



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

FOR

THE DIAMOND EXPORT LEVY BILL, 2006

11 October 2006

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INTRODUCTION

A. The 1986 Diamonds Act

The Diamonds Act, 1986 (Act No. 56 of 1986), as amended, sought to promote the local beneficiation of rough diamonds by imposing a 15 per cent levy on rough diamonds exported from South Africa. The 15 per cent export levy essentially operated as a “regulatory” measure to ensure an adequate supply of rough diamonds to the local polishing and cutting industries.

The original version of the Diamonds Act, 1998 (before the 2005 amendments) contained key exemptions from the 15 per cent export levy. First, agreements in terms of section 59 allowed for an exemption if the exporting party could demonstrate the promotion of local beneficiation via other means (such as the long-term contractual supply of rough diamonds to local cutters). Second, all parties (miners and dealers) could escape the 15 per cent levy merely by proving that the rough diamonds had been offered for sale on a local bourse before export. As a result, the 15 per cent export levy has rarely been applied over its more than 20-year history.

B. The 2005 amendments to the Diamonds Act

Government is stepping up its efforts to promote the local beneficiation of rough diamonds. This strategy includes:

The 2005 Diamond Amendment Acts ((Diamond Amendment Act (Act No. 30 of 2005) and Diamond Second Amendment Act (Act No.30 of 2005)) create a State Diamond Trader. Producers will be required to sell a certain percentage of their rough diamonds to the State Diamond Trader at market value. This prescribed percentage of sales will be set by the Minister of Minerals and Energy. The State Diamond Trader in turn will sell these diamonds to local cutters for polishing. This process should create a steady long-term supply for local cutters.

The export levy on rough diamonds will be retained at a reduced rate and will be subject to slightly different procedures and exemptions. The objective of the export levy on rough diamonds is similar what it was in the past and will complement the intentions of the State Diamond Trader (also ensuring that diamonds sold by the State Diamond Trader are polished and cut locally and not merely exported by local purchasers).

The 5 per cent diamond export levy will be enacted via the Diamond Export Levy Bill for Constitutional reasons. As of 1996, all taxes and levies must be imposed or amended by Money Bills (a requirement not in existence when the original Diamonds Act was enacted in 1986).

DIAMOND EXPORT LEVY BILL: TERMS

BASIC LEVY REGIME

Charging provision: Section 2

Subsection 1

A 5 per cent levy applies to all rough diamonds exported. Rough diamonds include any natural unpolished or enhanced diamonds, but not synthetic diamonds (i.e. man made diamonds).

The levy is triggered by section 69 of the Diamonds Act, "*Release of unpolished diamonds for export*". Section 69 states that an unpolished diamond, intended for export, will be subject to the 5 per cent levy upon the Regulator's release of that diamond from the Diamond Exchange and Export Centre.

Note: The Regulator's release of any person's rough diamond only signals that person's intention to export the diamond. In other words, the charging provision section only serves as a trigger for the valuation process of a rough diamond intended for export. The levy is imposed and collected only when a person physically exports a released diamond as contemplated in section 4.

Subsection 2

The 5 per cent levy applies to the value of exported rough diamonds. In order to prevent artificial under-valuations, the 5 per cent levy will be imposed on the greater of the following two values:

- (a) The value specified by an exporter on a return as required by section 69 of the Diamonds Act, or
- (b) A value assessed by the Diamond and Precious Metals Regulator (i.e. the government diamond valuator) as described under section 65 of the Diamonds Act.

Note: In terms of the Diamonds Act (as amended), the Diamond and Precious Metals Regulator may review any exporter's rough diamonds placed at the Diamond Exchange and Export Centre (This includes such things as the carat amount, description, and value of the rough diamonds). Upon a difference of opinion, the Regulator reserves the right to revalue a person's diamonds.

Subsection 3

If a person sells rough diamonds in exchange for foreign currency and physically exports (i.e. gets them cleared through customs) those diamonds, their sales value will be converted into Rand at the closing spot rate on the date of export.

Subsection 4

Any levy or penalty payable in terms of this Act must be paid into the National Revenue Fund.

Rates: Section 3

The diamond export levy will be imposed at a rate of 5 per cent. The 5 per cent rate has been determined in consultation with the Department of Minerals and Energy and the South African Police Service. The 5 per cent rate is viewed as sufficiently high to ensure, in addition to the efforts of the State Diamond Trader, a reasonable supply of rough diamonds to the local market and low enough not to unduly encourage smuggling.

Liability date: Section 4

A bill of entry for export submitted by an exporter of rough diamonds to a South African Revenue Service ("SARS") Customs official triggers liability (i.e. payment) for the levy. The impact of this liability date depends upon the nature of the exporter. Producers (i.e. miners) are required to register with SARS and must pay the levy during the relevant 6-monthly assessment period (section 10). Non-registered diamond dealers must pay the levy when a rough diamond is exported.

RELIEF MEASURES

The Bill contains relief measures that may offset the levy in full or in part. Such relief measures exist to minimise any potential distortionary and unintended negative impacts of the proposed export levy.

It is important to note that only producers will qualify for the proposed relief measures. Independent diamond dealers and cutters who intend exporting rough diamonds will have to account for the 5 per cent export levy without being able to resort to any relief provisions since relief provisions for independent dealers and cutters could effectively undermine the original intent of the levy.

Import credit: Section 5

Subsection 1

A producer is entitled to receive import credits for any rough diamonds imported. These credits can be used to offset (in full or in part) that producer's export duties which would otherwise be payable. These credits ensure that the levy applies only to net exports (i.e. the net outflow from South Africa).

Subsection 2

The credit is equal to the value of imported rough diamonds multiplied by the rate (5 per cent).

Subsection 3

The credits arising during an assessment period will offset the levy owing (i.e. paid or payable) during that same period. The level of offset will be prescribed by the Minister of Finance as issued by regulation [which will depend on the revenue needs, if any, (i.e. potentially to fund the Regulator) of Government that may stem from the Diamonds Act]. As on-budget funding has been provided for the funding of the Regulator the proposed credit offset will be in full. At this stage no direct government funding for the State Diamond Trade is envisaged.

Subsection 4

All excess credits (i.e. credits that exceed the levy paid or payable during an assessment period) will be carried forward to following assessment periods for as long as that excess lasts (or the taxpayer remains in existence).

Subsection 5

After consultation with the Diamond and Precious Metals Regulator, the Commissioner may, in determining the value of any imported rough diamond, adjust that value to reflect an arm's length price (e.g. comparable uncontrolled price, using the cost plus or resale minus methods). This power is intended to prevent artificial over-valuations of imported rough diamonds. This effort must be the direct responsibility of the Commissioner because SARS officials are stationed at Customs entry points whereas the Regulator is stationed at the Diamond Exchange and Export Centre. However, the value will be determined in consultation with the Regulator because the Regulator has the established expertise to value diamonds.

Subsection 6

Subsection 6 is designed to prevent taxpayers from acquiring producers solely, or mainly for their accumulated import credits. More specifically, the acquisition of an equity interest of more than 50 per cent in a producer, solely

or mainly, for that producer's unutilised imported credits, will result in the outright denial of those credits.

Subsection 7

The import credit does not apply to a producer who already benefits from the receipt of a Ministerial levy exemption described in section 6 or 7. This denial of import credits is required as a matching principle (i.e. credits for imported diamonds must be matched against the levy on exported diamonds in order to ensure that the levy applies on a "net export" basis).

Ministerial exemption in terms of the Diamonds Act: Section 6

Subsection 1

The Minister of Minerals and Energy has the power to exempt a producer from the requirement to offer rough diamonds intended for export for sale at the Diamond Exchange and Export Centre (as per section 48A of the Diamonds Act). The conditions under which the Minister of Minerals and Energy may exercise this discretion will be contained in regulations. This exemption will also ensure that the Diamond Exchange and Export Centre (DEEC) is not overwhelmed with a high volume of low valued diamonds.

Should the Minister of Minerals and Energy decide that a producer need not offer his or her rough diamonds for sale at the Diamond Exchange and Export Centre before export, such diamonds will be exempted from the 5 per cent export levy. The reasons for exempting producers from being required to offer diamonds at the DEEC would be the same as those for waiving the 5 per cent levy. This waiver of the 5 per cent levy will be automatic: no further approvals will be required.

As in the case of an import credit, the level of the waiver from the 5 per cent levy will be prescribed by regulation as determined by the Minister of Finance. This level will again depend on the revenue needs, if any, of Government that may stem from the Diamonds Act. As discussed above, a full exemption is proposed at this stage.

Subsection 2

The exemption provided by section 6 does not apply to a producer who already benefits from the import credit described in section 5 (refer to the above explanation provided for section 5(7)). Moreover, this exemption does not apply to any rough diamond purchased from the State Diamond Trader. The State Diamond Trader's function is to create an enhanced local supply for local polishing and cutting.

Ministerial exemption at Diamond Exchange and Export Centre: Section 7

Subsection 1

The Minister of Minerals and Energy may exempt a registered producer exporting rough diamonds from the 5 per cent levy if the diamonds are properly offered at the Diamond Exchange and Export Centre. This offer essentially gives local polishers a “right of first refusal”.

The Minister of Minerals and Energy may provide this exemption to a producer under the following conditions:

- (i) The producer must conduct activities within South Africa that are supportive of local beneficiation (e.g. perform its own local polishing, have long-term contracts with local polishers, etc.); or
- (ii) A small producer. For this purpose, a small producer is one whose rough diamond sales do not exceed R10 million per annum. Anti-avoidance measures will be considered to ensure that producers do not split their operations to unduly qualify for an exemption under this provision.

The level of this exemption (like the level of the exemption described in section 6) will be set by regulation as prescribed by the Minister of Finance. This level will similarly depend on the revenue needs, if any, of Government that may stem from the Diamonds Act. As discussed above, a full exemption is proposed at this stage.

Subsection 2

In addition to the requirements discussed in subsection (1) above, each diamond offered at the Diamond Exchange and Export Centre (DEEC) must satisfy the following four requirements to qualify for an exemption:

- (i) The rough diamond must be offered for sale at the Centre for a minimum of four days.
- (ii) The offer at the Centre must not have resulted in a local sale.
- (iii) The diamond sold for export must yield a price that is at least equal to the price at which that diamond was offered for sale at the Centre.
- (iv) Proof of the reserve price must be submitted to Customs.

These provisions preserve South Africa’s “right of first refusal” by ensuring that local cutters and polishers have a fair opportunity to bid on rough diamonds prior to their export.

Subsection 3

Section 7(3) contains the same prohibitions found in section 6(2). The exemption provided by section 7(3) does not apply to a producer who already benefits from the import credit described in section 5 (refer to the above explanation provided for section 5(7)). This exemption similarly does not apply to any rough diamond purchased from the State Diamond Trader.

ADMINISTRATION

Overview

The Diamond Export Levy Bill provides for two sets of levy payers – producers (miners) and non-producers (independent dealers and cutters). All diamond producers (miners) are required to register with the South African Revenue Service. Registered producers must pay these export levies twice per year (i.e. every 6 months). Non-producers (independent dealers and cutters) must pay the full levy when a rough diamond is exported (i.e. when a bill of entry for export is submitted to Customs).

Producer-level registration is critical to the administration of this Bill. According to the South African Police Service, most diamond smuggling stems from record defects at the local producer-level. Compulsory registration at the producer-level initiates an audit document trail that is traceable, thereby deterring illegal activities.

Lastly, it should be noted that the producer definition (contained in section 1) extends beyond holders of mining rights. Other company within the same consolidated financial group can be treated as a producer if: (i) it is approved by the Minister of the Department of Minerals and Energy, and (ii) a company within a consolidated group of companies sells diamonds purchased from that producer. This extension of the term producer reflects the economic reality of group operations, which often separate extraction from their sales activities into different companies.

Registration: Section 8

The Commissioner may determine the required registration process for producers. However, the Bill mandates that registration with SARS must occur within 45 days after the date a person was granted a producer's licence.

Cancellation of registration: Section 9

The Commissioner may cancel registration upon application. Cancellation can only occur after the last day of the 6-monthly assessment period on which a person qualifies as a producer.

Returns and assessment periods: Section 10

Registered producers must submit 6-monthly returns (section 10(2)). Natural persons are to base their periodic submissions on their year of assessment prescribed by the Income Tax Act, 1962 (Act No. 58 of 1962), starting on 1 March and ending on the last day of February. Other persons (i.e. entities) must use their financial year. The actual return plus payment must be submitted 30 days after each 6-monthly assessment period (section 10(1)).

Form, manner and place determined by the Commissioner: Section 11

The Commissioner largely controls the administration of returns, forms and payments (section 11(1)). The only explicit statutory requirement relates to consolidated financial returns. All registered producers (which include consolidated diamond sellers) must submit a single return at time and place determined by the Commissioner. This single return requirement will ensure that a single economic unit can be audited accordingly.

Maintenance and records: Section 12

Like all tax acts, producers submitting 6-monthly returns must maintain sufficient books and records for the Commissioner to verify compliance (section 12(1)). These books and records must be maintained for a minimum of 5 years (subsections (2) and (3) of section 12). This 5-year minimum requirement matches the time limit for assessments described in section 16 (as well as the time limit for refunds referred to in section 17).

Assessments to re-determine, re-calculate and estimate amounts: Section 13

The Diamond Export Levy operates as a self-assessment system, much like the Value-added Tax. A notice of assessment triggers an additional 30-day liability for payment (subject to objection and appeal).

Reduced assessments: Section 14

The Commissioner has the power to reduce assessments without having to rely on the formal objection and appeal process. This power similarly exists in the Income Tax and Value-added Tax Acts.

Withdrawal of assessments: Section 15

The Commissioner has the power to withdraw assessments without having to rely on the formal objection and appeal process. This power similarly exists in the Income Tax and Value-added Tax Acts.

Time limit for assessments: Section 16

Like the Value-added Tax, the Diamond Levy has a 5-year time limit for assessments. This 5-year period commences only after the submission of a diamond levy return to which that assessment period relates (Section 16(1)). Hence, if no return is submitted, the time limit for assessment continues indefinitely. Moreover, even if a return is submitted, the 5-year does not apply if the Commissioner has reason to believe that failure to pay the Diamond Export Levy stems from fraud, misrepresentation or non-disclosure of material facts (Section 16(2)).

Refunds: Section 17

Persons may claim refunds for overpayments (Section 17(1)). Refunds have a 5-year time limit (Subsections (2) and (3) of Section 17).

Interest: Section 18

Both the Commissioner and diamond export levy payers are eligible for interest to the extent of underpayments and overpayments, as the case may be (Subsections (1), (2) and (3) of Section 18). This interest is calculated on a monthly basis. The interest rate is calculated in accordance with the rate required by section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962).

Division of responsibility: Section 19

The Commissioner is generally responsible for administering the Diamond Export Levy Act (Section 19(1)). However, the Minister of Minerals and Energy will be responsible for assisting the Commissioner on issues requiring diamond expertise (Section 19(2)).

Applicability of the Income Tax Act: Section 20

Administrative processes falling within the purview of the Diamond Export Levy Act are covered by reference to the Income Tax Act, 1962 (Act No. 58 of 1962) (Section 20(1)). The Commissioner and the Minister of Minerals and Energy may freely share information to enforce the Diamond Export Levy Act (Section 20(2)). Lastly, discretionary decisions by the Commissioner and the Minister of Minerals and Energy are subject to objection and appeal (Section 20(3)).

Act binding on State and application of other laws: Section 21

The Diamond Export Levy Act will be determined solely by its terms without reference to any other Act (unless that other Act makes specific mention of the Diamond Export Levy Act).

EFFECTIVE DATES

Short title and commencement: Section 22

The Diamond Export Levy Bill will come into operation on a date set by the Minister of Finance (Section 22(1)). This discretionary date will ensure that the operation of the Diamond Export Levy Act coincides with the existence of supporting administrative apparatus (including the apparatus relating to the State Diamond Trader).

Currently, the 15 per cent diamond export levy contained within the Diamonds Act is technically legally enforceable except for the waiver via the section 59 agreement. The waiver via the section 59 agreement only applies for one year from the promulgation date of the Diamonds Amendment Act, 2005 (Act No. 29 of 2005). The Minister of Finance has, however, been empowered to continue the section 59 waiver agreement until the new Diamond Export Levy Act is fully operational (Section 22(2)). Without this deferral, a situation could inadvertently arise in which the 15 per cent export levy would apply without any section 59 agreement relief.

Schedule

The Diamond Export Levy Bill replaces the 15 per cent export levy on rough diamonds as contained in the Diamonds Act, 1986, as amended. In addition, all other diamond levies imposed by the Diamonds Act will be removed, including such levies / fees imposed to fund the previous Diamond Board.