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"Fuel Tax is a major source of State revenue . . ."

FUEL TAX REFORM

Patrick Henderson, Oil Industry Controlled Prices and Customs Adviser

We report on certain significant future trends in fuels taxation policy, and also provide a brief review of the recent history of fuels taxation which may be of interest.

The oil industry has played a major role in the development and implementation of many of the matters outlined in this review, and intends to continue to do so in the future. The process of engagement with Government and other stakeholders on fuels taxation policy issues is facilitated by Sapia's representation on the "Advisory Body on Indirect Taxation of Petroleum Products" which was created in 1997 with the objective of enabling Government, the oil industry, and other stakeholders to work together to achieve a balanced fuels taxation policy.

FUTURE DEVELOPMENTS IN FUELS TAXATION: SOME TAXING QUESTIONS AHEAD

Fuel Tax is a major source of State revenue in most countries of the world, easily taxed, and allegedly therefore abused by some governments. Fortunately this has not been the case in South Africa, where the authorities have been following balanced policies, appropriate both to the fiscal needs and to the nature of the South African economy.

Significant and vital as these sources of revenue are, our fuel taxes are not as heavy as in some countries, partly in recognition of our proportionately greater reliance on road transport for commuting in metropolitan areas than elsewhere: for example the United Kingdom, which has an impressive rail commuter system and very high fuels taxes.

Though the amounts (as shown in Appendix 13) and the structure of fuels taxation in South Africa have changed considerably over the years, taxation policy has been focused and disciplined. During 2000/01 these taxes brought in more than R16.5 billion in revenue.

Most of the increase in the price of petrol and diesel recently has been due to the fluctuations in the Rand/US Dollar exchange rate and to the international price of oil, factors beyond the control of Government and the South African petroleum industry. As is shown in Appendix 13 the increase in taxes and other imposts has been modest in recent years, in keeping with Government's inflation targeting and economic growth policies

ENVIRONMENTAL TAXES

National Treasury are at present carrying out a study

to gather facts and opinions for a policy framework document that will serve as a guide for the imposition and/or restructuring of environmentally related fiscal measures. The objective would be to evaluate incentives (positive and negative) for initiatives to stimulate environmentally friendly production and consumption patterns.

The oil industry is already committed to a process of working with government to set future fuels specifications to meet agreed environmental standards. These new specifications will result in significant investments in refinery upgrades if the required products are to be refined locally. The industry is therefore keen to work with Government to ensure a holistic and balanced approach to the process of evaluating appropriate fiscal and other incentives related to improved environment performance.

DUTY AT SOURCE

This South African Revenue Service (SARS) initiative is aimed at improving administration and control over Excise and Fuel Levy collections on locally produced goods, such as alcoholic beverages, tobacco, and fuels, such that the taxes become payable at the point of production rather than at the (Customs-bonded) warehouses of firms wholesaling these commodities which is the situation at the present time.

In the case of the oil industry, with its complex supply and distribution system, it has been a challenging task to plan the various steps to achieve conversion to paying these taxes at source-refineries in a manner which will leave both SARS and the oil industry members financially neutral. However, through a process of ongoing interaction during the past two years between relevant stakeholders (SARS, refiners, oil companies, Petronet, as well as Customs authorities in neighbouring countries), all major obstacles have been overcome and are accommodated in legislative changes which should result in the planned implementation of "Duty at Source" procedures for the oil industry by April 2003.

LEVYING OF FUELS TAXES BY PROVINCIAL GOVERNMENTS

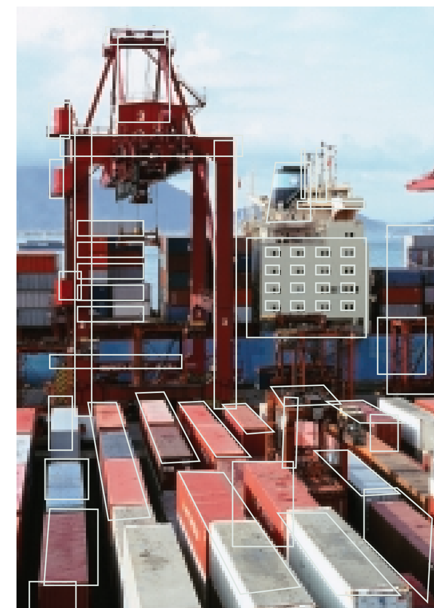
The funding of the specific and varying needs of Provincial and other Local Governments for income which cannot be sourced from service provision (such as electricity) can be sourced only from either Central Government or from some other local taxation means (e.g. property rates, the Regional Services Council Levy on payroll and turnover of businesses, and/or motor vehicle licence fees).

The Western Cape Provincial Government, having recently established the Constitutional position regarding the rights of Provinces to impose taxes, has initiated a process which could lead to the imposition of Provincial fuels taxes, and which would be in addition to those imposed by central government.

Whilst it is premature to comment on the possible implications of this development, we can say that Sapia's engagement with the authorities concerned will be focused on attempting to ensure implementation measures which will be equitable to all concerned.

DIESEL TAX EVASION: UPGRADE OF ILLUMINATING PARAFFIN MARKER

The chemical marker and supporting procedures introduced in 2000 have proved to be very effective in assisting SARS to enforce compliance with the legislation which criminalizes diesel taxation evasion practices, and which mainly involve the mixing of paraffin into diesel. However, there are certain technical shortcomings of the present technology, which, if not addressed, could compromise inspection and related compliance procedures. Therefore, at SARS' request, the oil industry has conducted research into alternatives, and it is probable that this will culminate in an upgrade to the most sophisticated and relevant technology presently available. At stake are considerable sums of "taxpayers money", assessed at around R300 million p.a., as well as the need to protect unsuspecting motorists and tractor-owners from the risks of engine damage caused by off-specification fuel supplied to them by unscrupulous distributors who mix tax-free paraffin with diesel, selling the mixture at "taxed" price levels – and thus profiting from these illegal transactions to the extent of the estimated R300 million p.a.



A BRIEF HISTORY OF EVENTS LEADING UP TO THE PRESENT FUELS TAXATION DISPENSATION

Not only the amounts (as shown in Appendix 13), but also the structure of fuels taxation in South Africa has changed considerably over the years. Some of the main events have been:

PHASING IN OF GST AND SOME "EAR-MARKED" TAXES

1978 – When General Sales Tax (GST) was first introduced in June, at 4% (this amounted to 1 c/l of the pump price of 26,4 c/l.)

1979 – Following the revolution in Iran there was a disturbance in the global oil market which resulted in a major spike in oil prices. This impacted negatively on South Africa's position, which was in any event subject to an international embargo on oil supplies at that time. In response to these abnormal developments, and in an endeavour to ensure continuity of supply and also to address related local fuels price volatility issues, the South African government introduced a special government funding mechanism, originally known as the "Equalisation Fund Levy", and which subsequently became the "State Oil Fund Levy" and then ultimately the "Central Energy Fund Levy" to finance oil acquisition. The initial levy in fuels prices was set at 1,0 c/l in January 1979, increased to 6,35 c/l in February and with two subsequent increases reached a peak of 18,75 c/l by June (representing 37% of the petrol pump price at that time). Thereafter the levy was reduced progressively as circumstances changed and was down to 4,0 c/l by 1985, at which time it provided for the following ear-marked funding:

- 0,055 c/l for combating oil pollution
- 3,725 c/l for financing synthetic fuels production
- 0,22 c/l for financing crude and fuels strategic storage.

1984 – GST was increased to 7% in February and then again to 10% in July.

1985 – By April GST had reached 12%, which amounted to 8,9 c/l of the petrol pump price of 82,9 c/l.

- A rearrangement in fuels tax administration and allocations, including the reduction of Customs and Excise duties (from 10,341 c/l) to the present level of 4,0 c/l. A major reason for this was to provide the member-countries of the SA Customs Union (SACU) with greater fiscal freedom as regards taxation raised via fuels taxes (noting that the SACU Agreement binds all members to applying the same amounts of Customs and Excise duties). Flowing from this change was a re-apportioning of fuels taxation through the creation of a discrete "National Roads Fund Levy" at 5,0 c/l, intended to provide ear-marked funding of trunk road building and maintenance.

1987 – INTRODUCTION OF THE FUEL LEVY IN PLACE OF GST AND VAT, AND PHASING OUT OF MOST "EAR-MARKED" TAXES

1987 was the next watershed year for fuels taxation in South Africa, as it was the time when:

(a) GST (now VAT) was replaced as a tax on petrol and diesel by the Fuel Levy – into which new tax was also incorporated the National Roads Fund Levy as part of a policy change that such funding should in future be budgeted for and allocated in the same manner as all other State expenditure. This change represented a change in government fiscal policy away from ear-marked taxes and levies, and which with the notable exception of the Road Accident Fund Levy, still largely prevails today.

(b) Because the Fuel Levy is a Customs and Excise-administered tax applied to stock, as opposed to GST/VAT which is applicable to sales, in order to avoid impacting negatively on oil industry financing it was agreed that Customs and Excise Duties as well as the new Fuel Levy would no longer be brought to account at source refinery level, but at point of sale from the individual oil company distribution depots. This payment system pertains at this time, but is planned to revert in April 2003 to payment at refineries (so-called "Duty at Source"). This has been made possible by a special monthly payment financing arrangement proposed by SARS, which will ensure cash neutrality for the oil industry as a whole.

(c) A changed dispensation was introduced intended for improved control of the various diesel tax rebates applicable for primary production users (e.g. farmers, fishing, mining). The change was to move away from deductions off oil company diesel selling prices of the various rebate amounts applicable, to a system where rebates were administered as post facto refunds.

However, a subsequent shift in Government policy led to the phasing out over time of all rebates other than a residual amount in the case of agriculture and fishing, and also the special system put in place for the agricultural sector proved to be open to abuse and was discontinued in 1997.

Pressure on government by primary industry then led to the introduction of the present rebate/refund system in July 2001.

1988 – "THIRD PARTY" MOTOR VEHICLE INSURANCE

1988 was the year in which a tax (at 3,6 c/l for petrol and 2,1 c/l for diesel) was introduced on fuels to replace the previous compulsory 3rd Party motor vehicle insurance scheme which was linked to ownership of each vehicle. This national insurance scheme, now called the Road Accident Fund (RAF), is administered by the Department of Transport. In terms of their legislation and a link with the Central Energy Fund Act (administered by the Department and Minerals and Energy), the present gross RAF Levy collections are some R3,1 billion p.a. via the levy amount of 18,5c/l imposed on petrol and diesel prices. Since July 2001 certain "off-road" users of diesel have been entitled to a rebate or refund of this levy.

1996 – ENVIRONMENTAL TAX INCENTIVE INTRODUCTION OF UNLEADED PETROL

1996 saw the introduction of unleaded petrol, facilitated by a lower Fuel Levy amount on unleaded versus leaded grades – the policy motivation being to provide a tax and price incentive to encourage fuel users to choose the more "environmentally friendly" fuel.

2000 – DIESEL TAX EVASION CORRECTIVE MEASURES

The escalation in taxation of diesel (for example from 30,9 to 114,1 cents/litre between 1987 and 2000) versus the minimal taxation of illuminating paraffin created an incentive to blend the two fuels thus reducing the cost of the tax component of the blend.

2000 saw the introduction of SARS legislation aimed at curbing diesel taxation evasion practices of mixing tax-free Illuminating Paraffin into diesel by some fuel users and distributors. In terms of this legislation, a special chemical marker is added at refineries to paraffin, which enables SARS to detect fuel mixtures containing paraffin. It is estimated that resultant tax-evasion savings to the State are now in the region of R300 million p.a.

2001 – RE-INTRODUCTION OF DIESEL TAX CONCESSIONS

2001 saw the re-introduction of significant tax concessions for certain diesel fuel users (mainly in the primary production economic sector), via a refund procedure integrated with the VAT system. This tax rebate concession will amount to a "loss" of about R310 million p.a. to the Road Accident Fund and R420 million p.a. to the fiscus, a total of approximately R730 million for the fiscal year 2002/2003.

2002 – NEW TAXATION POLICY FOR "BIO-FUELS"

2002 saw the introduction of a fuel taxation dispensation and related concessions to encourage the production and consumption of "bio-fuels" (specifically diesel fuel substitutes).