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Dear Sir/Madam

SUBMISSIONS BY CAPE GATE (PTY) LTD RELATING TO THE PROPOSED APPLICATION OF THE EXPORT DUTY ON FERROUS AND NON-FERROUS WASTE AND SCRAP

1. INTRODUCTION

- 1.1 We refer to the Standing Committee on Finance's request for written submissions on the key tax proposals contained in **The 2020 Draft TALAB** with specific reference to the proposed introduction of an export tax on scrap metals.
- 1.2 Cape Gate (Pty) Ltd is the largest consumer of ferrous scrap in South Africa. On its site in Vanderbijlpark, Gauteng, the company beneficiates scrap metal into numerous steel and wire products through the use of an Electric Arc Furnace. Employing this method of production, scrap metal is a major determinant of the cost of production of steel products.
- 1.3 As an employer of circa. 1,700 individuals, our company's objective is to be a sustainable steel and wire manufacturing business that benefits all its stakeholders including its employees, community and shareholders. One of the key drivers of our success is the ability to procure quality scrap metal in the required volumes and at a competitive price.

Executive Directors:

B N Coetzee Joint Chief Executive Officer (Alternate E Human)
M I Friedman Joint Chief Executive Officer (Alternate R Sonntag)
D M Ziegenhagen Financial Director

Non-Executive Directors:

N Friedman (Chairman) (Alternate R H Kaplan), O M Kaplan, L S Moleko, J P Monahadi



1.4 Cape Gate strongly believes that the proposed export tax on ferrous scrap will provide an impetus for competitiveness, growth and re-investment. As a major cost component of steel production through the Electric Arc furnace route, lower scrap input costs will aid in restoring the sustainability of the South African primary steel producers in a market with reduced demand and significant over-capacity. With steel mills requiring high capacity utilisation to be sustainable, this reduction in ferrous scrap cost will stimulate better utilisation particularly by making exports viable again. This increase in production volume and sales in not just our company, but throughout the downstream supply chain, will lead to job creation, growth and sustainable businesses paying corporate taxes and inwardly re-investing.

2. **MOTIVATION**

As stated in previous submissions, Cape Gate supports the proposed export tax at the specified ZAR amount per ton of scrap metal for the following reasons :

- 2.1 Reduction in administrative burden and “red tape”
- 2.2 A clear mechanism for enforcement with SARS having a history as one of the top-performing governmental bodies
- 2.3 The ZAR based tax provides certainty and stability being less subject to market pricing fluctuations and currency volatility
- 2.4 The specific duty of a Rand per ton irrespective of grade of scrap will prevent circumvention through the manipulation of the values of scrap metal (i.e. false declaration of values), as well as the misrepresentation of grades. The specific duty per ton will provide a more manageable system from an audit and enforcement perspective.

3. **CONCERNS IRT PROPOSED EXPORT DUTIES NOT APPLYING TO COUNTRIES BENEFITING FROM EXEMPTIONS UNDER TRADE AGREEMENTS WITH SOUTH AFRICA**

- 3.1 We re-iterate that we welcome and support the proposed export duty. However, there is one key aspect, namely the exemption of certain exports from the proposed export duty, that raises significant concerns for us. Accordingly, we wish to make submissions pursuant to certain amendments that could be made to the Draft Bill to mitigate this issue.
- 3.2 Section 59 of the Draft Bill amends Schedule 1 of the Customs and Excise Act 91 of 1964 (the **Schedule**) by the insertion of notes in Part 6 of that Schedule which, *inter alia*, read:

"EXPORT DUTY ON SCRAP METAL

NOTES:

...

2. The rate of export duty specified in each column under "Rate of export duty" shall apply when goods are exported to the territory specified in the header of the column, provided that the imposition of the export duty is consistent with the provisions of any applicable agreement.

..."

3.3 In this regard, as per the table to be inserted by the Draft Bill into Part 6 of the Schedule, the rate of export duty specified under the column titled "Rate of export duty" for the European Free Trade Association (**EFTA**) states and the South African Development Community (**SADC**) is stated as "free".

3.4 Accordingly, the Draft Bill proposes that the export duties would not apply to those countries benefiting from exemptions under certain trade agreements to which South Africa is a party, namely those countries participating in the EFTA and SADC.

3.5 The primary issue with this proposed exemption is that this would give rise to the opportunity for circumvention of the export duty system if exports are re-routed to take advantage of the EFTA or SADC treaty.

3.6 ***Problem identified: risk of circumvention of the proposed regime***

3.6.1 If there is an exemption for exports to the EFTA and SADC, there is a very material risk that certain industry participants would attempt to circumvent legislation by transporting scrap metal through the EFTA territories and SADC. The exporter could purport to export to the EFTA states or SADC in order to avoid the export duties. Following transport to the EFTA states or SADC, the goods could be re-routed, or transported onwards, to the actual final destination that is not the EFTA states or SADC.

3.6.2 This means that, while one may at first glance anticipate that the exemption for exports to the EFTA and SADC would have a limited effect, this could end up being extremely material because of avoidance or circumvention of the new provisions. Given that the relevant avoidance actions would take place outside of South Africa, there is very limited practical possibility of direct control or audit.

3.6.3 By way of illustration: a way in which this could easily be done is by loading scrap metal on a vessel to any of the countries in the EFTA or SADC region (and thus not paying the export duties). Once the vessel reaches the EFTA or SADC region, the crew would then be changed and the vessel tidied up to ensure that there is no sign that the vessel is from South Africa (thus losing track of the country of "origin"). At this stage, it would not even be necessary to off-load and then further on-load scrap metal onto the vessel. Thereafter, the vessel would proceed to the actual intended destination. Similarly, it would be easy to truck the relevant scrap metal overland into a country within the SADC, such as Mozambique, and claim the exemption, and then for the scrap metal to be on-shipped to the actual final destination. We are already

aware that Mozambique is being considered as a destination in order to circumvent the proposed tax, given that the cost to transport scrap metal to Mozambique is similar to the cost of transporting this to Durban, making this destination the cheapest and easiest, as a mechanism to avoid export duty. This accordingly results in the legal provisions being circumvented very easily, with all of the negative impacts on growth and employment in South Africa, as well as lower collection of duties on the scrap metal exported. This therefore has a large potential impact on the South African economy.

3.7 **Suggested solution 1: refund mechanism (rather than exemption from duty) combined with a quota system**

3.7.1 South Africa could consider a refund mechanism rather than an exemption, with the refund requiring proof of final destination.

3.7.2 The way in which this could work is that the exporter would be required to make an upfront payment of the specific Rand amount of duty, but would then qualify for a refund of this duty paid on presentation of proof of final destination. This proof of final destination would ordinarily be proof of clearance for customs purposes and entry for home consumption for customs purposes at that destination within the EFTA or SADC, as the case may be. These documents could be reviewed or audited, before the relevant refund is paid.

3.7.3 In addition, a quota system, specifically for the SADC countries, should be imposed, limiting the amount of exports to SADC countries, with this quota being based on the normal export levels prior to the announcement of the export levy.

3.7.4 This would ensure that suppliers are not able to circumvent the legislation by transporting scrap metal through the EFTA or SADC without these goods being entered as being imports into the relevant country.

3.7.5 This alternative would not fully protect South Africa's economic position, in that exports that are truly intended for use or consumption within the EFTA or SADC would fall outside of the new system (being subject to refunds). However, it would go a long way to prevent aggressive tax avoidance and circumvention schemes that undermine the South African tax base and economic development.

3.7.6 We are also of the opinion that a refund mechanism would not breach the SADC Treaty as the SADC Treaty states:

"Article 5

ELIMINATION OF EXPORT DUTIES

1. Member States shall not apply any export duties on goods for export to other Member States.

2. This Article shall not prevent any Member States from applying export duties necessary to prevent erosion of any prohibitions or restrictions which apply to exports outside the

Community, provided that no less favourable treatment is granted to Member States than to third countries.

...

Article 9

GENERAL EXCEPTIONS

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Member States, or a disguised restriction on intra-SADC trade, nothing in Articles 7 and 8 of this Protocol shall be construed as to prevent the adoption or enforcement of any measures by a Member State:

...

(d) necessary to protect intellectual property rights, or to prevent deceptive trade practices;

...".

3.7.7 Accordingly, these provisions provide sufficient scope such that export duties can be applied on goods between SADC Treaty members where the purpose of doing so is to prevent the erosion of any prohibitions or restrictions which apply to exports outside the SADC or to counteract deceptive trade practices. Therefore, the SADC Treaty would not be breached by this proposed solution 1.

3.7.8 Similarly, the Free Trade Agreement¹ provides in Article 23 for "**General Exceptions**", to be governed by Article XX of the GATT 1994. Article XX of the GATT provides that "*nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:... (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement... and the prevention of deceptive practices;*". Given that the purpose of the refund mechanism is to promote customs enforcement and prevent deceptive practices (artificial re-routing, or misstatement of the destination of the products), the Free Trade Agreement with EFTA would not be breached by this proposed solution 1.

3.8 **Suggested solution 2: regulation of destination of goods**

3.8.1 The Customs and Excise Act 91 of 1964 (the **Customs and Excise Act**) and the associated Rules (regulations) currently contain a number of provisions which regulate the origin of goods imported into the country. These provisions are largely contained in section 46 of the Customs and Excise Act, titled "**Origin of Goods**" and the corresponding Rules. However, the Customs and Excise Act does not contain provisions which regulate the destination of goods to be exported from South Africa.

¹ The Free Trade Agreement concluded between the EFTA States and the Southern African Customs Union (SACU) in Höfn, Iceland, on 26 June 2006, which entered into force on 1 May 2008.

3.8.2 Just as rules of origin are necessary, to protect against the improper claiming of tax treaty relief in relation to imported goods, it is submitted that rules of destination are necessary, to protect against the improper claiming of tax treaty relief in relation to exported goods.

3.8.3 The detailed processes necessary to protect the fiscus could be determined in terms of the Rules, which could (and should) be published in draft form for comment, to the extent that input from the industry is useful. However, as a starting point now, the Draft Bill should include a provision amending the Customs and Excise Act relating to rules of destination.

3.8.4 For example, a new section 46B could be introduced, titled "**Destination of goods**", including provisions along the following lines:

"46B. Destination of goods.- (1) For the purposes of this Act, goods shall not be regarded as having been exported to any particular territory, such that no preferential tariff treatment shall apply to any exports, unless-

(a) The relevant goods are agricultural goods that have been consumed by persons or animals within the relevant territory to which they were exported; or

(b) The relevant goods have been used in a manufacture or production process within the relevant territory to which they were exported, and:

i) At least twenty-five per cent (or such other percentage as may be determined under subsection (2)) of the production cost of the goods so produced or manufactured, determined in accordance with the rules, is represented by materials produced and labour performed in that territory;

ii) Such other processes as the Commissioner may by rule prescribe, have taken place in the production or manufacture process; and

iii) Such other requirements as the Commissioner may by rule prescribe, have been met.

(2) The Commissioner may from time to time, at the request of the International Trade Administration Commission, by rule increase the percentage prescribed in subsection (1), in regard to any class or kind of exported goods, or in regard to any class or kind of such goods exported to a particular territory, to which that subsection applies.

(3) Any person exporting any goods which are potentially liable to any export duty, shall produce to the Controller at the time of presenting the customs declaration, a declaration of the destination of the goods.

(4) The Commissioner may by rule prescribe for the purposes of this section –

(a) a declaration or other forms; and

(b) any other matter which the Commissioner may consider reasonably necessary and useful to achieve the efficient and effective administration of this section."

- 3.8.5 The Rules would then set forth in more detail the types of documentation, and the period within which this documentation should be obtained, to substantiate the export destination declared.
- 3.8.6 It is also submitted that the security levels required for the registration as exporter should, in practice, be sufficiently high to cover any export duty on products exported by the relevant exporter, for the period until proof of the export destination has been provided.
- 3.8.7 We also note that there is a section in the Customs and Excise Act, section 46A, titled **“Non-reciprocal preferential tariff treatment of goods exported from the Republic”**. This provides for detailed provisions, including permitting the Commissioner to make Rules as regards these provisions, to protect the tax base of other countries to which goods from South Africa are exported. Section 46A includes registration requirements, and criminalization of various harmful practices. It is submitted that, since the legislature saw fit to introduce this type of legislative provisions to prevent the erosion of other countries' tax bases, in relation to exports from South Africa, it is submitted that it would be absurd not to introduce similar provisions to prevent erosion of South Africa's own tax base in relation to exports from South Africa.
- 3.8.8 Accordingly, it is submitted that a new section should be introduced into the Customs and Excise Act, providing for registration requirements and criminalization of various harmful practices involving “circumvention” as envisaged in section 46A, adapted to relate to the place of destination (rather than the place of origin).

Please do not hesitate to contact us if you would like to clarify anything.

Yours faithfully

Riaan Sonntag

Cape Gate (Pty) Ltd