sales activities into different companies*".
- 2.1.2 In De Beers' case, the Group trading and marketing entity in South Africa, De Beers Group Services (Proprietary) Limited, is under common control with the Group's mining entity (De Beers Consolidated Mines Limited), the two having a common controlling parent based in another jurisdiction (ie they are "*sister*" companies). The definition of "*producer*" in the draft Bill does not include this structure within its ambit and, on the assumption that this is inadvertent, De Beers requests that the definition of "*producer*" should be broadened to include sister companies that are

under the common control of a foreign parent, and which sells diamonds from, or on behalf of, the producer.

2.2 Mutual exclusions (clauses 5(7), 6(2)(b) and 7(3)(b))

2.2.1 Clause 5(7) provides that the import credit "*will not apply in respect of a producer that has been granted an exemption described in section 6 or 7.*" Conversely, each of clauses 6(2)(b) and 7(3)(b) provides that the exemptions provided for in the relevant clause will not apply in respect of producers that have been granted a credit in terms of section 5 (together, "**the mutual exclusion provisions**").

2.2.2 According to the Explanatory Memorandum in relation to the draft Bill released by Treasury on 11 October 2006 ("**the Explanatory Memorandum**"), the rationale for the mutual exclusion provisions is to ensure that credits for imported diamonds are matched against the levy on exported diamonds so that the levy applies on a "*net export*" basis.

2.2.3 The effect of the mutual exclusion provisions is that a producer may qualify for an exemption or a credit, but not both. It is submitted that this is an undesirable consequence as it reduces the flexibility of both producers and the Minister and may undermine government's goal of promoting local beneficiation.

2.2.4 We understand that Treasury has a concern that the system may be abused to the extent that both an import credit and an export levy exemption apply to the same rough diamond. It is submitted that this concern could rather be addressed by replacing the mutual exclusion provisions with a stipulation to the effect that imported rough diamonds will only qualify for import credits where the imported rough diamonds are sold to diamond beneficiators. The onus should be on the producer claiming the import credit to demonstrate this. In this way, producers will be incentivised to support local industry by "exchanging" rough diamonds that are uneconomic to manufacture in South Africa for those that are.

2.3 Exemptions in the discretion of the Minister (section 74 of the Diamonds Act and clause 6 of the draft Bill)

2.3.1 In terms of section 74 of the Diamonds Act, 1986 ("**the Diamonds Act**"), the Minister may exempt an exporter from the provisions of section 48A

of the Diamonds Act (ie from the requirement that all unpolished diamonds intended for export must first be offered at a Diamond Exchange and Export Centre ("DEEC")). The Explanatory Memorandum provides that *"the conditions under which the Minister of Minerals and Energy may exercise this discretion will be contained in regulations."*¹

2.3.2 In terms of clause 6 of the draft Bill, where the Minister has granted an exemption under section 74 of the Diamonds Act, the producer concerned will also be automatically exempt from the export levy with respect to that unpolished diamond (to the extent prescribed by the Minister as issued by regulation).

2.3.3 Similarly, clause 7 of the draft Bill provides that the Minister may exempt any producer from the export levy where:

2.3.3.1 that producer's activities in South Africa are supportive of local beneficiation or its rough diamond sales do not exceed R10 million per annum; and

2.3.3.2 the unpolished diamonds concerned have been offered at a DEEC for a minimum of four business days and have not been sold.

2.3.4 It is submitted that the criteria that the Minister may take into account when deciding whether to grant an exemption under section 74 of the Diamonds Act or clause 7 of the draft Bill should include the following:

2.3.4.1 the extent to which the exporter/producer concerned promotes local beneficiation at any level along the diamond pipeline, including:

- sorting and valuing of unpolished diamonds;
- cutting and polishing;
- jewellery design and manufacture;
- diamond jewellery retailing and marketing; and/or

¹ The media statement released by Treasury provides that: "[a]n objective set of criteria for granting an exemption to offer rough diamonds intended for export at the Diamond exchange and Export Centre by the Minister of Minerals and Energy will be spelled out in regulations in terms of the Diamonds Act."

- 2.3.4.2 the extent to which the exporter/producer promotes skills development and/or skills transfer in the downstream diamond industry; and/or
- 2.3.4.3 in relation to the clause 7 exemption, the extent to which the unpolished diamonds or categories of unpolished diamonds to be exported have been won or recovered from a mine that is entitled to marginal mine rate relief under the Royalty Act;² and/or
- 2.3.4.4 the extent to which the unpolished diamonds or categories of unpolished diamonds are, based on the trading activities and experience of the State Diamond Trader and the DEECs, uneconomic to manufacture in South Africa;³ and/or
- 2.3.4.5 the extent to which capacity and appropriate skills exist in South Africa to manufacture the category or categories of unpolished diamonds being exported; and/or
- 2.3.4.6 the extent to which the export concerned is temporary (for example, to be exhibited or displayed or to obtain an expert opinion) and is likely to be re-imported;⁴ and/or
- 2.3.4.7 the extent to which the unpolished diamonds concerned are destined for scientific or other non-commercial usage; and/or
- 2.3.4.8 the extent to which the unpolished diamonds concerned may be included in a geological sample destined for geological assessment.

² Section 63(1)(a)(i) of the existing Diamonds Act provides for an export duty exemption in respect of marginal mines. As currently drafted, the draft Bill will repeal this provision.

³ This consideration seeks to address the following concerns: 1. that it would be impractical to offer the high volumes of lower quality unpolished diamonds that are produced in South Africa and which cannot be manufactured economically locally at the DEECs (as noted in the Explanatory Memorandum, this avoids the risk that the DEECs might be overwhelmed by the high volumes of these types of rough diamonds produced in South Africa); 2. the availability of high volumes of goods at exchanges, combined with an export duty, can lead to unethical behaviour such as switching, theft and smuggling (thus undermining the Kimberley Process Certification Scheme); and 3. that any delay in getting goods to the market has negative cash flow and revenue consequences for the mines (as well as producers of synthetics). It is accordingly in South Africa's best interests to place the South African production that is uneconomic to manufacture locally into the hands of those that are best able to market it (and drive consumer demand) without delay.

⁴ This criterion would not be necessary if section 64 of the Diamonds Act were to be retained as suggested in paragraph 2.6 of this submission.

2.4 Proposed repeal of section 64 of the Diamonds Act (Deferments)

2.4.1 Part 1 of the schedule to the draft Bill provides for the repeal of a number of sections in the Diamonds Act, including section 64. Section 64 of the Diamonds Act provides for the deferment of export duty for a period not exceeding six months in circumstances where [the Regulator] is satisfied that any unpolished diamond is exported:

- (a) to be exhibited or displayed;
- (b) to obtain an expert opinion on it;
- (c) in the case where that diamond is of unusual size or value, in an endeavour to find a purchaser for it; or
- (d) in circumstances where that diamond is likely to be returned unsold to the exporter.

2.4.2 It is submitted that this section serves a valuable purpose and that it should be retained.

2.4.3 To the extent that a temporary export under section 64 might otherwise be regarded as an export of an unpolished diamond in terms of section 48A (which requires that all unpolished diamonds intended for export must first be offered at a DEEC), it is submitted that section 64 should be amended to specifically provide that such temporary export in terms of section 64 shall not constitute an export for the purposes of section 48A.

3. Conclusion

De Beers is supportive of government's goal of promoting the local beneficiation of diamonds in South Africa and firmly believe that with a few modifications, the draft Bill will prove workable from industry's perspective while at the same time furthering government's aims. We are grateful for this opportunity to comment on the draft Bill and appreciate the open and constructive manner in which Treasury has engaged with industry.

We would be happy to provide further input should this be required.

Technical comments

1. Ad clause 1 – definitions

1.1 the definition of "rough diamond"

1.1.1 The definition of "rough diamond" in clause 1 includes "any diamond that is not polished (but not including any synthetic diamond) as defined under the Diamonds Act, ... regardless of whether or not that diamond is won or recovered within the Republic." [emphasis added]

1.1.2 To be consistent with the Diamonds Act, which uses the defined term "unpolished diamond", it is submitted that the reference in the definition of "rough diamond" in the draft Bill to diamonds that are "not polished" should be changed to "unpolished diamonds, as defined under the Diamonds Act".

1.1.3 The definition of "rough diamond" in the draft Bill specifically includes imported diamonds and thus brings such diamonds into the ambit of the draft Bill. It is submitted that this, combined with the fact that the relief measures provided for in the draft Bill are not available to diamond beneficiators and dealers, will discourage the import of diamonds for local manufacture and may undermine government's stated objective of growing the local diamond beneficiation industry.

1.2 definition of "synthetic diamond"

The definition of "rough diamond" in the draft Bill refers to "synthetic diamonds". This latter expression is not defined in the draft Bill. In the interests of consistency, it is suggested that there should be a cross-reference to the definition of "synthetic diamond" in the Diamonds Act, as amended.

2. Ad clause 2(3) – foreign currency conversions

Clause 2(3) of the draft Bill provides for values denominated in a foreign currency to be translated in ZAR "at the closing spot rate on the date described in section 4" (ie the date a person submits a bill of entry for export as required under the Customs and Excise Act, 1964). It is submitted that this gives rise to a problem of timing inasmuch as the closing spot rate for that day is not known at the time that

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Customs documentation is completed and submitted on that day. It is also not clear what is meant by "*the closing spot rate*". To cure these difficulties, it is submitted that clause 2(3) should be amended to provide that any value denominated in a foreign currency "*will be translated into the currency of the Republic at the closing rate quoted on the South African Revenue Services website on the day prior to the date described in section 4*".

3. Ad clause 22(2) – grace period

In the interests of certainty, it is submitted that clause 22(2) should cross-refer to section 63(1)(a)(ii), which is the section in the existing Diamonds Act that provides for an export duty exemption where unpolished diamonds have been offered to cutters or tool-makers in terms of an agreement referred to in section 59.
