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The logo for the South African Revenue Service (SARS), consisting of a stylized blue 'S' followed by the letters 'ARS' in a bold, blue, sans-serif font.

South African Revenue Service

DISCUSSION PAPER FOR PUBLIC COMMENT:

REVIEW OF THE DIESEL FUEL TAX REFUND SYSTEM

February 2017

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EXECUTIVE SUMMARY

The diesel refund system provides full or partial relief for the fuel levy (FL) and Road Accident Fund (RAF) levy to primary producers in the agriculture, forestry, fishing and mining sectors. It was introduced from 2000 in a phased approach and is aimed at protecting international competitiveness of local industries and reducing the road-related tax burden of the RAF levy for certain non-road users. Enterprises conducting eligible activities must be registered for VAT purposes in order to claim the refund but must maintain a record of supporting documents including purchase invoices, sales invoices and logbooks.

Diesel refunds are claimed based on the type of usage the diesel is put to including primary producers (on land), offshore activities (commercial fishing, coasting vessels, offshore mining, NSRI vessels, vessels conducting research in support of marine industry, coastal patrol vessels, vessels servicing fibre optic telecommunications cables), harbour vessels, rail freight and peak power electricity generation plants (with a capacity of more than 200 MW). Primary producers on land (farming, forestry and mining) qualify for a refund amounting to 100 per cent of the RAF levy and 40 per cent of the FL in respect of 80 per cent of their eligible diesel fuel purchases. Rail freight (not passenger rail) and harbour vessels are refunded the RAF levy only. Full refunds of both the FL and RAF levy apply to offshore activities and peak power electricity generation plants, although the FL refund for electricity generation has been reduced to 50 per cent since 1 April 2016.

The Discussion Document on the Review of the Diesel Fuel Tax Refund System follows on announcements in Budget 2015 to undertake a review of the administration system to address anomalies in the system related to qualifying activities and beneficiaries. National Treasury and the SARS committed to explore alternative, more equitable rules and administrative procedures following consultation with affected industries.

The implementation of the new standalone diesel refund administration will have to be phased in to ease the compliance burden on beneficiaries and administrative burden on SARS. The design of the proposed new system is envisaged to be finalised by the end of 2017 after the public consultations, followed by an announcement of the details in Budget 2018.

TECHNICAL CHALLENGES FACING THE DIESEL REFUND SYSTEM

The diesel refund system has faced several technical administrative and legal challenges including some eligible firms being unable to benefit from the system, while others appear to be making disproportionate refund claims. The main administration concerns relate to:

- Shared VAT Administration – Potential diesel refund beneficiaries such as small scale primary producers that are not required to register for VAT purposes are inadvertently excluded from the diesel refund system. This also affects those joint ventures that share production output between members without making taxable supplies, which may not register for VAT and therefore cannot access the diesel refund.

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- Lack of logbook compliance - to qualify for the refund, taxpayers need to maintain accurate logbooks including information on diesel storage and volumes eligible for the refund. Certain taxpayers, especially in the agriculture, forestry and mining sectors currently claim refunds without maintaining the detailed logbook verification required by law.
- Authorisation of primary production – Commercial fishing and mining operations may only qualify for diesel refunds if authorised through a fishing permit or mining right in terms of the relevant legislation. Qualifying fishing and mining operations that fall within the intended scope of the diesel refund system have therefore in some instances been denied refunds where authorisation was outsourced to contractors, pooled in joint venture partnerships or had their fishing permits or mining rights delayed by the Departments of Agriculture, Forestry and Fisheries or Mineral Resources respectively.
- Outsourcing of operations - Primary producers in the agriculture, forestry, fishing and mining industries regularly outsource a range of operational activities. Under the current rules of the diesel refund system, only primary producers can claim diesel refunds where the primary producer provides the diesel to the contractor for dry contracting while any diesel that is obtained by the contractor itself, referred to as wet contracting, is disallowed. These outsourcing arrangements commonly take the form of either contracting or joint venture partnerships.
 - Contracting - arrangements are typically based on service level agreements whereby the contractor charges fees for distinct and limited services rendered, while the financial risk and legal obligations of the enterprise remains wholly the responsibility of the primary producer.
 - Joint ventures - in this context are contractual partnerships where primary production operations are rendered in exchange for sharing in output or profits. Joint ventures are therefore allowed to register and are treated as vendors under the VAT Act. The exception is joint ventures that share their output between members without making taxable supplies, which are unable to register for VAT. Joint ventures are not recognised as legal entities under the C&E Act and therefore cannot register for the diesel refund system to qualify as diesel refund users. However, joint ventures may elect a member to register for diesel refund purposes in his or her personal capacity in order to access the diesel refund benefit for the enterprise. This has been particularly the case in agriculture and forestry joint ventures that are not subject to the further legal authorisation requirements of the fishing and mining sectors.

PROPOSALS FOR REFORMING THE DIESEL REFUND SYSTEM

To address these concerns, interim amendments were felt necessary ahead of the longer term reforms to address outstanding assessments, disputed cases and pending litigation. The interim

amendments included allowing qualification for refunds by ceded mining right holders, contract and small-scale farmers in sugarcane production, on-going mining rehabilitation; and reducing the benefit rate from 100 per cent to 50 per cent of the FL for peaking electricity generation plants. The interim amendments to the current diesel refund system became effective on 1 April 2016.

The longer term reforms were proposed to facilitate a simplified administration system which ensures that the policy intent of the diesel refund system is maintained. The proposed reforms include:

Qualifying primary production activities rather than users

The systemic problems confronting the current administration of the diesel refund system are due to the emphasis on eligible diesel purchases by qualifying users, rather than on qualifying activities and use.

- It is proposed that the basis of the diesel refund administration be shifted from the current emphasis on allowed users to qualifying primary production activities. An indicative list of the type and nature of qualifying activities and use by primary producers is provided in the discussion paper and this will be finalised through the public comment consultative process.

Inclusion of contractors

The inclusion of contractors is proposed in the revised diesel refund system to allow smaller producers and new entrants who lack the necessary funding or experience to benefit from the system. This proposal might also require a suitable diesel use threshold, possibly by sector, to address possible administrative complexities for SARS and the taxpayer.

Standalone Diesel Refund Administration System

A standalone diesel refund administration is proposed separate from the VAT system. This will address limitations around intended beneficiaries that cannot claim the diesel refunds due to not being VAT registered. To ease the compliance burden on taxpayers and administrative burden on SARS, the new system will be phased in through the initial confirmation of current diesel refund registrants followed by the re-registration of all beneficiaries anew over time.

Administrative enforcement and taxpayer compliance

Audits under the proposed new diesel refund regime will be based on risk profiling of diesel refund beneficiaries, while enforcement will continue to rely on taxpayer compliance with logbook obligations.

- Beneficiaries will be expected to update and maintain their diesel refund registration profiles electronically to validate their claims. Claims outside the scope of the beneficiary's registration profile will be denied and the user may be flagged for audit under SARS' risk-profiling enforcement.

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- Diesel refunds will only be allowed in respect of diesel dispensed from storage facilities formally on record with SARS to diesel-powered equipment and vehicles also formally on record with SARS. In addition to logbooks, claimants will be obliged to maintain proper service and repair records for such machinery and vehicles to prevent ghost claims.
- Special treatment will be considered for small and emerging primary producers that fall below the proposed diesel refund sectoral registration threshold. Options such as the collective registration within an industry of beneficiaries who would share claims under a cooperative arrangement or a formula-based methodology could be considered. Such an approach is intended to assist small and emerging primary producers without abandoning the full logbook and recordkeeping generally required for diesel refund claims.

The need to link the qualifying activities to a physical location has also been identified, which will enable easier definition of primary activities and monitoring of diesel use to prevent double claims and help curb abuse of the system. The proposed limitation of diesel refund benefits to primary production activities to the exclusion of all off-site transport and any processing activities, as well as stricter registration and enforcement measures, are expected to allow the intended beneficiaries to benefit from the system while significantly curbing the potential for abuse and reducing the risk of unintended revenue losses to the fiscus.

1. INTRODUCTION

This discussion document outlines the background and evolution of the diesel refund system, its objectives, administration, limitations and policy proposals for the design of a new administrative system to address current shortcomings. The aim of the document is to elicit public comment and inputs from stakeholders to assist with reforming the diesel refund administrative system whilst broadly maintaining the policy intent.

The proposal to review the diesel refund system and its administration emanates from the announcements in the 2015 Budget review:

The diesel refund system allows for a refund of all or part of the fuel levies to producers in the agriculture, forestry, fishing and mining sectors. The administrative system in place since 2000 faces significant technical problems and legal challenges. Some eligible firms are unable to benefit from the system, while others appear to be making disproportionate refund claims. To address these concerns, government proposes to delink diesel refunds from the VAT system from 1 April 2016. The National Treasury and SARS will explore alternative, more equitable rules and administrative procedures after consultation with the affected industries.

Government also proposes to reduce diesel fuel levy refunds to 20 per cent and 50 per cent of the general fuel levy respectively for on-land mining activities and generation of electricity by Eskom's open-cycle gas turbines. The current full exemption provides a perverse incentive to use diesel excessively. This change will become effective from 1 April 2016.

In the interim, government proposes several technical amendments to this system. The diesel refund system's implementation has experienced technical and administrative challenges. The system's administration will be comprehensively reviewed. While the review is under way, steps will be undertaken to deal with some of the immediate challenges. This includes, among others, disputes over refunds for subcontracting in the mining sector through cession mining licences in terms of the Mineral and Petroleum Resources Development Act (2002). In the farming sector, attention will be given to the rules of sugarcane contract farming and issues related to small-scale sugarcane growers. The review also aims to clarify record-keeping requirements that apply to diesel deliveries to claimants' premises and the approval of diesel tanks on these premises.¹

2. OVERVIEW OF THE DIESEL REFUND SYSTEM

Diesel forms an important source of energy and input cost in primary production and offshore economic activities. The demand for diesel by these sectors is relatively inelastic. Given the nature of international competition in the context of commodity prices and the fact that producers in the primary sector tend to be price takers, there has historically been a need to cushion primary production sectors (agriculture, forestry, fisheries, mining) through a full or partial relief from diesel fuel taxes. At the time of implementation in Budget 2000, the rationale for the diesel refund was firstly, the protection of international competitiveness; and secondly, the reduction of the road-related tax burden for certain non-road users from the Road Accident Fund (RAF) levy.

¹ National Treasury, Budget Review 2015, p.51-52; 149-150

Local primary producers are largely price takers that have to sell their commodities at prices set internationally. The argument for relief to these sectors for competitive reasons is premised on the fact that similar relief is provided by other countries. Similar fuel tax subsidies are available in major competing countries (for example Australia, New Zealand, and the United Kingdom).

Other considerations for the relief include equity reasons to refund some off-road and goods transport (non-passenger) operations for the RAF levy from which they do not benefit. As an insurance mechanism for road users, the RAF provides compulsory social insurance cover as well as rehabilitation and compensation for loss or damage resulting from motor vehicle accidents.

The tax relief has been extended to various sectors as the scheme has evolved over time. This is illustrated in Box 1 below.

Box 1: A Chronology of the Diesel Refund Scheme

Prior to July 1987 a multi-tiered pricing system existed for diesel fuel. Road users paid the fuel tax whilst non-road users paid varying rebated duty wholesale price at time of purchase. The rationalisation of the fuel taxation in July 1987 replaced the rebate structure with the refund system; however it led to administrative complexities and the abuse of the system. Subsequent fiscal policy phased out the rebates over time.

The rebate on coastal shipping use was scrapped in 1988 and in 1991 the remaining rebates were withdrawn for all sectors except agriculture, forestry and domestic fishing industry. In April 1997, the rebates on agriculture, forestry and domestic fishing were also withdrawn. The rebate system was abolished mainly due to abuse by the beneficiaries and the costs and inadequacies of its administration.

Phased re-introduction of the diesel refund system

In 2000, the diesel refund system was re-introduced in a phased approach. It was argued that taxation on diesel fuel in South Africa negatively impacted some fuel-intensive primary production industries; they were downsizing resulting in loss of employment and of foreign exchange earnings which necessitated the restructuring of the diesel refund system to allow for some redress.

Coastal shipping and fishing

- From June 2000, coastal shipping and fishing industries were exempted entirely from the fuel levy (FL) and the RAF levy. The motivation for the relief for coastal shipping and fishing were respectively:

The total burden to the coastal shipping industry of the diesel fuel imposts is equal to 22 per cent of its vessel operating costs...Foreign shipping lines that call at South African ports en route to their ultimate destinations often bid for inter-port cargo between South African ports. These foreign vessels therefore compete directly with the dedicated South African coastal trading ships, but purchase their diesel free of the South African imposts. They are thereby granted a decisive competitive price advantage over the local shipping industry.²

The fishing industry is the most intensive user of diesel fuel...The contribution of fuel levies to total production costs in the fishing sector ranges up to 21 per cent. This cannot be recovered from international markets due to fierce competition and resulted in the suspension of certain fishing activities. Most other major fishing countries do not require their domestic fishing industries to bear the cost of any fuel levy or similar tax on the consumption of fuel for

² National Treasury, Budget Review 2000, pp.96,97

*their vessels. Foreign-flagged vessels, fishing South African resources, using South African ports and targeting the same markets, operate in a fuel tax free environment.*³

Agriculture, forestry and onshore mining

- From July 2001, the agriculture, forestry and onshore mining sectors received a concession in respect of 80 per cent of their eligible diesel fuel purchases. Eligible purchases are used for qualifying activities, whilst non-eligible purchases are used for non-qualifying activities (including private use, non-qualifying transport). The 20 per cent reduction was premised on fiscal affordability. The relief is pegged at 40 per cent of the FL and 100 per cent of the RAF levy. The motivation for the inclusion of agriculture, forestry and onshore mining were because:

*Liquid fuels are a primary source of energy in the primary production sector. In agriculture, forestry and mining it is estimated that almost 80 per cent of energy consumption is diesel-based. Since the ability to use alternative energy sources, such as electricity, is constrained by the nature of the production processes, demand for diesel is relatively inelastic and its cost affects the competitive position of these industries.*⁴

Offshore activities, harbour vessels and rail freight

- From April 2002, the full diesel fuel concession was extended to offshore vessels conducting research in support of the marine industry, coastal patrol vessels and a vessel that is employed to service fibre optic telecommunication cables along the coastlines of Southern Africa. Further, offshore mining and the National Sea Rescue Institute (NSRI) also received the full concession of 100 per cent of the FL and RAF. In addition, rail freight, harbour vessels operated by Portnet and in-port bunker barge operators were refunded the RAF levy for equity reasons. The motivation for the inclusion of offshore activities, harbour vessels and rail freight were because:

*...Offshore mining...operate(s) under similar conditions as these sectors and it is therefore proposed to extend the...diesel fuel concession to these taxpayers. Spoornet and other rail freight hauliers rely on diesel. As the rail freight sector competes directly against its road counterparts, the payment of road-related fuel levies (i.e. the RAF levy) implies an indirect subsidy to its competitors.*⁵

Electricity generation plants

- From 2006, a full refund of the FL and the RAF levy was extended to diesel peak power electricity generation plants with a capacity of more than 200 MW, in response to capacity constraints in electricity generation. The motivation for the inclusion of peak power generation plants was:

*In response to capacity constraints in electricity generation, four diesel-powered electricity generation plants are planned. Eskom will build two plants, and two independent power producers will build the others. Diesel power plants with a capacity of more than 200 MW will receive a full (diesel) refund...*⁶

Diesel refunds are claimed based on the type of usage the diesel is put to including primary producers (on land), offshore activities (commercial fishing, coasting vessels, offshore mining, NSRI vessels, vessels conducting research in support of marine industry, coastal patrol vessels, vessels servicing fibre optic telecommunications cables), harbour vessels, rail freight and peak power electricity generation plants (with a capacity of more than 200 MW). Primary producers on land (farming, forestry and mining) qualify for a refund amounting to 100 per cent of the RAF levy and 40 per cent of the FL in respect of 80 per cent of their eligible diesel fuel purchases. Rail freight (not passenger rail) and harbour vessels are refunded the RAF levy only. Full refunds of both the FL and

³ National Treasury, Budget Review 2000, p.96

⁴ National Treasury, Budget Review 2001, p.86

⁵ National Treasury, Budget Review 2001, p.86

⁶ National Treasury, Budget Review 2006, p.81

RAF levy apply to offshore activities and peak power electricity generation plants, although the FL refund for electricity generation has been reduced to 50 per cent since 1 April 2016⁷. Box 2 below shows how the refund rates for different sectors have changed over time.

Box 2: Diesel refund rates over time

- The fishing and coastal shipping (maritime) sectors have received a full refund of the FL and RAF levies since 1 June 2000.
- The agriculture, forestry and on land mining sectors have received a refund of 31.6 per cent of the FL from 4 July 2001, increased to 38.8 per cent from 7 April 2004 and to 40 per cent from 6 April 2005. In addition the sector also received 100% RAF levy refund. This refund is on qualifying diesel consumption that constitutes 80 per cent of eligible diesel purchases. This means an effective refund rate historically of 25.28 per cent and 31.04 per cent and currently 32 per cent of the FL and effective refund rate of 80% of the RAF levy.
- The offshore mining sector has received a full refund of the FL and RAF since 4 July 2001.
- The National Sea Rescue Institute (NSRI) has received a full refund of the FL and RAF levy since 4 July 2001.
- Offshore vessels that conduct research in support of the marine industry, coastal patrol vessels and vessels employed to service fibre optic telecommunication cables along the coastlines of Southern Africa have received a full refund of the FL and RAF levy since 3 April 2002.
- The Eskom electricity generation plants of Ankerlig and Gourikwa have received a full refund of the FL and RAF levy since 5 April 2006 for its open cycle gas turbine operations. Since 1 April 2016, the rate of refunds for peak electricity generation plants has been reduced to 50 per cent of the FL and 100 per cent of the RAF levy so as not to create a perverse incentive for excessive diesel use in electricity generation. Two private sector peak power plants will also be included in the diesel refund provisions as qualifying electricity generators.
- The rail freight sector has received a full refund of the RAF levy since 4 July 2001.
- Harbour vessels operated by Portnet and vessels used by in-port bunker barge operators have received a full refund of the RAF levy since 3 April 2002.
- Currently, the FL and RAF levy on diesel are 270 cents/ litre and 154 cents/ litre respectively. The primary producer on-land diesel refund amounts to 262 cents/ litre (40% of FL + 100% of RAF levy) on 80% of the total eligible diesel purchases. Offshore activities qualify for 424 cents/ litre (100% FL + 100% RAF levy), electricity generation plants qualify for 289 cents/ litre (50% FL + 100% RAF levy) and rail freight and harbour services 154 cents/ litre (100% RAF levy). The Customs and Excise Act, 1964, provides for biodiesel or a mixture of distillate fuel and biodiesel to be eligible for the refund and the rate of the refund is calculated at the rate of duty applicable to biodiesel; i.e. 135 cents/ litre (50% of the mineral

In addition to the increase in the diesel refund rates in the past, there has been a substantial increase in the diesel refund claims recently. This sharp increase in diesel refunds claimed in recent years poses a risk to the fiscus and to the net revenue shares for metros, about 23 per cent of the FL

⁷ In the 2006 Budget Review, it was envisaged that Eskom would build two peaking power plants and two independent power producers will build the other two peaking plants, however there was a delay in the procurement of the power generation from the two independent power plants. As a result, when Schedule 6 Part 3 of the Customs and Excise Act, 1964 was updated to include the peaking plants for electricity generation, only the Eskom built open-cycle gas turbines (OCGTs) plants, namely, Ankerlig and Gourikwa were added to the schedule. However, on 3 June 2013, the Department of Energy (DoE)'s independent power producers (IPP) Office procured peaking energy through private IPP generators namely Avon and Dedisa in line with the 2006 policy intent. The Dedisa plant started commissioning in June 2015 and commercial operation in September 2015 whilst Avon is expected to start operation in early September 2016. These private IPPs will also be added to the schedule as eligible electricity generation plants for peaking power.

revenue is shared with the metros after the abolishment of the RSC levies. Figure 1 below shows the diesel refunds in South Africa from 2010/11 to 2015/16 financial years.

Figure 1: Diesel Refund Claims (2010/11 to 2015/16)

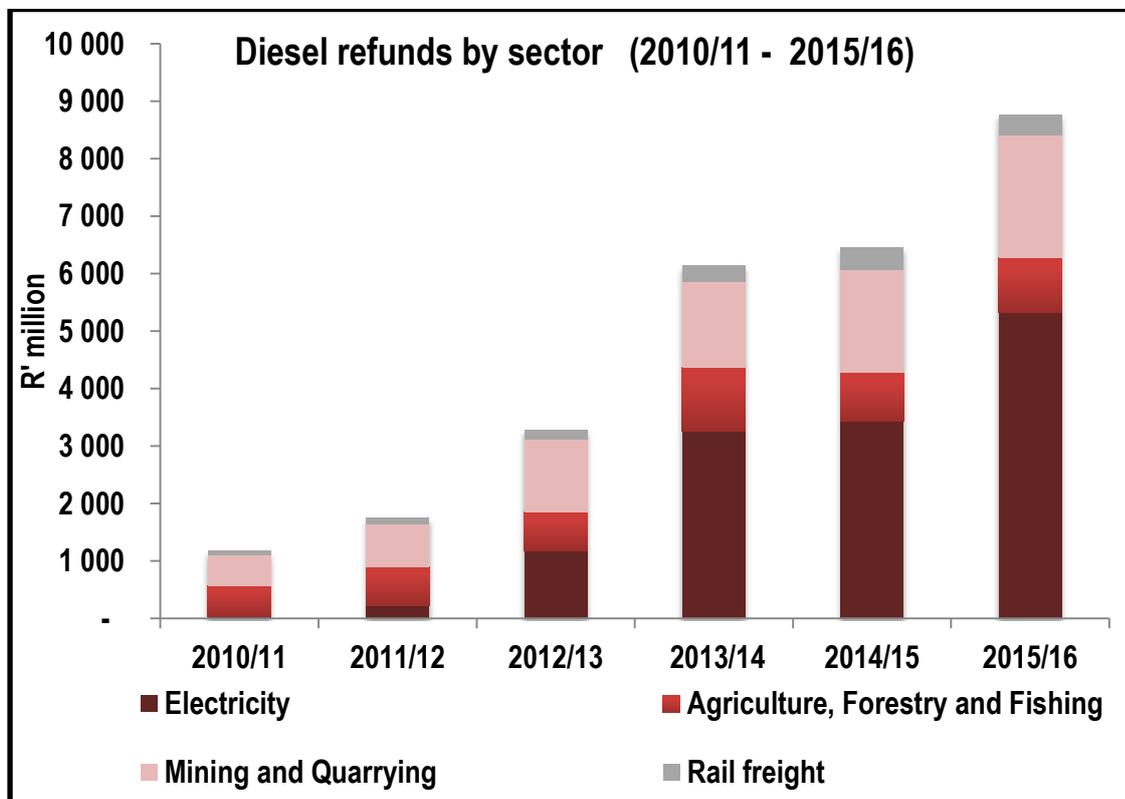


Table 1: Percentage share of diesel refunds by sector

Diesel refunds: % Share	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Electricity	3%	13%	36%	53%	53%	60%
Agriculture, Forestry and Fishing	46%	39%	20%	18%	13%	11%
Mining and Quarrying	45%	42%	38%	24%	28%	24%
Rail freight	6%	6%	5%	5%	6%	4%
Other	0%	0%	0%	0%	0%	1%
Total Refunds	100%	100%	100%	100%	100%	100%

Source: SARS data

Diesel refunds to the value of R8 815 million were claimed in 2015/16, compared to R6 478 million in the 2014/15 fiscal year, a 36 per cent increase. This is mainly due to the disproportionate increase in refunds to the electricity sector. The original policy intent was to provide relief to peak power electricity generation (for peak demand) only. However, these Open Cycle Gas Turbine (OCGT)

power stations have been operated (using diesel) more intensely to supplement electricity supply to meet demand due to operational challenges faced by Eskom. The disproportionate increase in the refunds by the electricity sector is also an indication of the perverse incentive of the 100 per cent relief for the peak power plants.

3. FUEL TAXES AND INEFFICIENT FOSSIL FUEL SUBSIDIES

The current fuel tax regime in South Africa applies to petrol, diesel and biodiesel based on volume (per litre) to help achieve various policy objectives. Petrol, diesel and biodiesel are classified as fuel levy goods and zero-rated for value added tax (VAT) purposes. The current fuel taxes imposed include the fuel levy (FL), the Road Accident Fund (RAF) levy, a very small impost to fund the marking of paraffin (to limit the mixing of diesel and illuminating paraffin) and a relatively modest excise duty that is included in the Southern African Customs Union (SACU) revenue pool.

It should be noted that fuel taxes in South Africa are not road taxes. They are imposed as both a revenue raising instrument (for general revenue and to compensate victims of vehicle accidents) and as a means to address some of the negative externalities associated with fossil fuel and vehicle usage. The main negative environmental externality associated with fuel combustion is local air pollution and the social costs associated with road use include congestion, noise, and injuries and deaths as a result of road accidents. Work is underway to add an explicit greenhouse gas emissions element to the fuel tax regime to help address concerns about climate change.

3.1 Climate change and the proposed carbon tax

According to the 2010 National Greenhouse Gas Inventory, non-stationary emissions from the road transport sector accounted for around 47 million tonnes of GHG emissions and about 8 per cent of total GHG emissions in South Africa. Government has proposed the carbon tax policy as a key mitigation instrument in South Africa's broader climate change policy response to internalise the negative externality costs of GHG emissions and take into account the social costs resulting from carbon emissions.

The introduction of a carbon price will change the relative prices of goods and services, making emission-intensive goods more expensive relative to those that are less emissions-intensive. A carbon tax seeks to level the playing field between carbon intensive (fossil fuel based firms) and low carbon emitting sectors (renewable energy and energy efficient technologies) and provides an incentive for consumers and businesses to adjust their behaviour, resulting in a reduction of emissions.

GHG emissions arising from liquid fuels will be covered by the carbon tax regime and incorporated into the current fuel tax regime as an add-on. The proposed carbon tax will result in a higher effective tax on diesel than on petrol due to the higher carbon intensity of diesel fuel relative to petrol. The proposed explicit additional GHG emissions (or CO₂ related) tax on diesel will not be allowed as a refund under the diesel fuel tax refund system.

3.2 Diesel refunds – an inefficient fossil fuel subsidy?

Since 2009, there have been concerted global efforts to raise awareness on the magnitude and incidence of inefficient fossil fuel subsidies (IFFS) by the Organisation for Economic Cooperation and Development (OECD), G20, the International Monetary Fund (IMF), the World Bank, and the International Energy Agency (IEA). In September 2009, the G20 leaders committed to *“rationalise and phase out over the medium term inefficient fossil fuel subsidies that encourage wasteful consumption”*⁸.

Fossil fuel subsidies are defined as *“any government action that lowers the cost of energy production, raises the revenues of energy producers or lowers the price paid by energy consumers”*⁹. Accordingly, IFFS tend to *“...encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change”*¹⁰. The OECD (2015) report suggests that *besides putting a strain on fiscal resources, deadweight loss, discouraging investment in energy-efficient technologies by businesses, households and governments which can lock-in energy-intensive investments, IFFS also tend to aggravate local pollution problems which damage health and the environment*¹¹.

Support for primary sectors comes in different forms as measures to redistribute income to industries and populations that could potentially be hurt by international competition¹². In a recent survey on fossil fuels support, combined, the many measures in the OECD Inventory are estimated to be in the order of \$160 – 200 billion annually in the 2010 – 2014 period with most of the support going to consumption of refined petroleum products¹³. The IEA estimates that global subsidies to consumers stood at US\$543 billion in 2013¹⁴ more than four times the amount allocated globally for renewables and the latest estimate from the IMF is that post-tax energy subsidies (consumer prices below supply costs plus efficient levels of taxation) will be at a cost of \$5.3 trillion in 2015¹⁵.

Firmer timeline proposals to implement the commitments made in the G20 forum were discussed in a November 2015 session of the meetings ahead of the 2015 United Nations Framework Convention on Climate Change (UNFCCC)’s Conference of Parties (COP21) in Paris. Thus, internationally, there is a call for the phasing out of IFFS as they could prejudice investment in other strategic sectors and

⁸ Source: http://www.worldenergyoutlook.org/media/weowebiste/energysubsidies/second_joint_report.pdf

⁹ Ibid

¹⁰ Source: http://www.worldenergyoutlook.org/media/weowebiste/energysubsidies/second_joint_report.pdf

¹¹ Source: OECD (2015), *OECD Companion to the Inventory of Support Measures for Fossil Fuels 2015*, OECD Publishing, Paris. Available at: <http://dx.doi.org/10.1787/9789264239616-en>

¹² Cheon, A., J. Urpelainen and M. Lackner (2013). Why do governments subsidize gasoline consumption? An empirical analysis of global gasoline prices, 2002-2009. *Energy Policy* 56 (2013) 382-90.

¹³ Source: OECD (2015), *Measuring and reforming support for fossil fuels 2015*, Trade and Agriculture Directorate. Available at: <http://www.oecd.org/tad/envtrade/fossil-fuel-support-inventory-september-2015.pdf>

¹⁴ International Energy Agency. (2014). *World energy outlook 2014*. Available: <http://www.worldenergyoutlook.org/publications/weo-2014/>

¹⁵ International Monetary Fund (2015). *How Large Are Global Energy Subsidies?* Available: <http://www.imf.org/external/pubs/ft/wp/2015/wp15105.pdf>

due to their contribution to GHG emissions. IFFS could act as a negative fuel tax; they work as a negative price on carbon¹⁶.

The results from other countries indicate that there is no “one size fits all” solution to reforming IFFS. Somewhat *“The right policy approach for each country must take account of local market conditions, the structure of the energy sector, patterns of energy use, institutional characteristics, and changing circumstances”*¹⁷ as well as changing global conditions when devising ways to transition from subsidised to competitive global markets.

It is also argued that although a strong case for the reform of consumption fossil fuel subsidies exist since they would contribute towards environmental, economic, and budgetary performance improvement, this should not be done in a way that adversely affects the real income of the poor or access to essential services. Rather, successful reforms have shown that support should be well-targeted and transparent as part of a package if broader structural reforms have been implemented¹⁸.

In terms of Article 25 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) rules of the WTO, countries that lodge complaints about subsidies *“...must prove that a subsidy suppresses prices for the subsidized commodity or that it permits the subsidizing country to gain a greater market share”* The SCM Agreement only restricts subsidies that are either considered to be inherently trade distorting or that are shown to have “adverse effects” on other WTO members¹⁹. It would appear that the WTO’s SCM Agreement would not be as effective in restraining IFFS due to the varied nature of the relief different countries employ in supporting their primary production sectors. A comparison of diesel fuel concessions in different countries is not always practical because there is no clear benchmark due to differing tax rates for different fuel types and uses²⁰.

However, the diesel refunds in South Africa could potentially be viewed as an IFFS as it lowers the diesel input costs of primary producers thus encouraging higher levels of diesel consumption and, in some instances, inefficiencies resulting in negative environmental impacts. A review of similar concessions for primary producers in other countries might trigger the need for a more fundamental re-look at the diesel refund / subsidy system in future. It should be noted that the scope of the current review is limited to streamlining the administration of the system, ensuring fair access, and minimising any potential abuse and perverse incentives.

4. CURRENT DIESEL REFUND ADMINISTRATION

As discussed earlier, the diesel refund system consists of two separate components:

¹⁶ Fossil-Fuel Subsidies and Climate Change: Options for policy-makers within their Intended Nationally Determined Contributions Available: <http://norden.diva-portal.org/smash/get/diva2:786861/FULLTEXT02.pdf>

¹⁷ UNEP (2008). Reforming Energy Subsidies: Opportunities to Contribute to the Climate Change Agenda. Available: http://www.unep.org/pdf/pressreleases/reforming_energy_subsidies.pdf

¹⁸ McLure Jr., C.E. (2013). Reforming Subsidies for Fossil Fuel Consumption: Killing Several Birds with One Stone. International Center for Public Policy, Georgia State University, Working Paper 13-12.

¹⁹ WTO, Agreement on Subsidies and Countervailing Measures, available at http://www.wto.org/english/docs_e/legal_e/24-scm.pdf.

²⁰ Martini, R. (2012), “Fuel tax concessions in the fisheries sector”, OECD Food, Agriculture and Fisheries Papers, No. 56, OECD Publishing. Available: <http://dx.doi.org/10.1787/5k9bdccqft30-en>

- A refund in respect of the FL which aims to improve the international competitive position of beneficiaries and therefore benefits mainly primary production and offshore economic activities; and
- A refund of the RAF levy for equity reasons to refund some non-road and goods transport operations (i.e. rail freight) from contributions to the RAF (motor vehicle accident insurance scheme) from which there can be no benefits claimed.

4.1 Legislative framework

Administration of the diesel refund system is done through both the the Customs and Excise Act, 1964, (C&E Act) and the Value-Added Tax (VAT) Act, No. 89 of 1991 (VAT Act).

The C&E Act authorises the refunds of the FL and the RAF levy imposed by this legislation. Part 3 of Schedule No. 6 of the C&E Act regulates the administration of the diesel refund system by SARS, while actual claims and refunds are administered through the VAT system. Part 3 of Schedule No.6 of the C&E Act defines a potential diesel refund beneficiary as a “user”, which means a person registered for VAT purposes under the VAT Act, and for diesel refund purposes under the C&E Act. The C&E Act provides for biodiesel to qualify for the same concessions as mineral diesel in terms of the diesel refund system.

For the purpose of claiming the refund, a claimant needs to determine the amount of the eligible purchases, in terms of the schedule to the C&E Act. The diesel refund provisions further define a qualifying user before ultimately outlining those specific activities in respect of which refunds may be claimed by such a qualifying user.

4.2 Enforcement and compliance

Qualifying diesel refund users have their claims and payments processed through the VAT system and set off against their VAT liability payable to SARS. The diesel refund system is therefore enforced by SARS’ excise compliance division assisted by the VAT audit section. In some instances the primary focus of historical audits was on VAT compliance with the verification of diesel refund compliance taking secondary place. However, widespread problems around logbook compliance, fishing permits and mining rights, contracting and joint ventures led over time to more focused diesel refund enforcement drives.

Concerted efforts have been made to address these problem areas, educate qualifying users and thereby improve taxpayer compliance. However, these complexities have proved to be inherent in the current design of the diesel refund system that is more based on the principle of a qualifying user rather than qualifying activities.

4.3 Based on qualifying users

The administration of the diesel refund is based on the principle of qualifying users. The compliance requirements for beneficiaries depend on the keeping of accurate logbook information of diesel storage and usage to determine the diesel volumes eligible for inclusion in the determination of refunds. Only qualifying users may claim refunds in respect of such eligible diesel purchases that were used in own primary production and adequately substantiated by logbook information. However, the diesel refund system imposes a further condition on fishing and mining users that requires beneficiaries from these sectors to also possess fishing permits or mining rights authorising their commercial activities.

Only users that are in possession of a valid commercial fishing permit in terms of the Marine Living Resources Act, 1998 (MLRA), or a mining right in terms of the Mineral and Petroleum Resources Development Act, 2002 (MPRDA), may claim diesel refunds in these primary sectors. Commercial fishing vessels that are nominated on a fishing permit or mining operators who have been ceded mining rights in terms of the aforementioned legislation may also qualify for diesel refunds. This additional obligation is an expedient way to identify legitimate commercial fishing and mining activities. No such requirement exists for farming and forestry beneficiaries, as no similar regulatory frameworks govern those industries.

5. KEY CHALLENGES WITH THE ADMINISTRATION SYSTEM

Several technical challenges have been encountered in implementing and administering the diesel refund system in South Africa. This review aims to address these concerns and to ensure that the principles of the system are maintained and the original policy intent is achieved. Table 2 below highlights some of the concerns raised by the primary producers (i.e. mining, farming and forestry sectors), National Treasury and SARS on the current system:

Table 2: Summary of Key Sector Concerns

Sector	Key Issues
Mining	<ul style="list-style-type: none"> refunds for ceded mining rights , and different forms of contracting; allowing operational mining rehabilitation to be an eligible activity; definition of quarrying; addressing the disproportionate benefit of refunds by the sector
Farming sector	<ul style="list-style-type: none"> refunds for contract farming in sugarcane farming and withdrawal of diesel refunds for small-scale sugarcane growers not registered as VAT vendors
Electricity	<ul style="list-style-type: none"> disproportionate increase in diesel refunds claimed by the sector
Forestry, farming and mining sectors	<ul style="list-style-type: none"> the level of refunds of the transport component for transportation that occurs on public roads (on-road)

In addition, over the past 15 years, the administration and enforcement of the current diesel refund system have identified several problematic areas in need of reform. The main concerns can be grouped thematically as:

- the shared VAT administration;
- logbook compliance;
- authorisation of primary production and
- outsourcing of operations.

5.1 Shared VAT administration

The administration of the diesel refund concession through the VAT system means that beneficiaries must register for both diesel refund and VAT purposes to qualify for the diesel refund system. Those intended diesel refund beneficiaries that do not register for VAT are by implication also inadvertently excluded from the diesel refund scheme, as their refund claims cannot be processed through the VAT system.

This unintended exclusion has especially impacted negatively on small and emerging primary producers who might lack the capacity to meet the VAT compliance requirements for voluntary VAT registration. More recently this problem has also been experienced by some taxpayers like joint ventures that share production output between members without making taxable supplies, which may not register for VAT and therefore cannot access the diesel refund.

5.2 Logbook compliance

The administration of the diesel refund system and the compliance by beneficiaries hinge on the keeping of accurate logbook information of diesel storage and use to determine the diesel volumes that would be eligible for inclusion in the determination of diesel refunds. The legal requirements for logbooks have been clear since the inception of the diesel refund scheme in 2000 and the onus is on diesel refund beneficiaries to ensure that they are compliant with logbook obligations. Nonetheless, it has been common practice for many beneficiaries, particularly in agriculture, forestry and mining, to have claimed refunds without the detailed logbook verification required by law.

Many agriculture, forestry and mining beneficiaries are apparently confused by the prescribed method of calculating diesel refunds. Eligible diesel purchases must first be distinguished from total diesel purchases through logbook verification. The eligible diesel use is then reduced by 20 per cent to arrive at the qualifying volumes for which diesel refunds may be claimed. Some claimants mistakenly believe that their non-eligible diesel use is reflected in the 20 per cent reduction and therefore do not keep the required logbook verification. As the diesel refund is administered through the VAT system, affected taxpayers also argue that their past clean VAT audits imply that SARS had condoned their historical diesel refund claims and practices in this regard.

5.3 Authorisation of primary production

In terms of the current diesel refund provisions, fishing or mining operations may only qualify for diesel refunds if carried on for own primary production by a commercial fishing vessel or person whose primary production is authorised through the necessary fishing permit or mining right in terms of the MLRA or MPRDA. SARS applies this requirement to mean the vessel nominated on the fishing permit or the holder / cessionary of the mining right in terms of this regulatory legal framework. However, there has been widespread non-compliance in this regard with many enterprises interpreting the requirement as access to a fishing permit or mining right.

Qualifying fishing and mining operations that fall within the intended scope of the diesel refund system have therefore in some instances been denied refunds where the necessary authorisation was outsourced to contractors, pooled in joint venture partnerships, or delayed by the Department of Agriculture, Forestry and Fisheries (DAFF) or the Department of Mineral Resources (DMR). The fact that the agriculture and forestry sectors are not similarly regulated means that, by contrast, a diesel refund user that operates a farming or forestry enterprise can potentially access the diesel refund without requiring authorisation or even necessarily owning the farm or plantation.

While it is important that only legal fishing and mining operations qualify for diesel refunds, the restriction of refunds to only the holder, nominee or cessionary of the required authorisation has been criticised as unfair especially for emerging primary producers.

5.4 Outsourcing of primary production

Primary producers in most of the agriculture, forestry, fishing and mining industries regularly outsource a range of operational activities. This is particularly true for smaller producers and new entrants who lack the necessary funding or experience. Attempts to create economies of scale by the pooling of resources between operators and the sharing of commercial expertise between established producers and new entrants are essential for the success of smaller and emerging enterprises.

The diesel refund treatment of such outsourced primary production is arguably the most contentious aspect of the design of the current system. This is particularly true of outsourcing arrangements in the fishing and mining sectors that may only qualify for diesel refunds subject to the added requirement of authorisation of production through a valid fishing permit or mining right.

These outsourcing arrangements commonly take the form of either contracting or joint venture partnerships. The diesel refund treatment of each is summarised below:

5.4.1 Contracting

Primary producers that utilise contractors generally outsource only certain aspects of their operations and remain in control of overall production themselves. Contracting arrangements are typically based on service level agreements whereby the contractor charges fees for distinct and limited services rendered, while the financial risk and legal obligations of the enterprise remains wholly the responsibility of the primary producer.

The diesel refund rules for contracting are clear in that refunds may only be claimed in instances where the primary producer provides the diesel to the contractor (dry contracting), while any diesel that is obtained by the contractor itself (wet contracting) is disallowed. Only the primary producer may therefore claim diesel refunds and only for dry contracting. In the case of fishing and mining, the primary producer also needs a valid fishing permit or mining right to qualify for diesel refunds before this dry contracting rule is applied.

5.4.2 Joint ventures

Joint ventures in primary production are different from contractors in that the partnership is inseparable from the primary producer, has no limitations on shared rights and responsibilities and performs whole-scale primary production. Joint ventures in this context are contractual partnerships where primary production operations are rendered in exchange for sharing in output or profits. Joint ventures are therefore allowed to register and are treated as vendors under the VAT Act. The exception is joint ventures that share their output between members without making taxable supplies, which are unable to register for VAT. Joint ventures are also recognised as partnerships for purposes of the Income Tax Act, 1962, which taxes each individual member in his / her own right, similar to any other partnership.

The diesel refund provisions in the C&E Act do not reflect a comparable tax treatment. Joint ventures are not recognised as legal entities under the C&E Act and therefore cannot register for the diesel refund system to qualify as diesel refund users. However, joint ventures may elect a member to register for diesel refund purposes in his or her personal capacity in order to access the diesel refund benefit for the enterprise. This has been particularly the case in agriculture and forestry joint ventures that are not subject to the further legal authorisation requirements of the fishing and mining sectors.

By contrast, fishing and mining joint ventures cannot qualify for diesel refunds, as the required fishing permit or mining right would be in the name of one of the partners and not the joint venture. As a result, joint venture fishing or mining activities are not carried on by the holder, nominee or cessionary of the authorisation are disqualified from the diesel refund system on technical grounds. The exclusion of joint ventures in fishing and mining, while identical joint ventures in farming and forestry may potentially qualify might be viewed as inconsistent and does not take cognisance of the reality that production is often outsourced in all of these primary sectors.

6. PROPOSALS FOR REFORM

The shortcomings of the current diesel refund system arise from the current design of the concession that is founded on the principle of a qualifying user underpinned by a shared VAT administration. As the limitations of the present system are integral to the current design, it is recommended that the diesel refund system and administration be overhauled according to the proposals outlined below.

The qualifying diesel allowed for RAF levy refunds in primary production is identical to that used for FL refund claims and the reform proposals would therefore apply similarly. Diesel refunds for non-primary production (for example rail freight, harbour vessels, offshore activities and electricity generation plants) have not proven problematic and are therefore not specifically discussed.

6.1 Interim diesel refund amendments

The technical and administrative challenges of the current diesel refund system necessitate a systematic review to address the concerns highlighted above as announced in Budget 2014:

Government proposes to review the diesel refund policy and administration system. Refunds in the electricity sector have grown more than anticipated, reducing net fuel tax revenues available to be shared between metropolitan municipalities. Amendments will also address equity issues, ensuring that some sectors do not benefit disproportionately from the system.²¹

Whilst the holistic review is under way, interim amendments were necessary ahead of the longer term reforms to address outstanding assessments, disputed cases and pending litigation. Since then, these interim measures have been finalised and the required amendments to the current diesel refund provisions are being effected. This includes qualification for refunds by cessionaries of mining rights, small-scale farmers in sugarcane production, operational mining rehabilitation and reducing the FL benefit rate to 50 per cent for peak electricity generation plants.

6.2 Separate diesel refund administration

In Budget 2015, government announced that *to address these concerns, government proposes to delink diesel refunds from the VAT system from 1 April 2016.*²² To give effect to this announcement, a standalone diesel refund administration is being proposed separate from the VAT system. The limitations around intended beneficiaries that cannot claim diesel refunds due to not being VAT registered will therefore fall away. This might also necessitate the setting of a suitable diesel refund threshold for administrative ease below which taxpayers may not be able to claim, which could vary by sector to accommodate differing scope and scale of primary production activities.

²¹ National Treasury, Budget Review 2014, p.55

²² National Treasury, Budget Review 2015, p.51

The implementation of the new standalone diesel refund administration will have to be phased in to ease the compliance burden on beneficiaries and administrative burden on SARS. Current diesel refund registrations will initially be confirmed, but all beneficiaries will be required over time to register anew. Criteria will be set for new and re-registration to create client-specific diesel refund profiles that must reflect the necessary information to corroborate claims. Diesel refund audits will be risk-based underpinned by the up-to-date information contained in these client-specific profiles.

6.3 Qualifying primary production activities and use

The systemic problems confronting the current administration of the diesel refund system are due to the emphasis on eligible diesel purchases by qualifying users, rather than those primary production activities and use that the concession aims to assist. As the primary objective of the diesel refund is to protect the competitiveness of domestic primary producers, the focus of the diesel refund administration should be on those qualifying primary production activities and use that government intends to support.

It is proposed that the basis of the diesel refund administration be shifted to qualifying primary production activities and away from the current emphasis on allowed users to better achieve this overarching objective and simultaneously resolve the identified shortcomings. The type and nature of qualifying activities and use necessary for such primary production is provided in an indicative list in Annexure 1 and this will be finalised through the public comment process. The technical detail of the type and nature of allowed activities and use, together with the vehicles and equipment used therein will also be determined through stakeholder engagements between the National Treasury, SARS and representative industry associations within each sector. The indicative list in Annexure 1 is provisional and based on the current allowed activities solely for purposes of eliciting comments and inputs ahead of these National Treasury and SARS engagements with industry.

The delineation of activities will be limited to purely primary production as such. All transport activities beyond the site where qualifying primary production occurs and any processing activities whatsoever will be excluded. Ideally, only activities necessary for primary production up to the harvesting of crops, plantations, fish and animals, and the winning of minerals should qualify. All off-site transport activities, inclusive of inputs to the primary production site or outputs to markets, and any processing, whether on site or elsewhere, will be excluded.

Qualifying primary production activities would have to be linked to a physical site where such operations will take place and these activities must be legally sanctioned by a valid fishing permit or mining right where applicable. In the case of fishing, the physical site is the commercial fishing vessel nominated on a valid fishing permit and for mining it is the physical mining site specified on a valid mining right. Persons that conduct qualifying primary production activities could claim refunds for diesel used therein, provided proper logbook keeping is linked to the physical site where such qualifying primary production takes place and to the legal sanction where required.

Claims will only be allowed in respect of diesel used in qualifying primary production activities and the current 80:20 percentage allocation to determine qualifying refunds in farming, forestry and mining on land will therefore fall away.

As the shift is away from the current qualifying user to focus on qualifying activities instead, all producers, operators, contractors and joint ventures that perform qualifying primary production activities and use could be accommodated. This would necessitate the creation of a suitable diesel refund sectoral registration threshold, below which taxpayers will not be able to claim the refund, for administrative ease. Given the varied nature and scope of activities in the different sectors, a blanket threshold might not be ideal. Therefore, a sector based threshold is recommended. The base of potential diesel refund beneficiaries would significantly expand, but simultaneously the scope of the refund would be curtailed through the exclusion of all off-site transport and any processing activities.

6.4 Administrative enforcement and taxpayer compliance

Audits under the proposed new diesel refund regime will be based on risk profiling of diesel refund beneficiaries, while enforcement will continue to rely on taxpayer compliance with logbook obligations. These are discussed in more detail below:

6.4.1 Diesel refund risk profiling

All applications for registration under the new diesel refund system will require potential beneficiaries to provide details of:

- The type and nature of qualifying primary production activities to be conducted;
- The physical site where such qualifying primary production activities will take place;
- The valid fishing permit or mining right where applicable and details of the holder, nominee or cessionary thereof;
- An asset register of all diesel-powered equipment and vehicles to be used in qualifying primary production with details of the serial / VIN numbers and the diesel consumption specifications thereof;
- A register of all diesel storage facilities linked to the qualifying primary production activities to be conducted and the physical sites thereof; and
- Examples of logbooks and other recordkeeping that will be maintained and updated to verify the abovementioned information.

Diesel refund registrants will be required to enter into an agreement with SARS that inter alia specifies:

- The person who has the management of the business as per section 103 of the C&E Act;
- The specialist as per Rule 59A.10(2) / Rule 60.08(2)(b) of the C&E Act who has sufficient knowledge to ensure compliance; and

- An obligation for registrants to update their profile information and conclude new agreements annually with SARS.

Diesel refunds will only be allowed in respect of claims that are substantiated by the abovementioned information in SARS' database for the beneficiary's current registration profile. Beneficiaries will be expected to update and maintain their diesel refund registration profiles electronically to validate their claims. Claims outside the scope of the beneficiary's current registration profile will be denied and the user may be flagged for audit under SARS' risk-profiling enforcement.

6.4.2 Logbook and recordkeeping obligations

The key to diesel refund enforcement and compliance will remain adequate and accurate logbook keeping of all diesel received, dispensed and applied in qualifying primary production activities, but explicitly linked to the physical site where such qualifying primary production takes place and to a valid fishing permit or mining license where applicable. This will effectively verify allowed claims and prevent duplicate claims.

Two logbook records would be required. Firstly, a logbook to reflect the receiving and dispensing of diesel at each storage facility at every primary production site and, secondly, a logbook that provides a detailed record of the usage by the claimant of the dispensed diesel. The dispensing of diesel is one of the greatest risks in the diesel refund system. The diesel should therefore be delivered to the physical site where the qualifying primary production will take place and independent logbooks should be kept for each storage facility at such sites.

Diesel refunds will only be allowed in respect of diesel dispensed from storage facilities formally on record with SARS to diesel-powered equipment and vehicles also formally on record with SARS. In addition to logbooks, claimants will be obliged to maintain proper service and repair records for such machinery and vehicles to prevent ghost claims.

SARS is in the process of developing logbook templates in consultation with representative organised industry for each beneficiary sector. The new logbook templates will therefore reflect the specific needs and circumstances of each industry. An external policy guide with a matching internal standard operating procedure is simultaneously being developed to guide both taxpayers and SARS auditors in the correct completion and consistent application of the new logbook requirements. The full set of logbook templates and external policy guide will upon finalisation be published on the SARS website for public notification. It should be noted that not all templates and industry engagements have been completed hence a full set of logbooks might not yet be available on the SARS website at the time of publication of this document.

6.4.3 Treatment of small and emerging primary producers

Special treatment will be considered for small and emerging primary producers that fall below the proposed diesel refund sectoral registration threshold. Options such as the collective registration within an industry of beneficiaries who would share claims under a cooperative arrangement could

be considered. As such enterprises may lack the capacity to meet all the logbook and recordkeeping requirements of the proposed new diesel refund dispensation, alternative approaches will be explored to estimate the typical eligible diesel use for these users. Suggestions for alternative approaches for such enterprises will also be considered.

A formula-based methodology could be considered for small and emerging primary producers, such as small-scale growers in the sugarcane and wattle industries. Such an approach is intended to assist small and emerging primary producers without abandoning the full logbook and recordkeeping generally required for diesel refund claims. Logbooks will remain the preferred proof of eligible consumption and, importantly, only logbooks will be accepted as evidence of diesel received, dispensed and applied going forward.

7. CONCLUSIONS

In Budget 2000 it was clearly spelled out that the reintroduction of a diesel fuel tax concession after the widespread abuse of the previous system was on condition that an appropriate administrative regime be developed to minimise the risk of fraud and ensure the affordability of the concession within the broader fiscal framework.

The proposed limitation of diesel refund benefits to primary production activities and use excluding all off-site transport and any processing activities, as well as the stricter registration and enforcement proposals, would significantly curb the potential for abuse, while the extension to contractors and joint ventures would more equitably meet the objective of the concession to protect the international competitiveness of domestic primary production activities.

Government is of the view that the reform proposals outlined in this discussion document for the redesign of the diesel refund system will sufficiently enhance the efficient, effective and equitable administration of the concession to meaningfully improve taxpayer compliance and reduce the risk of unintended revenue losses to the fiscus.

The policy intent of the diesel refund concession is to protect the international competitiveness of the primary production sectors, and exempt certain non-road diesel users from the RAF levy. However, the administration of the diesel refund system and the fiscal cost thereof within government's broader energy and environmental objectives to help the country transition to a low carbon economy need to be considered.

A new diesel refund system should therefore take cognisance of the environmental impact of diesel use, the taxation of transport and international efforts to reduce inefficient fossil fuel subsidies. It is against this broader policy framework that the current diesel refund system will be restructured and simplified into a new dispensation that will ease administration and facilitate taxpayer compliance, while upholding its original policy intent.

ANNEXURE 1: PROVISIONAL INDICATIVE LIST OF ELIGIBLE ACTIVITIES AND USE BY SECTOR

- (A) **MINING ON LAND:** The mining activities which qualify for a refund of levies be carried on by a person who is in possession of the necessary authorisation granted in terms of the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002).
- (iii) Primary production activities in mining include the following:
- (aa) The exploration or prospecting for minerals.
- (bb) The removal of over burden and other activities undertaken in the preparation of site to enable the commencement of mining for minerals.
- (cc) Operations for the recovery of minerals being mining for those minerals including the recovery of salts but not including any post – recovery or post – mining processing of those minerals.
- (dd) Searching for ground water solely for use in a mining operation or the construction or maintenance of facilities for the extraction of such water.
- (ee) The pumping of water solely for use in a mining operation if the pumping occurs at the place where the mining operation is carried on or at a place adjacent to that place.
- (ff) The supply of water solely to the place where the mining operation is carried on, from such a place adjacent to that place.
- (gg) The construction or maintenance of private access roads at the place where the mining operation is carried on.
- (hh) The construction or maintenance of –
- (A) tailings, dams for use in a mining operation;
- (B) dams, or other works, to store or contain water that has been used in, or obtained in the course of carrying on a mining operation.
- (ii) The construction or maintenance of dams, at the place where the mining operation is carried on, for the storage of uncontaminated water for use in a mining operation.
- (kk) The construction or maintenance of buildings, plant or equipment for use in a mining operation.
- (ll) The construction or maintenance of power stations or power lines solely for use in a mining operation.
- (mm) Coal stockpiling for the prevention of the spontaneous combustion or coal as part of primary mining operations
- (nn) The reactivation of carbon for use in the processing of ores containing gold if the reactivation occurs at the place where mining for gold is carried on.

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- (oo) The removal of waste products of a mining operation and the disposal thereof, from the place where the mining operation is on.
- (pp) The transporting by vehicle, locomotive or other equipment on the mining site of ores or other substances containing minerals for processing in operations for recovery of minerals.
- (qq) The service, maintenance or repair of vehicles, plant or equipment by the person who carries on the mining operation solely for use in a mining operation, at the place where the mining operation is carried on.
- (rr) The service, maintenance or repair of transport networks for use in a mining operation, to the extent that the service, maintenance or repair is performed at the place where a mining operation is carried on.
- (ss) Quarrying
- (tt) The following equipment and vehicles are regarded as forming an integral part of the mining process:
 - (A) Agitators
 - (B) Drilling rigs
 - (C) Hammer mills
 - (D) Smelters
 - (E) Tunnelling machines
 - (F) Specially manufactured underground equipment.
 - (G) Front – end loaders
 - (H) Excavators
- (iii) The refund of levies in respect of the mining of sand, stone, rock soil (other than topsoil), clay gravel and limestone applies only if mined from a quarry.

- (B) **FORESTRY:** Refund of levies on purchases of distillate fuel for forestry.
- (i) In accordance the distillate fuel must be purchased and used as fuel for primary production activities in forestry and include the following:
 - (aa) Land preparation:
 - (A) Clearing of land
 - (B) Ploughing, discing, hoeing
 - (C) Making of initial access roads.
 - (bb) Planting of land:
 - (A) Transport of seedling from nursery to plantations.
 - (B) Making of planting pits, line seeding and similar activities.

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- (C) Application of herbicides and fertilisation.
- (D) Follow- up activities replacing dead seedlings with new seedlings (blanking).
- (cc) Maintenance of plantations:
 - (A) Weeding in plantation (manual, chemical, mechanical).
 - (B) Making of fire breaks, including fire control access roads.
 - (C) Pruning of branches.
 - (D) Thinning of trees and removal of trees.
 - (E) Road and infrastructure maintenance which forms an integral part of the forest.
- (dd) Harvesting of trees:
 - (A) Making of extraction roads.
 - (B) Felling of trees (manual with chainsaws; mechanical with equipment).
 - (C) Stripping of bark off felled trees.
 - (D) Stacking of felled tree timber (in field or at roadside).
 - (E) Crosscutting into specified log lengths.
 - (F) Extraction of timber to roadside.
- (ee) Transporting of trees in a forest where they were felled
- (ff) Transporting by the user of timber to a sawmill or chip – mill that is outside the forest or plantation.
- (gg) The process of growing, cutting or carting of trees and logs.
- (hh) Generating electricity for the carriage of domestic use at the place where forest or plantation.
- (ij) Use of locomotives for the carriage of goods by rail in the forest of plantation.
- (iii) The above activities only qualify for the refund if carried on for primary production in forestry.
- (C) **FARMING:** Refund of levies on eligible purchases of distillate fuel for farming.
- (i) For the purposes of these Notes, unless the context otherwise indicates –
“primary production activities in farming” –
 - (A) Means the production of farming products by the user for gain on a farming property;
and
 - (B) Includes the following activities:

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- (AA) Growing crops and harvesting and storing crops on the farming property.
- (BB) Horticulture, pasturage and apiculture
- (CC) The Breeding of fish in dams and the farming of oysters.
- (DD) The breeding and caring for animals and reptiles.
- (EE) The breeding and caring for race and show horses.
- (FF) The shearing or cutting of hair or fleece of livestock, or the milking of livestock.
- (GG) The rounding up or herding of livestock.
- (HH) Baling of hay.
- (JJ) The planting or tending of fruits trees.
- (KK) Any activity undertaken for the purpose of soil or water conservation.
- (LL) The carrying out of fire fighting activities.
- (MM) The construction or maintenance of fences.
- (NN) The construction or maintenance of firebreaks.
- (OO) The service, maintenance or repair of vehicles or equipment for use in a farming activity if is carried out at the place where farming is carried on.
- (PP) The construction or maintenance of sheds, pens, silos or silage pits for use in a farming activity.
- (QQ) The construction or maintenance of dams, water tanks, water troughs, water channels, irrigation systems or drainage systems including water pipes and water piping for use in a farming activity carried out on the farming property.
- (RR) The carrying out of earthworks for the purpose of a farming activity, carried out on the farming property.
- (SS) Searching for ground water solely for use in a farming activity, or the construction or maintenance of facilities for the extraction of such water, solely for that use.
- (TT) The pumping of water solely for use in farming if the pumping is carried out on a farming property.
- (UU) The supply of water solely for use in farming if the supply is to a farming property and the water is supplied or a place adjacent to that property.
- (VV) The storage of farming products.
- (WW) The packing or prevention of deterioration of farming products, if the packing or the prevention of deterioration of the product is carried out on a farming property.
- (XX) Weed, pest or disease control.

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- (YY) Hunting or trapping that is carried on as part of farming operations including the storage of any carcasses or skins.
- (ZZ) Game farming, excluding leisure activities such as game viewing and lodging.
- (AAA) Generating electricity or the use of other farm equipment for domestic purposes.
- (BBB) Use of locomotives for the carriage of goods by rail on the farming property.
- (CCC) Floods management on farming property.
- (ii) The above activities only qualify for the refund if carried on for primary production in farming.

- (D) **COMMERCIAL FISHING:** Refund of levies on purchases of distillate fuel for commercial fishing vessels.
- (aa) Fuel purchases are only applicable in respect of fishing vessels –
 - (A) which are owned or chartered by a legal person registered in the Republic in accordance with the laws of the Republic and which has its place of effective management in the Republic, or by a natural person who is ordinary resident in the Republic;
 - (B) which are registered or licences in terms of the Merchant Shipping Act, 1951 (Act No. 57 of 1951);
 - (C) that are nominated on a valid commercial fishing permit issued by the Department of Agriculture, Forestry and Fisheries in terms in terms of the Marine Living Resources Act. 1998 (Act No. 18 of 1998):
 - (D) which are used in fishing activities carried on with the aim of making a profit; and
 - (E) if used in an engine for the propulsion of, or operating of any equipment used on board, of such fishing vessels.
- (bb) The equipment may include the following:
 - (A) Air and refrigeration compressor
 - (B) Bilge pump
 - (C) Generator.
 - (D) Lighting plant
 - (E) Pump
 - (F) Auxiliary engine
 - (G) Other diesel powered engines.
 - (H) Boiler
 - (I) Chiller or freeze

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- (J) Cooking facilities
 - (K) Heater
 - (L) Incinerator
 - (M) Welder
 - (N) On-board crane
 - (O) Winches
 - (P) Other diesel powered equipment.
- (E) **OFFSHORE MINING:** Refund of levies on purchases of distillate fuel for offshore mining including:
- (aa) Any installation, including a pipeline which is used for the transfer of any substance to or from a research, exploration or production platform.
 - (bb) Any exploration or production platform used in prospecting for or the mining of any substance.
 - (cc) Any exploration or production vessels used for exploration or exploitation of the seabed.
 - (dd) Any vessels or appliance used for the exploration in or exploitation of the seabed.
 - (ee) Diamond dredges must operate under a permit issued by the Department of Mineral Resources.
 - (ff) machinery and equipment which form an integral part of the installation or device;
 - (gg) a vessel used solely to convey persons or goods to and from any installation or device, which is supplied with distillate fuel by such installation or device; and
 - (hh) in the case of diamond dredges, distillate fuel used in a vessel chartered by the owner of the dredging vessel to bunker the diamond dredges at sea and the fuel bunkered by such vessel.
- (F) **OFFSHORE VESSELS:** Refund of levies on distillate fuel for offshore vessels conducting research in support of the marine industry, coastal patrol vessels or vessels employed to service fibre optic telecommunication cables along the coastline of Southern Africa.
- (i) Refunds are only applicable to such vessels, which are –
 - (aa) Owned or chartered by a legal person registered in the Republic in accordance with the laws of the Republic and which has its place of effective management in the Republic or by a natural person who is ordinary resident in the Republic; and a natural person who is ordinary resident in the Republic; and

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- (bb) registered or licenced in terms of the Merchant Shipping Act, 1951 (Act No. 57 of 1951).
 - (ii) The distillate fuel may only be used for the propulsion of the vessels or the operation of any equipment on the vessels.
- (G) **HARBOUR VESSELS:** Refund of Road Accident Fund levy on distillate fuel for harbour vessels operated by Portnet or vessels used by in – port bunker barge operators and are only applicable to such vessels, which are –
- (aa) owned or chartered by a legal person registered in the Republic and which has its place of effective management in the Republic or by a natural person who is ordinary resident in the Republic; and
 - (bb) which are registered or licenced in terms of the Merchant Shipping Act, 1951 Act No.57 of 1951).
- (Q) **RAIL FREIGHT:** Refund of levy on fuel for locomotives used for hauling rail freight. Only distillate fuel purchased for use and used in locomotives when hauling rail freight in Republic qualifies for such a refund.
- (J) **ELECTRICITY GENERATION PLANTS:** Refund of levies on eligible purchases of distillate fuel for use as fuel solely by electricity generation plants as specified, supplying electricity to the national electricity distribution network.