BMW
South Africa

Standing Committee on Finance
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8000

Your reference	Ad Valorem Change – TLAB 21.07.2019
Our Reference	Ad Valorem change
Department/From	C3-ZA / C3-ZA-F
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Date	06 September 2019
Subject	**Draft Tax Law Amendment Bill: Commentary on proposed Change to section 65 of the Customs and Excise, Act 2014 (Act no 32 of 2014).**

Dear Honourable Minister Yunus Carrim and Members of the Standing Committee on Finance

BMW South Africa (Pty) Ltd ("BMW SA") submits this written submission in relation to the proposed change to the Ad Valorem tax on imported vehicles as published for comment in the Department of Treasury's Draft Taxation Laws Amendment Bill ("TLAB"):

CLAUSE 63

Customs and Excise Act: Amendment of section 65

The amendment proposes the deletion of the reference in subsection (8) of section 65 to "non-rebated" customs duty, which has the effect that all customs duty payable on imported goods in terms of Part 1 of Schedule No. 1 must be taken into account when calculating the value for purposes of *ad valorem* duty on such goods, and not only non-rebated customs duty.

BMW SA would like the opportunity to appear before Parliament in person and present the contents of this submission to the Standing Committee on Finance on 10 September 2019.

The details of the persons who will be representing BMW SA will be:

Mr. Dumisani Radebe
Director Business Relations Sub-Saharan Africa
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Mr. Jabu Selumane

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Mr. Sven Hovden
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Introduction

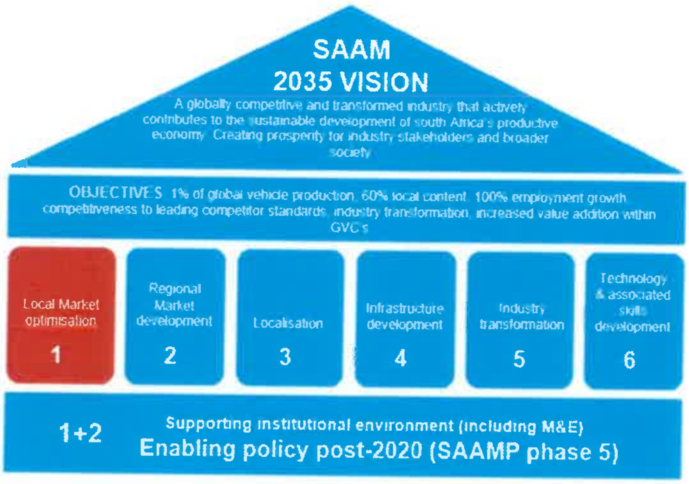
As BMW SA, we fully support Government's recently communicated South African Automotive Masterplan (SAAM), the overall vision and pillars and agree on the need for change in order to drive further development of the automotive industry going forward. It is due to the successful Government intervention into the automotive programmes that have resulted in BMW SA's highest ever investment into the new X3 production and together with it, record production volumes as well as support employment and local content for the next few years.

The successful 'duty – rebate' structure that has been implemented throughout the Motor Industry Development Programme ("MIDP") and Automotive Production Development Programme ("APDP"), resulted in BMW SA rationalising production with higher production runs, focusing on exports to markets such as the United States of America and Europe. The success of this strategy has been BMW SA's ability to be competitive versus other larger BMW Group Plants, mainly due to the Automotive Policy support and the Free-Trade-Agreement (FTA) benefit we have over other Group Plants. It is this 'duty – rebate' structure that makes the Plants and Sales Divisions of South African Automotive Manufacturers inextricably linked.

It has allowed BMW SA to successfully establish a large local footprint comprising of the Plant, Sales Division, Financial Services Company and an IT Hub which provides IT development for other BMW Group companies around the world. We have established a large supplier base and dealer network.

That being said, competition for South African Automotive Manufacturers is becoming more and more challenging with the emergence of Automotive Industries in countries such as Mexico, China and Eastern Europe who with much cheaper labour, logistics costs and higher production volume, are difficult to compete against.

Due to the significance of the impact of the planned Ad Valorem change on our business, we are compelled to put our position in writing as well as present to the Standing Committee on Finance, as it would have severe consequences to our operations in South Africa. Furthermore, we firmly believe it works against what the first pillar of the SAAM is trying to achieve, 'Local Market Optimisation'. Increasing the Ad Valorem tax will result in price increases to the customer and a corresponding reduction in sales and fiscus collection.



International Competitiveness

BMW Plant Rosslyn is part of an international production network within the BMW Group. Internationally vehicle manufacturing is characterised by a relentless focus on continuous cost reductions and efficiency improvements to ensure that production remains competitive in global markets. Price competitiveness, reliability of supply, adherence to delivery schedules and compliance with quality standards represent "non-negotiables".

South African vehicle manufacturers have to operate in a global environment characterised by these realities and they compete often through a tender process, with "sister" plants elsewhere in the world for vehicle production allocations.

Vehicle manufacturing in SA is confronted by numerous additional challenges including:

- Difficulties in achieving economies of scale
- General competitiveness gap with competing global manufacturing and assembly locations
- Distance from major export markets/geographical dislocation and associated high logistics costs
- Limited technology investment by lower tier suppliers
- Lack of manufacturing competitiveness of SA automotive component manufacturers
- Lack of regional market opportunities to support plant volumes

It is due to all these challenges that the continued levels of support and incentives are necessary as these are included in the business cases for volume allocation.

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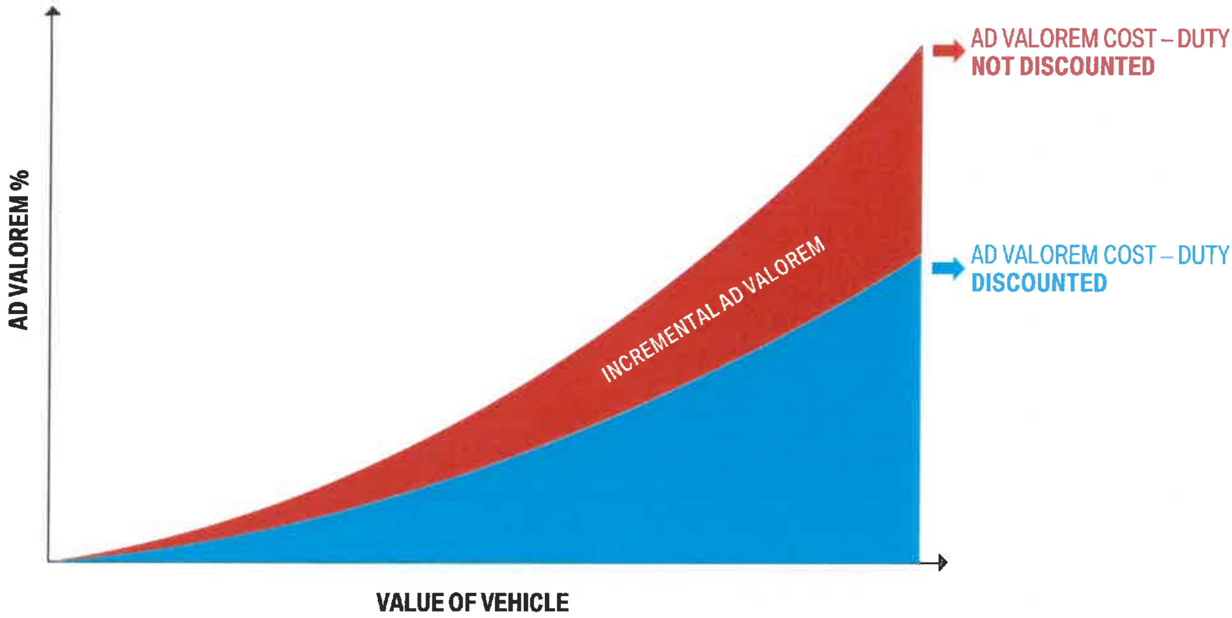
Ad Valorem

Ad Valorem is an excise tax levied on the basis of a sliding scale where the Ad Valorem percentage increases exponentially as the vehicle value increases.

When tendering for model and volume allocations, as intended by the APDP, BMW SA include the benefits earned under both the APDP and AIS in the business case for production in South Africa. The APDP benefits are valued at the financial value that is realised from using the rebates. In this case, it is a combination of:

- The duty rebated, and
- The Ad Valorem saved from rebating the duty (incremental Ad Valorem).



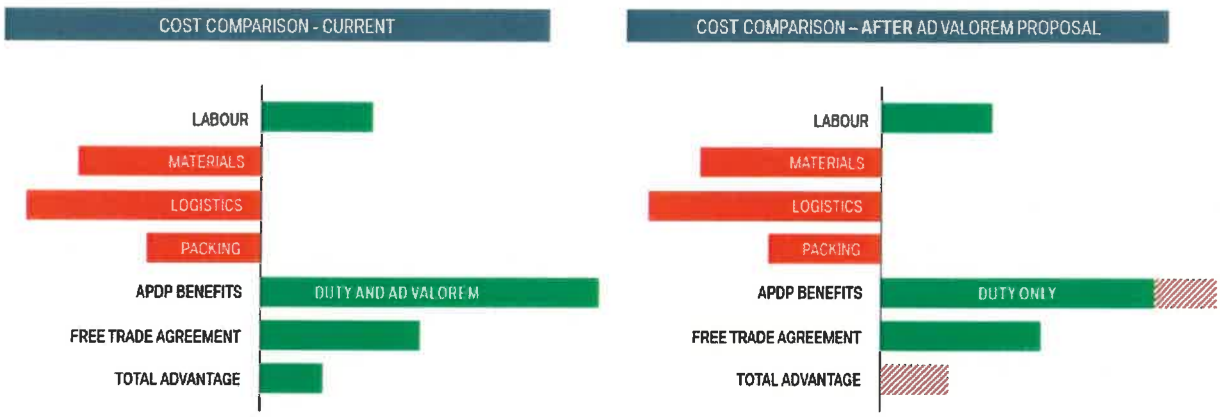
The rebating inclusive of the Ad Valorem has two significant impacts on Automotive Manufacturing in South Africa:

1) The incremental Ad Valorem saving makes up a substantial part of the total benefit included in the BMW SA production business case, thus ensuring export competitiveness,
2) The local sales price would include a higher percentage Ad Valorem if no rebating for Ad Valorem purposes is allowed.

1) <u>Ad Valorem and Export Competiveness</u>

A substantial part of the APDP benefit earned and considered in SA production business cases is the Incremental Ad Valorem saved. This together with the duty rebated, support local production to be internationally competitive and to be able to export vehicles to other countries. These exports are key to be able to get the economies of scale needed in local production. Removing the Incremental Ad Valorem benefit would significantly worsen export competitiveness and not only **take away opportunities for further volume growth** but **risk the currently allocated production volume** which has been allocated based on a certain package of benefits available at the time of the investment. **This will result in reduced local production** and together with it, **significantly reduced direct employment** at both local vehicle manufacturers and their suppliers. Furthermore, a similar impact will occur within the **indirect employment** that automotive manufacturing creates. In addition, exports would reduce as a result of the reduced international competitiveness which will have an **adverse impact on the trade balance** of the country.

Refer below to an illustrative example of an export competitiveness evaluation versus an international Plant elsewhere in the world. Although this illustration shows a labour cost advantage, South Africa is no longer a low labour cost country due to the high annual wage increases versus other countries. Compared with countries such as China, Mexico and Eastern Europe no labour advantage exists (and in some instances South African labour is more expensive).



Materials are more expensive due to the economy of scale impact of smaller Plants in South Africa versus the rest of the world.

Logistics and Packing costs are more expensive due to South Africa's geographical dislocation to other markets.

Furthermore, the current APDP program has credibility with multi-national holding companies due to the stability of the benefits in the programmes over many years. Current investments, with lifecycles that run past 2020, have been made on the basis of the current level of benefits (including the Incremental Ad Valorem saved). If this now changes, due to removing the Ad Valorem benefit, it would severely undermine multi-national holding companies confidence in relying on South African Automotive Industrial Policy and these incentives will no longer be included in future business cases.

2) Ad Valorem – Local Sales Price Increases

The success of the BMW SA local sales division is dependent on the success of the local production facilities due to the "duty- rebate" structure together with the rebating inclusive of the ad valorem taxes that have been set up and been in place since 1996. As previously mentioned, the Plant and Sales Divisions are inextricably linked. The aim to at least produce and earn enough rebates to be able to rebate all their imports to ensure a competitive model range for local sales.

The impact of the proposed Ad Valorem change will result in a substantial increase in taxes on the South African Manufacturers imported vehicles that are sold locally. This will be passed onto the customer together with all other regular price increases (inflation, rates of exchange etc.). This will result in reduced new car sales (in a market that has been steadily declining over the last few years) and therefore an associated reduction in Sales, Aftersales and Financial Services jobs based on the price elasticity impact. Furthermore, any additional collection of Incremental Ad Valorem by the fiscus will be offset by a reduction of the import duty, C02, VAT and Ad Valorem lost due to the lower sales volumes.

By increasing taxes on locally sold vehicles contradicts the stimulation of the local market and the objective of the very first pillar of the SAAM.

Ad Valorem - Conclusion

The current suite of benefits under the SAAM have already been reduced compared with the current APDP.
In addition, the Ad Valorem duties on vehicles were increased in the 2018 Budget Speech.

In light of the above, it is requested that the proposed amendment in the legislation (Section 65 of the Customs and Excise Act, 2014 (Act no 32 of 2014)), not be implemented as it will have a significant adverse impact on local production operations at the Plant as well as the domestic Sales Division:

- Reduced international competitiveness for local production facilities which will result in reduced volume allocation and consequently reduced investment, local content, employment etc.
- Current investments have been made on the basis of the existing benefits. Reducing this will undermine the return on these investment and the credibility and stability of Auto Industrial policy which will have a significant impact for future model allocations.
- Additional taxes will be paid on locally sold vehicles which will be passed onto the customer and ultimately result in reduced sales. This would have a similar effect to the Plant, where reduced employment in the Sales, Financial Services and Aftersales divisions will occur.
- Reduced sales will spill over into the dealer network and supplier basis.
- Reduced local sales will result in lost collection by the fiscus of import duty, C02, VAT and Ad Valorem duties.

The above will most certainly have a severe negative impact on the South African economy.

Tim Abbott

Yours faithfully
BMW (South Africa) (Pty) Ltd.

Tim Abbott
CEO BMW South Africa

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