**NATIONAL ASSOCIATION OF AUTOMOBILE MANUFACTURERS OF SOUTH AFRICA**

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4th August, 2006

**The Chairman and Members of the Task Team appointed to consider the fiscal regime applicable to windfall profits in the liquid fuel sector**

c/o The Secretariat – kiyasha.thambi@treasury.gov.za
cc. Mr C Morden, Chief Director : Economic Tax Analysis, National Treasury

Lady and Gentlemen,

**COMMENT BY NAAMSA ON A DISCUSSION DOCUMENT : INVESTIGATION AND REVIEW OF THE FISCAL POLICY REGIME APPLICABLE TO WINDFALL PROFITS IN SOUTH AFRICA'S LIQUID FUEL ENERGY SECTOR, WITH PARTICULAR REFERENCE TO THE SYNTHETIC FUEL INDUSTRY**

## 1. Introduction and Background

On 14th July, 2006 Government published a discussion document "Possible reforms to the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector, with particular reference to the synthetic fuel industry" and invited interested parties to submit comments on the paper by 4th August, 2006.

The National Association of Automobile Manufacturers of South Africa (NAAMSA) is a trade organisation representing the collective, non-competitive interests of new vehicle manufacturers in South Africa as well as businesses involved in the importation and distribution of new motor vehicles in South Africa. Presently, NAAMSA has 26 member companies.

The Task Team, responsible for the preparation of the discussion document, is to be commended for setting out a comprehensive study of all the issues relevant to an assessment of the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector, with particular reference to the synthetic fuel industry. In particular, the Task Team is to be complimented on the detailed and systematic approach to a number of complex issues.

The South African synthetic fuel industry, comprising two main players Sasol and PetroSA, accounts for approximately 40% of domestic fuel sales in a Government administered price market at prices determined by the international price of crude oil and the Rand exchange rate without specific reference to domestic production costs. There are concerns that the current dispensation benefits synthetic fuel producers and their shareholders, at the expense of consumers. Moreover, internationally, oil and gas companies are often subject to fiscal regimes that effectively tax windfall profits associated with higher crude oil prices. Against this background, the Minister of Finance has requested that the fiscal regime applicable to South Africa's liquid fuel producers be re-assessed but that, in this regard, the "complex balance of economic aspects/considerations should be taken into account".

After due consideration, NAAMSA has resolved that it will confine its submission to matters of principle and broad macro economic considerations. Organisations and other stakeholders in the South African economy are better positioned to comment on many of the technical issues raised in the discussion document, however, NAAMSA has participated in the preparation of the submission by organised business through the auspices of Business Unity South Africa (BUSA) and the South African Chamber of Business (SACOB).

**2. Comment on Certain Matters of Principle and various important economic considerations**

NAAMSA remains opposed, as a matter of principle, to any form of windfall taxes.

An analysis of average returns, by various major sectors in South Africa, shows that the average returns, less cost of capital, generated by oil companies is in many instances lower than that achieved in other sectors. This must raise the question as to why synthetic fuel producers are being singled out.

The introduction of additional taxes on windfall profits in South Africa's liquid fuel energy sector will create an unacceptable and counter-productive precedent. Importantly, any tax on windfall profits would conflict with the overriding principle of certainty and predictability in Government policy, including fiscal policy. Oil companies are taxed on their profits in the same way as other companies. Retained profit after tax is used by corporations to pay dividends to shareholders and to re-invest in operations.

Specifically, the following broad economic considerations should be taken into account –

(i) The authorities should be careful not to introduce a precedent by way of the taxation of "windfall profits" which would compromise the imperative of certainty and predictability in official policy;

(ii) The imposition of this form of taxation would harm South Africa's international investment image, would discourage foreign direct investment and would have a negative impact on business confidence in South Africa;

(iii) Sasol and PetroSA operate in an extremely challenging and intensely competitive global environment. The imposition of ad hoc (additional) taxes on "windfall" profits would merely serve to undermine the international competitive position of these companies;

(iv) South Africa remains a net importer of crude oil and fuel. Sasol and PetroSA with their respective coal to liquid and gas to liquid technology and production represent a major source of foreign exchange savings in our country. These technologies should also make a major contribution in future in a global environment characterised by oil shortages;

(v) The South African Government is a major shareholder, directly and indirectly, in Sasol and PetroSA. PetroSA is a state owned gas to liquid company, whilst in the case of Sasol – the Public Investment Commission owns just over 14% of Sasol's equity and the Industrial Development Corporation 8%. Additionally, investment in Sasol shares represents an important cornerstone investment by most pension funds, unit trusts and retirement annuity policies in South Africa. The point here is that any shareholder value erosion as a result of a possible future imposition of taxes on windfall profits on synthetic fuel producers could have far reaching negative effects on the various stakeholders mentioned, including Government. It also begs the question whether there are appropriate alternative options which could result in a win-win situation for all parties concerned such as, for example –

- A revised and enhanced dividend policy on the part of Sasol to benefit shareholders, including Government. This represents an alternative to the (penalty) additional tax option and would avoid many of the unintended negative consequences.

- Government could prevail on Sasol to invest in additional synthetic fuel production facilities in South Africa, thereby increasing our self-sufficiency and reducing pressure on the balance of payments.

- Government could address the import pricing parity issue by for example de-regulating the South African fuel industry and allowing market forces and competitive pressures to run their course. The official concern about the potential loss of employment in a de-regulated South African fuel supply and distribution environment could be addressed by imposing a ban on self-service.

(vi) Government should not underestimate the important role of “high” profits in a market economy. High profits serve as a signal and, all other things being equal, could encourage more competition. Furthermore, high profits provide the necessary resources for new investment which in turn promotes growth and development. (Interestingly, investment by Sasol alone over the past five years has been of the order of R27 Billion). Additionally, high profitability ensures a major contribution in terms of corporate tax and provides the necessary funds for dividend distributions to shareholders.

**3. Concluding Comment**

For the reasons outlined in Section 2, NAAMSA urges caution in the consideration of the possible imposition of taxes on windfall profits in respect of any sector in our economy. Instead, as suggested, the authorities should consider a “win-win” alternative which would be consistent with the overall growth and development needs of the country. As a major stakeholder and shareholder in the South African synthetic fuel industry, it would be quite legitimate for Government to pressurise for incremental investment by the companies concerned as well as an enhanced dividend policy regime to the benefit of all shareholders, including Government.

The authorities will be aware that, all too often, policy interventions translate into unintended results which then creates the need for additional interventions to correct the unacceptable outcomes of earlier policies. We need to be careful not to repeat the same mistakes by proposing an ad hoc windfall profit tax regime in South Africa.

Yours sincerely

**N.M.W. VERMEULEN**
**DIRECTOR**
**as**