TAXATION OF MINING COMPANIES: THE LEGAL RAMIFICATIONS OF AMENDING SECTION 15(*a*) OF THE INCOME TAX ACT

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By

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DEDICATION

To my son, Tinashe Thandwefika Mvunelo.

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First and foremost, I thank my Lord Jesus Christ for giving me the intellect, passion, ability and perseverance to begin and successfully complete this academic achievement. To God be the glory, great things He has done!

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May God bless you all.

DECLARATION

I,**1473762** (Student number), declare that this Research Report is my own unaided work. It is submitted in partial fulfillment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

I have submitted my final Research Report through TurnItIn and have attached the report to my submission.

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ABSTRACT

It is often said that mining companies are a privileged class of taxpayer. This is because mining companies with mining rights are entitled to claim a section 15(*a*), read with section 36, of the Income Tax Act, capital expenditure allowance that is unique to taxpayers involved in the mining industry. The Income Tax Act does not, however, take into account the mutually beneficial collaboration between mining companies and contract miners in practice. Contract miners do not own mining rights, but play an important role in the stages of mining to the extent that it can be probed whether or not they are involved in 'mining activities' for purposes of the Income Tax Act.

The current Income tax legislation does not expressly include nor exclude contract miners from claiming a capital expenditure allowance, yet these deductions sought by contract miners have been disallowed by SARS. As a result, the Courts have had to adjudicate on the meaning of the terms "mining" and "mining operations" to give effect to mining tax laws and essentially uncover the intention of the legislature. Contract miners are currently not governed by mining legislation, and instead their existence is heavily based on the contractual agreements entered into to provide mining services for and on behalf of mining companies with mining rights. This research studies the tax treatment of contract miners and the compatibility of the current definition of 'mining' within the mining tax regime and the evolving mining industry practices.

The Supreme Court of Appeal judgement, *Benhaus* suggested that Parliament amend the Income Tax Act so as to clarify who exactly is entitled to the allowance to avoid an unintended class from benefitting to the detriment of the fiscus. The National Treasury in its 2020 Draft Tax Laws Amendment Bill proposed that the Income Tax Act be amended to specifically enable only taxpayers with mining rights to claim the full accelerated deduction of capital expenditure in respect of mining operations. At the time of writing, this section 15(*a*) amendment had not yet been promulgated.

This research recommends amending the Income Tax Act and corresponding mining legislation to incorporate contract miners and that a standard contract between mining right holders and contractors be formulated. This way, SARS will be better positioned to accept that contract

miners do perform mining activities and allow the capex allowance in equal treatment as mining right holders.

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ABBREVIATIONS LIST

CAPEX	CAPITAL EXPENDITURE
CIR	COMMISSIONER FOR INLAND REVENUE
COT	COMMISSIONER OF TAXES
DTC	DAVIS TAX COMMITTEE
DTLAB	DRAFT TAXATION LAW AMENDMENT BILL
GDP	GROSS DOMESTIC PROFIT
ITA	INCOME TAX ACT
MPRDA	MINERAL PETROLEUM RESOURCES DEVELOPMENT ACT
MRH	MINERAL RIGHTS HOLDER
SARS	SOUTH AFRICAN REVENUE SERVICES
SCA	SUPREME COURT OF APPEAL
TAA	TAX ADMINISTRATION ACT

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND

A mining company can be described as a company with a right to mine minerals within the Republic.[1] In South Africa, mining companies are a "privileged class of taxpayer"[2] by virtue of section 15(*a*) of the Income Tax Act[3] ("the Act") read with section 36, which uniquely provides mining companies the allowance to claim their capital expenditure deductions from income derived from mining operations. Section 11(*a*) of the Act generally prohibits the deduction of expenditure of a capital nature.[4] Section 15(*a*) of the Act, however, provides an exception to this general rule for companies carrying on "mining" or "mining operations".[5] The capital expenditure provisions of the Income Tax Act provide for the immediate deduction of capital expenditure.[6] The accelerated capital expenditure as provided by section 36(7C),allows the taxpayer to deduct the full cost of its expenses from their profits in the year of purchase. The mining company's taxable income is reduced by 100 percent of the value of qualifying capital expenditure.

The terms "mining" and "mining operations" are of material importance because they determine to whom the particular provisions of the Income Tax Act apply. In conjunction with the definitions, it becomes crucial to recognise and differentiate between key role players within the mining industry, namely, mining companies with mineral rights (mineral right holders) and

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[1] Minerals and Petroleum Resources Development Act 28 of 2002.
[2] *Western Platinum Ltd v Commissioner for the South African Revenue Service* (2004) 67 SATC 1 (SCA).
[3] Income Tax Act no 58 of 1962.
[4] Section 11(a) : "For the purpose of determining the taxable income derived by any person from carrying on any trade , there shall be allowed as deductions from the income of such person so derived expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature";
[5] Section 15(a) : "There shall be allowed to be deducted from the income derived by the taxpayer from mining operations an amount to be ascertained under section 36, in lieu of the allowances in sections 11(e), (f), (gA), (gC), (o), 12D, 12DA, 12F and 13quin."
[6] Department of Minerals and Energy White Paper on 'A Minerals and Mining Policy for South Africa' October 1998 at page 9.

contract miners (without mineral rights).[7] The Act currently does not make this distinction, and only refers to a taxpayer conducting mining operations.

Initially, mining tax legislation was not designed to cater for contract miners, precluding them from claiming a capital expenditure deduction.[8] As a result, capital expenditure deductions sought by contract miners have been disallowed by the South African Revenue Service (SARS), raising concerns over the compatibility of the definition of 'mining operations' within the mining tax regime and the evolving mining industry practices.[9] The seminal case of *Benhaus Mining v Commissioner for the South African Revenue Service,*[10] heard in the Supreme Court of Appeal in 2019 upheld that the allowance to deduct capex on mining income derived from mining operations does in fact apply to contract miners.[11] This brought about additional uncertainty regarding the legislator's intention in regards to the interpretation of section 15(a).

Shortly after the ruling, in 2020, the National Treasury issued its Draft Taxation Laws Amendment Bill ("2020 DTLAB") for public comment which, inter alia, proposed an amendment to section 15(*a*) of the Income Tax Act,[12] as follows:

(*1) Section 15 of the Income Tax Act, 1962, is hereby amended by the substitution for the words preceding paragraph (a) of the following words: "There shall be allowed to be deducted from the income derived by the taxpayer from mining operations if that taxpayer holds a mining right as defined in section 1 of the Mineral and Petroleum Resources Development Act in respect of the mine where those mining operations are carried on—".* [13] (own emphasis)

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[7] S.M Rupprech 'Owner versus contract miner — a South African update' (2015) 115 *The Southern African Institute of Mining and Metallurgy* 1021.
[8] K Thambi '*Benhaus - a landmark decision, one less hoop for contract miners but a clarion call for an overhaul of the South African mining regime'* (2020) 120 *The South African Institute of Mining and Metallurgy* 484.
[9] Ibid.
[10] *Benhaus Mining v CSARS* (165/2018) [2019] ZASCA 17 (22 March 2019).
[11] Ibid para 42.
[12] Louis Botha '*Losing ground – proposed amendments to reserve special mining deductions for mining rights holders*' Cliffe Dekker Hofmeyr article available at https://www.cliffedekkerhofmeyr.com/en/news/publications/2020/tax/Tax-Alert-20-August-2020-Losing-ground-proposed-amendments-to-reserve-special-mining-deductions-for-mining-rights-holders.html accessed on 15 November 2023.
[13] 2020 Draft Taxation Laws Amendment Bill - Clauses 22 and 32 (31 July 2020) available at https://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20Taxation%20Laws%20Amendment%20Bill%20-%2031%20July%202020.pdf .

The proposed amendment is controversial as it only qualifies the taxpayer who is a mining right holder to claim capex deductions in terms of section 15(*a*) and 36(7C) of the Income Tax Act. At the time of writing, Parliament had not yet passed the 2020 Draft Taxation Laws Amendment Bill.

1.2 HISTORICAL BACKGROUND

Taxation of mining companies in South Africa has a lengthy history, having developed over the years in response to the country's unique geological, economic, social, and environmental circumstances as well as case law.[14] The first record of mining tax in South Africa was in 1875, and pursuant to the expansion of the discovery of diamonds in the Union, attempts to secure income tax from mines became more strategic and calculated.[15] The Mining Taxation Act[16] was promulgated in 1910 and was the only piece of legislation at the time which sought to generate a tax on income, providing for a yearly tax on mining profits.[17] From 1910, the Mining Taxation Act[18] was further developed and by 1914, 'capital expenditure', in the context of mining, was properly defined in sections 23 and 24 in the Income Tax Act of 1914.[19] The Income Tax Act No 28 of 1914 was the first tax legislation which made provision for mining after the Mining Taxation Act 6 of 1910[20] was repealed.[21] The Income Tax Act 28 of 1914[22] was substantially amended and was eventually replaced in its entirety by the current Income Tax Act 58 of 1962.

There is a bundle of laws which deal with the taxation of mineral rights, namely the Mineral Act of 1991 (repealed), [23] the Mineral and Petroleum Resources Royalty Act of 2008,[24] the Income

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[14] The Davis Tax Committee, Second and Final Mining Report submitted to the Minister of Finance (2016) page 44 accessed from https://www.taxcom.org.za/docs/20171113%20Second%20and%20final%20hard-rock%20mining%20report%20on%20website.pdf

[15] Marius Cloete Van Blerck *Taxation principles applicable to the mining industry in South Africa* (unpublished LLM thesis, University of Cape Town 1990) 14.

[16] Mining Taxation Act no 6 of 1910.

[17] Marius Cloete Van Blerck *Mining Tax in South Africa* 2nd ed (1992).

[18] Mining Taxation Act no 6 of 1910.

[19] Peter Geoffery Surtees '*An Historical Perspective of Income Tax Legislation in South Africa, 1910 to 1925'* (unpublished MCom thesis, Rhodes University Dissertation,1986) 38.

[20] Mining Taxation Act 6 of 1910

[21] Surtees 115.

[22] Income Tax Act 28 of 1914.

[23] Mineral Act No 50 of 1991.

[24] Mineral and Petroleum Resources Royalty Act No 28 of 2008.

Tax Act (as amended) and the Minerals and Petroleum Resources Development ("MPRDA").[25] The Mineral Act regulated all legislation relating to the mining industry from 1991 until the MPRDA was promulgated. Previously the State was not the custodian of the country's mineral resources and third parties were not permitted to apply to the State for mineral rights since minerals were privately held.[26] Under the MPRDA, one requires a mining permit or mining right to commence mining activities. This research will not focus on the Royalties Act but specifically the Income Tax Act and on the MPRDA.

"Mining" and "mining operation" are defined in the Income Tax Act as "every method or process by which any mineral is won from the soil or from any substance or constituent of the soil".[27] While the word "mineral" is not defined in the Income Tax Act, the MPRDA defines it as "any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process, and includes sand, stone, rock, gravel, clay, soil and any mineral occurring in residue stockpiles or in residue deposit".[28] It however "excludes water, other than water taken from land or sea for the extraction of any mineral from such water, petroleum or peat." [29]

The purpose of the MPRDA is to promote equitable access to South Africa's mineral and petroleum resources to all its citizens.[30] The State is the custodian of all mineral and petroleum resources[31] and therefore no person may be allowed to conduct mining operations without a mining right. Mining permits, rights and licenses are issued by the Department of Mineral Resources and Energy, enabling for, inter alia, the controlled overseeing of responsible prospecting and mining activities.[32] Section 11 of the MPRDA states that "a mining right or an interest in any such right…may not be ceded, transferred, let, sublet, assigned, alienated or

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[25] Minerals and Petroleum Resources Development Act 28 of 2002.
[26] Elmarie Van der Schyff '*The Right to be Granted Access Over the Property of Others in Order to Enter Prospecting or Mining Areas: Revisiting Joubert v Maranda Mining Company (Pty) Ltd 2009 4 All SA 127 (SCA)*' PER / PELJ 2019 (22).
[27] Section 1 definition of "mining operation" in the Income Tax Act 58 of 1964.
[28] Section 1 definition of "mineral" in the MPRDA.
[29] Ibid.
[30] Section 2*(c)* of the MPRDA.
[31] Ibid Section 3.
[32] South African Government official website available at https://*www.gov.za/services/mining-and-water/apply-mining-permit* (accessed on 15 November 2023).

otherwise without the consent of the Minister."[33] The consent of the Minister, however, is not required where a mining right holder enters a subcontract agreement with a mining contracting company.[34] By virtue of section 101, a third party company may be appointed to conduct the mining activities on behalf of the right holder for a fee and without entitlement to a royalty.[35]

Subcontracting arrangements, particularly in the gold mines, became a trend in the late 1980s and over time the demand for subcontracting agreements has benefited big mining corporations seeking to structure their operations as well as for smaller contracting businesses, promoting access to the industry as envisioned in the MPRDA.[36]

The definitions attributed to the words 'mining', 'mining operation' and 'minerals' are significant to the extent of understanding the phases of mining. The phases of mining require a detailed enquiry, as will be discussed further, which even our courts undertake, to give effect to mining laws, particularly for tax purposes.[37] The definition of mining operations does not extend to prospecting[38] and this paper will solely focus on mining operations.

When the Income Tax Act was drafted, the phenomenon of contract mining had not yet been considered by the legislator.[39] As a result, contract miners are left out of mining income tax

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[33] Section 11 MPRDA.
[34] Kathleen Louw 'Sub-contract agreements vs the letting of mining rights' Werksmans article 01 November 2023 available at *https://www.werksmans.com/legal-updates-and-opinions/sub-contract-agreements-vs-the-letting-of-mining-rights/#:~:text=Sub%2Dcontract%20agreements%20are%20entered,sub%2Dcontract%20agreements%20are%20concluded* accessed on 15 November 2023.
[35] Section 101 MPRDA reads: "If the holder of a right or permission appoints any person or employs a contractor to perform any work within the boundaries of the reconnaissance, mining, prospecting, exploration, production or retention area, as the case may be, such holder remains responsible for compliance with this Act."
[36] Jonathan Crush, Ulicki Theresa et al '*Undermining Labour: The Rise of Sub-contracting in South African Gold Mines'* (2001) 27 *Journal of Southern African Studies* 1 at 6.
[37] Western Platinum Limited v Commissioner for South African Revenue Services [2004] 4 All SA 611 (SCA); Falcon Investments Ltd v CD of Birnam (Suburban) (Pty) Ltd & Others 1973(4) SA 384 (AD); Commissioner of Taxes (COT) v Nyasaland Quarries and Mining Co Ltd (1961) 24 SATC 579 (NY); ABC Mining v CSARS Case Number IT24606; Great Western Railway Co v Carpalla United China Clay Co Ltd (1909) 1 Ch D 218; Benhaus Mining (Proprietary) Limited v Commissioner for the South African Revenue Service (165/2018) [2019] ZASCA 17; 2020 (3) SA 325 (SCA) (22 March 2019); BP Southern Africa (Pty) Ltd v Commissioner for South African Revenue Services (60/06) [2007] ZASCA 7 (13 March 2007)
[38] M.O Dale, A.B.W Cox et al. *South African Mineral and Petroleum Law: Mineral and Petroleum Resources Development Act 28 of 2002* Chapter 1 Definitions Commentary, LexisNexis; Section 1 MPRDA : '"mining operation" means any operation relating to the act of mining and matters directly incidental thereto'
[39] Thambi K. (2020) op cit note 8 at 484.

legislation and claims for expenditure incurred in contract mining activities have often been disallowed by the South African Revenue Service (SARS).[40] Sections 15(*a*) read with section 36 currently does not define contract miners, and merely refers to a taxpayer conducting 'mining' and 'mining operations'.

In 2019, however, the Supreme Court of Appeal (SCA) in *Benhaus Mining v Commissioner for the South African Revenue Service* was tasked to decide on whether or not, a contract miner involved only in the initial stage of extracting ore from the ground, conducts mining operations within the ambit of section 15(*a*) of the Income Tax Act [41]. Following a detailed scrutiny of the mining process, the SCA ruled that, inter alia, contract miners without mining rights do perform the functions akin to mining operations therefore making them eligible for the capital expenditure deduction. The SCA found that contract miners and mineral right holders are equally entitled to benefit from the accelerated tax deduction as they "both participate in significant phases of the mining process".[42] The focus of this paper is on Mocumie AJ's concurring views calling for the necessity to amend the Income Tax Act so as to fix the unclear and ambiguous definition of 'mining' which entitles unintended beneficiaries to claim accelerated tax deductions to the detriment of the fiscus.[43] In 2020, the National Treasury issued its Draft Taxation Laws Amendment Bill ("DTLAB 20") for public comment which, inter alia, proposed an amendment to section 15(*a*) of the Income Tax Act excluding contract miners from claiming the capex deduction.

The proposed amendment has given rise to debates on whether such tax incentives should be expanded to include contract miners without compromising the revenue net, that is, preventing the abuse of the tax incentive. It is against this background that this paper will discuss the current position of contract miners in South Africa's mining income tax regime, discuss the legal framework of mining income tax, provide a detailed case analysis of *Benhaus*, and provide recommendations on whether contract miners should be incorporated into tax legislation in future.

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[40] Ibid.
[41] Benhaus Mining v CSARS op cit note 10.
[42] Ibid para 44.
[43] Ibid paragraph 45.

1.3 RESEARCH QUESTION

In light of *Benhaus*, the National Treasury has proposed that the Income Tax Act be amended to specifically enable only taxpayers with mining rights as defined in section 1 of the MPRDA to claim the full accelerated deduction of capital expenditure in respect of mining operations.[44] The question posed by this dissertation is therefore: should the section 15(*a*) amendment be promulgated, what will the tax implications be for contract miners, SARS and the individual mineral right holder?

1.4 RESEARCH OBJECTIVES

This study shall aim to assess the capex tax treatment of contract miners, particularly in light of *Benhaus* calling for legislative amendments to the Income Tax Act. Therefore, the aims of this study are as follows:

- To research the evolution of the specific treatment of section 15(*a*) read with section 36.
- To determine and assess the tax treatment of contract miners, the capex they incur and operational risks, if any, with the purpose to understand whether they perform the functions akin to mining.
- To critically analyse *Benhaus* , and the nexus between mining operations and the source of income
- To critically discuss the explanatory memorandum and draft response by the National Treasury.
- To propose reforms for South Africa's current mining tax legislation.

[44] Clauses 22 and 32 of the 2020 Draft Taxation Laws Amendment Bill - (31 July 2020) available at https://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20Taxation%20Laws%20Amendment%20Bill%20-%2031%20July%202020.pdf

1.5 RESEARCH RATIONALE

The Draft Taxation Laws Amendment Bill[45], which is yet to come into effect, has raised debates on the tax and legal ramifications of excluding contract miners from claiming a capex deduction under section 15(*a*) of the Income Tax Act.

1.6 BENEFITS OF THE STUDY

This study is important because the South African Government and National Treasury are currently considering an amendment to the Income Tax Act to exclude contract miners from claiming a full upfront deduction of its capital expenditure.[46] At the time of writing, the National Treasury had responded to public comments and had undertaken to investigate and find solutions to alleviate concerns raised by stakeholders.[47]
Taxation of mines is critical for the mining sector and the ficus as a whole. The dissertation aims to contribute to the debate and provide insight into the already-ongoing investigations.

This research will be beneficial to law students, policy makers, tax and legal practitioners, advisors and consultants operating in the area of mining tax. This study can benefit entities that are either mining right holders or contract miners in South Africa. They can benefit through gaining knowledge and understanding of the mining tax regime in South Africa and provide insight to the advantages and disadvantages of the proposed amendment.

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[45] Clauses 22 and 32 of the 2020 Draft Taxation Laws Amendment Bill(31 July 2020) available at https://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20Taxation%20Laws%20Amendment%20Bill%20-%2031%20July%202020.pdf

[46] Final Response Document on the 2020 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2020 Draft Taxation Laws Amendment Bill and 2020 Draft Tax Administration Laws Amendment Bill (20 January 2021) available at https://www.sars.gov.za/wp-content/uploads/Legal/RespDocs/LPrep-Resp-2020-09-Final-Response-Document-on-the-2020-Draft-Tax-Bills-20-January-2021.pdf page 49.

[47] Ibid pages 50 and 51.

1.7 RESEARCH METHODOLOGY

This is a desktop study, mostly based on primary and secondary sources. The dissertation relies on Acts and regulations, and case law, as its primary sources. Secondary sources to be used include, but are not restricted to journal articles, textbooks, interpretation notes, discussion papers, white papers, commentary, policy documents and commission reports to mention a few. The study uses two main research methodologies: first, a legal historical approach to trace the background and evolution of mining tax principles and laws. Thereafter, critical analysis will be adopted to review South Africa's current mining tax regime and discuss the landmark *Benhaus*[48] judgement in conjunction with analysing the proposed 2020 Draft Taxation Laws Amendment Bill.[49]

1.8 CHAPTER OUTLINES

- **CHAPTER 1** introduces the subject and gives a background to the study.

- **CHAPTER 2** looks at the evolution of the specific treatment of mining taxpayers in terms of section 15(*a*) read with section 36 of the Income Tax Act.

- **CHAPTER 3** analyses South Africa's mining tax laws and policy considerations on capital expenditure including the draft TLAB 2020 and balancing the economic, legal and fiscal objectives.[50]

- **Chapter 4** is a case analysis on *Benhaus*[51] and its implications.

- **Chapter 5** concludes and presents recommendations based on the research.

[48] Benhaus Mining v CSARS op cit note 10.
[49] 2020 Draft Taxation Laws Amendment Bill(31 July 2020).
[50] Ibid.
[51] Benhaus Mining v CSARS.

CHAPTER 2

MINING TAX LAW IN SOUTH AFRICA'S CONTEXT AND MAJOR DEVELOPMENTS

On the onset, it is valuable to understand the context of mining tax and how contract miners came to be.

South Africa's mining industry has for decades been dominated by gold and coal mining, whereas platinum group metals now maintain the largest mining activity in the economy.[52] The mining production has contributed immensely to urbanisation and economic growth, and in 2022, the mining sector contributed an added value of approximately 202.61 billion South African Rand (roughly 10.81 billion U.S. dollars) to the country's Gross Domestic Product (GDP).[53] In turn, the 2021/2022 was the same tax period in which the highest tax revenue contribution was made.[54] Since then, there have been considerable changes in the industry, more notably in gold mining, such as a contracting workforce, increase in wages, decline in commodity prices and the discovery of other vast platinum supplies/reserves (Platinum Group Metals (PGMs)).[55] According to the Minerals Council South Africa, elevated commodity prices have boosted mining tax revenue [56]

The industry is said to be volatile, this on the backdrop of the great recession in 2008, the Marikana Massacre in 2011 and the continued labour strikes and sit-ins, particularly along the

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[52] Mining taxation - the South African context Economic Tax Analysis, August 2013 available at https://static.pmg.org.za/131106mining.pdf accessed on 12 October 2023.
[53] Statista dataset 'Value added by the mining industry to the Gross Domestic Product (GDP) in South Africa from 2016 to 2022' available at https://www.statista.com/statistics/1121214/mining-sectors-value-added-to-gdp-in-south-africa/ accessed on 17 November 2023.
[54] National Treasury '2023 Budget Review Revenue Trends And Tax Proposals' Chapter 4 available at https://www.treasury.gov.za/documents/national%20budget/2023/review/Chapter%204.pdf accessed on 28 November 2023.
[55] Minerals Council South Africa Facts and Figures 2022 pocketbook available at https://www.mineralscouncil.org.za/component/jdownloads/?task=download.send&id=1996&catid=17&m=0&Itemid=119 accessed on 17 November 2023.
[56]Supra 33 page 43.

Rustenburg platinum belt over the years.[57] Notwithstanding these challenges, SARS is also under pressure to collect revenues in an industry where mining companies profits have shrunk significantly and in most instances are making losses.[58] The Davis Tax Committee ('DTC'), in its final report on hard-rock mining noted, inter alia, that despite these and other adverse conditions in the mining sector, tax policy and changes to the tax design "should be approached cautiously, without trying to compensate for problems which lie outside the tax system."[59] It was in this same report that the committee discusses the accelerated 100% write off of capital expenditure incurred against taxable income from mining operations and makes recommendations to incorporate contract miners within the tax legislation realm.[60] This will be discussed more in depth in chapter 3.

2.1 CAPITAL EXPENDITURE ALLOWANCE ('CAPEX')

The inherent risks and protracted timelines involved in establishing a mine informs the basis for a capital expenditure allowance. The risks attributable to mining range from the purchase of expensive machinery, long exploration periods with unpredictable geological outcomes, high sunk costs, prolonged productions before profitability, volatile mineral prices, and the exhaustibility of resources to name a few.[61] The capital expenditure allowance for mining companies was thus introduced as an incentive to encourage new mining ventures, to the advantage of the fiscus and the South African economy.[62]

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[57] Africa Programme Summary, South Africa's Mining Industry: The Trade Union Perspective available on https://www.chathamhouse.org/sites/default/files/field/field_document/20140428SouthAfricaMining.pdf accessed on 19 November 2023.
[58] Lisa Steyn, 'SA mining loses R100bn in profit as prices, rail constraints and load shedding bite' News24 article available on https://www.news24.com/fin24/companies/sa-mining-loses-r100bn-in-profit-as-prices-rail-constraints-and-load-shedding-bite-20231004#:~:text=As%20reported%20by%20PwC%20in,from%20a%20record%20R206%20billion accessed on 17 November 2023.
[59] The Davis Tax Committee, Second and Final Mining Report submitted to the Minister of Finance (2016) page 44.
[60] Ibid paragraph 11.7 page 10.
[61] Mining taxation - the South African context page 6.
[62] MC van Blerck 'Mining Tax: income tax capital allowances granted to South African gold and natural oil mines' (1988) *The South African Institute of Mining and Metallurgy* 88 page 227.

In lieu of alternative allowances, a taxpayer may deduct from its income from mining activities under Section 15(*a*) of the ITA. The amount of the deduction will be determined in accordance with Section 36 guidelines.[63] Furthermore, subject to section 36(7C), the Act allows for a complete write-off of capital expenditure incurred against taxable income from mining operations of any producing mine.[64]

The Income Tax Act defines capital expenditure to include expenditure on shaft sinking and mine equipment; expenditure on development, general administration and management prior to commencement of production or during any period of non-production; expenditure in respect of the acquisition, erection, construction, improvement of certain infrastructure and housing for its employees; and where a trade constitutes mining any expenditure incurred in terms of the mining right in accordance with the Mineral and Petroleum Resources Development Act (MPRDA).[65]

Yet, the deduction of such qualifying capital expenditure is limited to the available mining income[66] and can potentially reduce the tax liability of a mining taxpayer to zero. Where the capital expenditure is unredeemed, that amount may be ring-fenced against other non-mining income and carried forward. This will be deemed to be an amount of capital expenditure incurred in respect of that mine during the subsequent year.[67] And while it could be argued that the capex allowance has positive tax benefits for taxpayers conducting mining operations and to an extent, policy advantages to the government of the day, such allowances also leave the fiscus at a disadvantage with the less revenue owed to the state. According to the OECD, a balance needs to be found between the necessity of such tax incentives to attract mining investment, and the design of the law in a way that minimises the cost to government revenue.[68]

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[63] Alternative allowances being normal wear and tear, manufacturing, building and other capital allowances available to other taxpayers; see sections 11(e), (f), (gA), (gC), (o), 12D, 12DA, 12F and 13*quin*.
[64] Section 36(7C) Income Tax Act 1962 : "Subject to the provisions of subsections (7E), (7F), and (7G), the amounts to be deducted under section 15 (a) from income derived from the working of any producing mine shall be the amount of capital expenditure incurred."
[65] Section 36 (11)(a), (b), (c), (d) and (e)
[66] The Davis Tax Committee Report ,op cit note 59 page 50.
[67] *Armgold/Harmony Freegold Joint Venture (Pty) Ltd v Commissioner for the South African Revenue Services* (703/2011) [2012] ZASCA 152; 2013 (1) SA 353 (SCA); [2013] 1 All SA 253 (SCA) (1 October 2012).
[68] Organisation for Economic Co-operation and Development (OECD) Centre for Tax Policy and Administration Secretariat and the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) ' Tax Incentives In Mining: Minimising Risks To Revenue (2018) page 6 available at https://www.oecd.org/tax/beps/tax-incentives-in-mining-minimising-risks-to-revenue-oecd-igf.pdf accessed on 19 November 2023.

2.2 CONTRACT MINERS

The landscape of the mining industry, as illustrated above, is regularly evolving. It is then conceivable that over the decades subsequent to the drafting of the current section 15(*a*) of the Income Tax Act, mining companies holding mineral rights would expand their business models to include contract miners to service a phase or phases of the mining activities on their behalf.[69] Where a mining company operates using its own equipment and workforce, that company conducts 'owner mining'. Conversely, where a mining company assigns or outsources some of the operations to a second party then such company engages in 'contract mining'.[70] The Davis Tax Committee suggests the relationship to be one of agent and principal.[71] This approach is in line with the fact that separate agreements are entered into between owner miners and mining contractors creating a vertical relationship, with the owner/mineral right holder still retaining the majority of the risk, reward and ultimate compliance and accountability to the requirements of the MPRDA.[72] On the other hand, subcontracting is a transfer of all rights of use and enjoyment, and this is prohibited by section 11 of the MPRDA.

An important question to be answered is: what do contract miners do?

Rupprecht states that the reasoning behind the owner and contract miners working together in practice, is a corporate decision, adopted with project-specific issues in mind, such as the life of a mine, variability of the mining rate, availability and experience of personnel, project management and financial limitations.[73] Golosinski further summarises that the basic objectives of any contract process are economy, efficiency, equal access and transparency.[74] Apart from its

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[69] SM Rupprecht (2015) pages 1022 - 1025
[70] Raymond Suglo, 'Contract Mining versus Owner Mining - The Way Forward' (2009) *Ghana Mining Journal* pp.61-68.
[71] The Davis Tax Committee, Second and Final Mining Report page 84.
[72] Ibid.
[73] Op cit note 69.
[74] Tad S. Golosinki, 'Contract mining Improves performance: The Australian Experience' (1998) *Mining Engineering, Society for Mining, Metallurgy & Exploration Inc.*

practicality, the need for owner mining companies to focus on their core business and industrial reforms has increased the scope of contractors.[75]

The role of contract miners is thus limited to the extent of the agreement and does not confer the limited real right over the mineral extracted, that is, to the ownership of the fruit of the property, in line with the MPRDA.[76] A direct relationship between the contract miner and the mine itself does not exist. The MPRDA expressly provides that no person may be allowed to conduct mining operations without a mining right.[77] Notably, neither the current Income Tax Act nor the MPRD Act recognise contract mining, practically making contract miners unregulated. The provisions and enforceability of the contract will be governed by the general principles of the law of contract.

The dissonance remains: that despite their popularity and acceptance in the industry, the legislative framework governing mines and their taxation was never designed with contract miners in mind. This aggravates the uncertainty of unregulated contract mining activities and arguably to an extent whether the contract miner can claim the relevant section 15(*a*) tax allowance. Section 15(*a*) is only premised on the requirement that the miner should be conducting a mining operation, and not necessarily that it should be legally recognised.

[75] P Allonby, 'Use of contractors for mining operations' (1998) *Coal Operators' Conference, University of Wollongong & the Australasian Institute of Mining and Metallurgy* pages 254-257.
[76] Section 11 of the MPRDA.
[77] Section 5A of the MPRDA.

CHAPTER 3

AN ANALYSIS OF SOUTH AFRICA'S LEGAL FRAMEWORK ON MINING TAX: SECTION 15(*a*)

"Section 15(a) of the Income Tax Act requires that income should be generated from "such mining operations" and the courts have held that this requires a direct connection to the activity carried on. The problem which arises is in the interpretation of which party is carrying on such mining operation."[78] *– Davis Tax Committee Report*

The interpretation of section 15(*a*) is central to mining tax disputes, as the capital expenditure (capex) allowance is premised on the material requirement that the taxpayer must be conducting a *mining operation*. 'Mining' or a 'mining operation', although not directly defined in the Income Tax Act, includes every method or process by which any mineral is won from the soil or from any substance or constituent thereof.[79] Interestingly, Burt critiques that the statutory definitions of 'mining' and 'mining operations' for income tax purposes has been the same since the enactment of the first Income Tax Act in 1917 until today suggesting that the application of these terms are outmoded. [80] The ITA does not define the words "mineral," "won," and "soil," which are used in the definitions of "mining operations" and "mining." Therefore, in order to understand the meaning of these phrases, it is necessary to refer to case law to understand who is entitled to the section 15(*a*) allowance.

[78] The Davis Tax Committee, Second and Final Mining Report page 83.
[79] Section 1 of the Income Tax Act, 58 of 1962
[80] Kevin Burt 'More on Mining' *Income Tax, Tax Planning Corporate and Persona*l (2020) 34.

3.1 INTERPRETATION

3.1.1 “PROCESS BY WHICH ANY MINERAL IS WON FROM THE SOIL”

The statutory interpretation process generally commences by determining the ‘grammatical or ordinary meaning’ of the words of a legislative provision.[81] In the case of tax legislation and tax principles, SARS interpretation guides and notes hold persuasive value, although oddly, the SARS website (at the time of writing) has not published any Explanatory Notes, Interpretation Notes nor Practical Guides on the subject of mining tax. Despite this, the Constitutional Court in *Marshall and Others v CSARS*[82] has held that taxpayers should rather approach the interpretation of tax legislation in accordance with the standards set out in *Natal Joint Municipal Pension Fund* than follow SARS’ unilateral guidelines.[83]

The Income Tax Act’s grammatical definition is limited, and on the other end the corresponding Act, the MPRDA, defines "*mine”* (verb) to mean “any operation or activity for the purposes of winning any mineral on, in or under the earth, water or any residue deposit, whether by underground or open working or otherwise and includes any operation or activity incidental thereto”.[84]

When comparing the provisions in the relevant legislation, the definitions differ to the extent that MPRDA has a more broader and inclusive definition of “mining” compared to that in the Income Tax Act. The definition of “mineral” is also included in the MPRDA and not in the ITA. Where terms are not expressed in the text or the text is vague, ambiguous and uncertain, the courts apply a contextual and purposive interpretation to the words to derive the intention of the legislation.[85] Two cases stand out in mining income tax disputes.

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[81] This approach was established in the landmark *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) case.
[82] *Marshall and Others v Commission for the South African Revenue Service* (CCT208/17) [2018] ZACC 11; 2018 (7) BCLR 830 (CC) ; 2019 (6) SA 246 (CC) (25 April 2018).
[83] Ibid paragraph 10.
[84] Section 1 MPRDA
[85] *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012) at paragraph 17: ‘A court must interpret the words in issue according to their ordinary meaning in the context of the Regulations as a whole, as well as background material, which reveals the purpose of the Regulation, in order to arrive at the true intention of the draftsman of the Rules.’

The *Western Platinum Limited*[86] case concerned a mining company that earned interest on its overdraft bank accounts. The Commissioner disallowed the mining taxpayer's claim for a section 15(*a*) allowance on the basis that the interest income was not derived directly from the *mining operation* it conducted.[87] The Supreme Court of Appeal distinguished between mining and non-mining income, and whether a mining operation could produce other sources of income – in other words, is there a cogent causal link ('the test') between the mining operation and other income that is capable of qualifying for a section 15(*a*) capex allowance.[88] In establishing the test, reference was made to *CIR v BP Southern Africa,*[89] where an oil company challenged the Commissioner's decision to disallow certain expenditures incurred during the course of its trade as deductions in terms of s 11(*a*) of the ITA.[90] The court in *Western Platinum*, dismissing the appeal, held that, for it to be mining income, its source must be the business of extracting minerals from the earth (own emphasis).[91] The courts found in favour of the Commissioner in both cases.

After the requirements of the definition of "mining operations" and "mining" as contained in s 1 of the ITA have been assessed, there is a common pattern in case law that courts follow to identify related risks and rewards within the mining activities which will inform whether the taxpayer is involved in the mining process. Contextually, owner mining companies are exposed to various inherent risks and project delays. In mining, risk entails a situation involving exposure to high costs, such as startup capital and infrastructure costs which are not easily recoverable should the mine fail to be established and produce a profit.[92] The risk component seeks to resolve whether the taxpayer obtains a significant reward or a loss from the mining process. Thambi and Suglo propose that in fact, there are several risks in mining regardless of who does the actual

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[86] *Western Platinum Limited v Commissioner for South African Revenue Services* [2004] 4 All SA 611 (SCA).
[87] Ibid paras 2 and 26.
[88] Ibid para 21.
[89] *BP Southern Africa (Pty) Ltd v Commissioner for South African Revenue Services* (60/06) [2007] ZASCA 7 (13 March 2007).
[90] Section 11 of the Income Tax Act: "General deductions allowed in determination of taxable income — For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived — (a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature".
[91] *Western Platinum Limited* op cit note 86 para 35: "For the reasons stated above,the interest on the tax refund was only remotely connected with the mining source of the income. I agree with the judge a quo in this regard."
[92] K Thambi (2020) page 484.

mining.[93] In an earlier case - *ITC 13686*[94] - Sutherland J ruled the 'risk element' to be a prerequisite and the so called risk-test was further expanded upon in the *ABC Mining Pty Ltd* case. Despite the taxpayer arguing that neither the *Western Platinum* judgment nor the *BP Southern Africa* judgment require some kind of commercial risk for a trade to fall within the mining operation definition, the tax court followed Sutherland J's precedent. [95]
The Act, however, under sections 15(a) and 36 does not make reference to the risk element. Hence the *Benhaus* judgment interestingly does not emphasis on the risk element – and Lewis ADP in *Benhaus* reasonably expresses uncertainty as to why the question of an entity conducting mining operations is dependent on the miner bearing risk.[96]

In addition to the risk element, the "process of winning a mineral from the earth" is also generally interpreted to give effect to section 15(*a*). The hiring process of contract miners vary, and the scope of work will emanate from the contractual agreement.[97] The current legislation does not set out the basic terms and formalities of such a contract — instead the parties involved negotiate and draft these ad hoc agreements to suit their business models, capital budgets and mine requirements.[98] As in any business transaction, the objectives of the contracting parties will determine the form and substance of a contract mining agreement.[99] Dunlop identifies specific project areas that should be expected when acquiring the services of a contract miner, namely, drilling, blasting, loading and hauling.[100]

The kind of "mineral" being "won" from the earth also holds weight in deciphering whether an act of mining operation has taken place. The following cases are often referenced in various Court interpretations of mining for income tax purposes. *COT v Nyasaland Quarries,*[101] a Kenyan case, it was asserted that an extended meaning must be given to mining and mining

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[93] K Thambi (2020) 486; Suglo R (2009) 66.
[94] Unreported judgment of Sutherland J, Case Number 13686 (30 March 2017).
[95] *ABC Mining v CSARS* Case Number 13863 para 22;
[96] *Benhaus v CSARS* para 27.
[97]Suglo R (2009) page 62.
[98] S.M Rupprecht (2015) 1021.
[99] Henry M. Ingram & John H. Lawrence Jr. '*Contract Mining Agreements – The Contract Miner's Perspective*' (1984) Available at https://researchrepository.wvu.edu/wvlr/vol86/iss3/13 accessed on 30 December 2023.
[100] Dunlop S.F '*Contract versus owner mining – an update on Australasian open pit mining practice*' (2004) Mining technology 113 17-29.
[101]*COT v Nyasaland Quarries and Mining Co Ltd* (1961) 24 SATC 579 (NY).

operations to include quarrying, but South Africa does not uphold this approach. In South Africa, the extraction of gneiss (a mineral) is not considered a mining operation in terms of section 1 ITA. Similarly, in *New South Wales Blue Metals,*[102] the taxpayer was quarrying blue stone. Blue stone is neither a mineral nor a metal and the Australian High court found that quarrying blue stone did not constitute mining operation for tax purposes.[103] In South Africa, the extraction of stone is not considered a mining operation in terms of section 1 of the ITA. And lastly, *Great Western Railway v Capalla United China Clay Co*[104] which concerned paying compensation for entering through a farmer's land. The English court, in answering what a mineral was, held that it is any substance that can be got from within the earth and possesses a value in use apart from mere bulk and weight occupying the crust of the earth. Thus, china clay was included in the landowner's area of "mines or other minerals".[105]

Conclusion

It follows that the lack of grammatical or ordinary meanings attributable to the words "mineral", "won" and "soil" from the current legislation leads to the necessity to extend the language so that the apparent purpose of the provision and the context in which it occurs guides the taxpayer and the Courts to the most correct interpretation.[106] In addition, the scope of the contract mining agreements should be used to provide further evidence that indicates whether the contractor was conducting 'a *process* by which any *mineral* is won from the soil'.[107]

3.1.2 "INCOME DERIVED FROM MINING"

As indicated in the *Western Platinum Limited* case, as well as section 36(7C), a mining operation should have a causal link to the source of the mining income to qualify for the capex allowance.[108]

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[102] *New South Wales Associated Blue Metal Quarries Ltd v Federal Commissioner of Taxation* (1956) 94 CLR 509.
[103] Ibid page 525.
[104] *Great Western Railway Co v Carpalla United China Clay Co Ltd* (1909) 1 Ch D 218.
[105]Ibid. Also taken from Minister of Land Affairs v Rand Mines Ltd (320/95) [1998] ZASCA 32 paragraph 52.
[106] 'An interpretation will not be given that leads to impractical, unbusinesslike or oppressive consequences' in Endumeni case paragraph 25. Op cit note 81.
[107] Section 1 definition of 'mining operations' and 'mining'.
[108] Section 36(7C) ITA 58 of 1962.

The Tax Court dealt with the causal link in *Benhaus* (*ITC 1913)*[109] and *Classic Challenge* (*ITC 1907).*[110] In these cases, both respective taxpayers had derived their income from payments made to them in the form of an agreed fee for the services of extracting mineral bearing-ore rendered to the mining right holders. The issue was whether the fee income was considered to be income derived/sourced from mining operations. In both cases, the court found that the core of mining income is the sale of the mineral, not the service fee – that a contract miner is merely a service provider, does not obtain the reward or share of the profits from the mining process and thus cannot claim to be engaged in the mining operation.

In the judgment of *Optimum Coal Terminal v Richards Bay Coal Terminal*[111] *,* the High Court found that where it was agreed that the mining and production of coal would be conducted by mini-pit contractors for their exclusive benefit and profits, the mining right holder was not engaging in mining and producing the coal but on an actual analysis, was merely leasing its mining right.[112] Had this been a tax dispute - where the mini-pit contractors sought to claim a section 15(a) read with section 36(7C) allowance - it would be of interest to observe how the Commissioner would have challenged the claim as the contractors would firstly, satisfy the elements of risk and reward fitting the purposive meaning of a mining operation and second, its income is derived from a the working of a producing mine. In conjunction with amending the Income Tax Act, a standard universal agreement between contract miners and mineral right holders should be developed to further regulate the industry, as the line between justified and unjustified treatment contract miners is not always an obvious one.

It is submitted that, similar to the court in the above matter,[113] a factual enquiry is best suited to determine the true source of the mining income regardless of whether the mining is conducted for their own benefit or on behalf of another entity. Furthermore, the requirement to hold a mineral right has no tax legislative basis (the Income Tax Act merely refers to a taxpayer

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[109] *Benhaus v CSARS* reported as ITC 1913 (2017) 80 SATC 455 (Tax Court, Johannesburg, per Weiner J).
[110] *Classic Challenge Trading v CSARS* reported as ITC 1907 (2017) 80 SATC 271 (Tax Court, Johannesburg, per Sutherland).
[111] *Optimum Coal Terminal (Pty) Limited and Another v Richards Bay Coal Terminal (Pty) Limited and Others* (D531/2023) [2023] ZAKZDHC 9 (31 May 2023).
[112] Ibid paras 195 - 196; Also taken from Kathleen Louw 'Sub-contract agreements vs the letting of mining rights' Werksmans article 01 November 2023 as cited in footnote 34.
[113] *Optimum Coal Terminal (Pty) Ltd v Richards Bay Coal Terminal (Pty) Ltd.*

conducting mining operations, not a mining right holder) but was a policy and fiscal driven objective to regulate the collection of revenue and restrict the pool of potentially qualifying taxpayers from claiming the capex allowance.

Practically, a contractor taxpayer would ordinarily declare its fee income as "income derived from mining" and seek to claim the capital allowances in respect of the cost of its expenditure subject to section 36 limitations. It must submit a compulsory mining schedule (GEN-001) to SARS together with its ITR14 return - this mining schedule referred to is part of the assessment process and is administrative and procedural in nature, not substantive.[114] One of the questions in the schedule which must be answered is "Did the company conduct mining/mining operations where the company is not the legal owner of the mining right?"[115] A contractor, depending on how it answers the question, will be subject to an assessment by SARS and the claim may be disallowed. The dilemma this creates is that both the contractor and the mining company are essentially claiming capex allowances from mining the same mineral. Following the *Benhaus* judgment in 2019, discussed in chapter 4, the National Treasury and SARS in seeking to clarify the current legislative weakness, proposed in its Draft Taxation Laws Amendment Bill (DTLAB 2020) that, inter alia, only the taxpayer that holds the mineral right as defined in section 1 of the MPRDA be entitled to claim the accelerated deduction of capital expenditure in respect of mining operations.

3.2 POLICY AND FISCAL CONSIDERATIONS - PROS AND CONS

The Draft Taxation Laws Amendment Bill 2020, which is yet to come into effect, has raised concerns on the consequences of excluding contract miners from claiming a capex deduction under section 15(*a*) of the Income Tax Act. In acknowledging the increase of contact mining in the industry, the DTLAB 2020 seeks to remedy the lack of clarity in the Income Tax Act. The amendment inter alia aims to settle the uncertain treatment of capital expenditure incurred by

[114] SARS website available at https://www.sars.gov.za/types-of-tax/corporate-income-tax/completing-an-itr14/
[115] Ibid.

taxpayers carrying on activities of contract mining.[116] The proposed amendment is a policy measure that will ensure that only mineral right holders can claim the section 15(*a*) allowance and the bill is open for public comments to which it responded by requesting further time to investigate and mitigate the impact on the mining industry.

Based on the commentary received by the National Treasury, it is clear that the draft has a few notable shortfalls: the draft does not propose a new definition of contract mining, nor a way to distinguish it from mining. By consulting with stakeholders such as the Mining Resource Council and the Department of Mineral Resources, the National Treasury would be in an informed position to adopt some practical insight as to the stages of mining, and develop a definition that recognises and is consistent with industry practices.

Secondly, the proposal to exclude contract miners is not accommodative of joint ventures. Keith Engel, as interviewed by Visser, states that there are a number of joint venture relationships that have been set up where only one party holds the mineral right but the joint venture shares in the mining profit and loss[117]

From case law, it has been alluded to that in a mining joint venture the 'non-owner' of the mining right ultimately shares the risk in the whole venture.[118] The reality is that contract mines are taking on various risks in different forms. [119] Another industry norm is that contract miners work in close cooperation with mineral right owner miners, almost proverbially 'stepping into the shoes' of the latter, hence it is remiss to merely assume that contract miners do not bear 'equivalent risks' but rather those risk should be proportionalised according to the capex of each contractor.

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[116] 2020 Draft Rates and Monetary Amounts and Revenue Laws Amendment Bill, 2020 Taxation Laws Amendment Bill 2020 Draft Tax Administration Laws Amendment Bill - Presentation to the Standing Committee on Finance 13 October 2020 available on https://www.sars.gov.za/wp-content/uploads/Legal/RespDocs/LPrep-Resp-2020-09a-Final-Response-Presentation-on-2020-Draft-Tax-Bills-20-January-2021.pdf.

[117] Amanda Visser 'Mining industry in the dark about capex write-off for contract miners' (2021) Moneyweb article available at https://www.moneyweb.co.za/mineweb/mining-industry-in-the-dark-about-capex-write-off-for-contract-miners/ accessed on 12 December 2023.

[118] *Classic Challenge Trading v CSARS*; ITC 1907 2017 80 SATC 271 paragraph 27.

[119]Amanda Visser, Moneyweb article (2021) op cit note 117.

Thirdly, the draft proposal does not address the recommendations in the Davis Tax Committee (DTC) report released in 2016[120], which were inter alia:

- The DTC recommends that a template contract be devised as a guide to parties concluding contract mining arrangements
- Recommends that SARS issue a comprehensive Interpretation Note on this subject to dispel any uncertainty prevalent in the industry.
- Recommends that the upfront capex write-off regime should be discontinued and replaced with an accelerated capex depreciation regime, which is in parity with the write-off periods provided for in respect of the manufacturing (40/20/20/20) basis.
- Recommends the removal of the upfront capex tax allowance regime and subsequent removal of ring fences.

On a practical perspective, there are administrative concerns regarding the unnecessary delays in transferring of mineral rights, as provided for in section 11 of the MPRDA, subject to the consent of the Minister. These delays are cost consuming for both the mining company that seeks to transfer and the contractor that wants to begin working and claiming the capex deduction.

On a fiscal perspective, should the bill be promulgated in its current form, George Trollope, as interviewed by Visser, suggests that it could deter investments, already crippling an industry affected with loadshedding , labour issues and policy and political uncertainty.[121]

It seems as if SARS and the National Treasury foresee a situation where, should it approve contractors to claim their capex it will result in an abuse of tax and possibly create loopholes for tax evasion. SARS is likely aware of this and by amending the legislation to only allow taxpayers that hold mining rights as defined in section 1 of the Mineral and Petroleum Resources Development Act, to claim, closes a potential loophole that could have long term financial consequences to the revenue net.

[120] The Davis Tax Committee, Second and Final Mining Report paragraph 11.
[121] Amanda Visser, Moneyweb article (2021) op cit note 117.

CHAPTER 4

A CASE ANALYSIS: BENHAUS MINING v CSARS CASE

The section 15(*a*) accelerated capital expenditure allowance is given to taxpayers involved in mining and mining operations. Considering the fact that there are mining right holders and non-mining right holders involved in mining operations, the issue in *Benhaus Mining v Commissioner for the South African Revenue Service*[122] was to understand, who did the legislature intend to benefit from the section 15(*a*) allowance?

On one hand, SARS argues that only mining companies with mining rights may claim the allowance, and has its own interpretation of what a mining operation is for purposes of income tax. On the other hand, the taxpayer's view is that there are multiple entities - not only mining right holding companies - that participate in certain mining phases that conduct mining operations without a license such as contract miners, thus entitling them to the allowance as well.

The Supreme Court of Appeal found that mining contractors should be allowed to claim a deduction in terms of section 15(*a*). Furthermore, in its concurring judgment, the SCA called for the amendment of the legislation to provide clarity on the interpretation of s15(*a*) and on who exactly may and may not qualify for the capital expenditure deduction to close the loophole for those not intended to claim.[123]

The National Treasury and SARS has responded to the judgement by proposing the Draft Taxation Laws Amendment Bill, 2020 to amend section 15(*a*) of the Income Tax Act as follows:
(*1) Section 15 of the Income Tax Act, 1962, is hereby amended by the substitution for the words preceding paragraph (a) of the following words: "There shall be allowed to be deducted from the income derived by the taxpayer from mining operations if that taxpayer holds a mining right as*

[122] *Benhaus Mining (Proprietary) Limited v Commissioner for the South African Revenue Service* (165/2018) [2019] ZASCA 17; 2020 (3) SA 325 (SCA) (22 March 2019).
[123] Ibid paras 44, 45 and 46.

defined in section 1 of the Mineral and Petroleum Resources Development Act in respect of the mine where those mining operations are carried on—".[124] (own emphasis)

As mentioned earlier, contract miners are not regulated and until such time the amendment is passed in Parliament, the SCA ruling of *Benhaus* is the prevalent legal precedent.

FACTS

The Benhaus Group was a private company that provided construction services and later branched out into contract mining in 1997 - the same year in which Benhaus Mining Pty Ltd was incorporated. The company is not a mineral right holder but a 'hard rock opencast mining contractor' providing services on a 'stand-alone' basis or as an 'add on' to a contract.[125]

From 1998 to 2013, Benhaus Mining ('the taxpayer') had managed to claim capital expenditure deductions under section 15(*a*) without SARS taking an exception to the applicability of the provision. It was only in September 2013, and in accordance with the powers under section 92 of the Tax Administration Act (TAA),[126] when SARS raised additional assessments in respect of the 2005 to 2009 tax years on the grounds that the taxpayer was not a mining company. The TAA allows SARS to raise an additional assessment *at any time* to correct the application of a tax Act if it prejudices SARS or the fiscus.[127]

It was common cause that the taxpayer's business was premised on entering contracts with several mineral right holders (MRHs) in which the contracts would set out the essential corresponding obligations, that is, the extraction and delivery of mineral bearing oil in exchange for a fee. The services rendered during the relevant tax years included excavating, stockpiling, blasting mineral ore, delivery of the raw ore to its clients and rehabilitating the mine area.

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[124] 2020 Draft Taxation Laws Amendment Bill - Clauses 22 and 32 (31 July 2020) available at https://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202020%20Draft/2020%20Draft%20Taxation%20Laws%20Amendment%20Bill%20-%2031%20July%202020.pdf .
[125] Behaus website available at https://www.benhaus.co.za/ accessed on 26 December 2023.
[126] Tax Administration Act Act 28 of 2011.
[127] Ibid Section 92.

In its objection to the additional assessment, the taxpayer contended that there were three stages of mining chrome using the open cast method. The first stage is the practical digging and removal of the topsoil, blasting and extraction, crushing and screening, and delivery of the ore to the client's processing plant; leading to the second stage called ore washing. The third stage is to melt the concentrate ore separating the waste from metal to produce the final product, ferrochrome. The client was then responsible for stages two and three. In arguing its case, the taxpayer reasoned that despite it not being active in the entire process, the winning and extracting of the mineral-bearing ore from the ground is fundamental to a mining operation and thus constituted mining for purposes of the Income Tax Act. The SARS Commissioner however refuted the taxpayer's argument, stating that insofar as there the mining process involves multiple phases - such as refining and trading of the mineral bearing ore - without satisfying all stages, the taxpayer could not be said to be engaging in mining for tax purposes. The objection was disallowed and the dispute escalated to an appeal in the Tax Court. The Tax Court held that the taxpayer was not engaged in mining within the interpretation of section 1 and section 15(*a*) read with section 36(7C) of the Act and that it did not qualify for a capex deduction on its expenditure incurred in the relevant tax years, and the appeal was dismissed.[128]

As a result, the taxpayer proceeded to appeal to the Supreme Court of Appeal. The points of consideration before the SCA were whether a contract miner solely involved in the first stage of open cast mining constituted *mining* under the Act, and whether its service fees regardless of when it begins to earn it, constitutes *mining income* subject to sections 15(a) and 36(7C). [129]

COMMERCIAL RISK

Citing the author Marius van Blerk[130] in the Tax Court,[131] the taxpayer explained that extracting minerals from the soil is in essence the act of 'winning' the mineral from the earth.[132] As the

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[128] *Benhaus Mining v CSARS* reported as ITC 1913 (2017) 80 SATC 455 para 68.1 (Tax Court, Johannesburg, Per Weiner J)
[129] Ibid paras 1, 17, 36 and 41.
[130] Marius Cloete van Blerk 'Mining Tax In South Africa' (1990) 1992 Taxfax CC.
[131] ITC 1913 (2017) 80 SATC 455 para 14.
[132] *Benhaus* para 18.

right to mine these minerals belongs to the State, any persons who are legally allowed to mine (by applying for the right or leasing in terms of the MPRDA) and for all intents and purposes extracts the mineral-bearing ore from the soil, does so on a contract basis. Thus according to the author, an acute involvement in the first stage is necessary in order for it to be conducting a mining operation. In its counterargument, the Commissioner raised the *Classic Challenge Trading v CSARS*[133] case in which Sutherland J emphatically rejected van Blerk's views describing them as unhelpful and 'unsustainable'.[134] Sutherland J criticized van Blerks contribution, stating that 'mere extraction is not enough to render a contractor who earns a fee for extraction as a person eligible to fall into the class of persons engaged in "mining operations" as defined."[135] He went further to say that 'the contractor is not in the trade of mining, rather it is in the trade of servicing a miners requirements by the extraction of material'. This notion is very much in line with the 'risk element' test developed earlier in *ITC 13686*,[136] and the Tax Court in *Benhaus* relied on these previous cases to dismiss the application on the same grounds. The SCA does not mention or rely on van Blerck's authority like the previous judges, and this research submits that it might be attributed to the fact that his writings are older and have lost relevance. Yet, it does cast a sense of doubt over the consistency of Sutherland J's rulings.[137] Lewis ADP in *Benhaus* avoids the risk test, and directly accepts the claim that the taxpayer sustained a commercial risk . In her opinion, the degree of the risk need not be taken into account.[138]

SEPARATION OF THE MINERAL

The second leg to Sutherland J's approach in the *Classic Challenge* to the interpretation of mining was that the taxpayer should be involved in the process of separating the mineral from the rock – this is the second and third stage discussed earlier.[139] In *Classic Challenge*, Sutherland

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[133] *Classic Challenge Trading v CSARS* reported as ITC 1907 (2017), 80 SATC 271
[134] *Benhaus* para 23.
[135] *Classic Challenge* para 26.
[136] Unreported judgment of Sutherland J, Case Number 13686 (30 March 2017); also taken from *ABC Mining v CSARS* para 47.
[137] *Behaus* para 27 - Lewis ADP observes that Sutherland used the risk element in previous judgements except in *Gloucester*.
[138] *Benhaus* para 27 paraphrased.
[139] *Benhaus* para 29.

J refuted the suggestion there could be more than one entity involved in the mining operation.[140] According to him, it would be incorrect for both entities to claim the venture and income of mining, which would lead to the unintended consequence of both entities being entitled to tax benefits such as a capex deduction. He further opined that the mining operation factually ends when the mineral is modified and converted to the final substance and is worth trading – hence the nexus between the source (the mineral) and the income (profit).[141] The taxpayer (Benhaus), disputing the feasibility of such a linear approach, used domestic and foreign case law to explain how minerals such as diamonds, gold, iron oxide and particularly ore vary in how they are processed.[142] For example, iron is mined as soon as it is extracted from the soil; gold is extracted, refined, processed and melted in multiple stages then molded for the mining process to be concluded; platinum is extracted then refined; and coal is mined as soon as it is extracted from the soil.[143]

It has been held by our courts that extracting a mineral is not the same as manufacturing. That in fact, the 'winning' of a mineral is the end of 'mining' and the commencement of 'manufacturing'.[144] The facts pertaining to *Richards Bay,*[145] *Forskor*[146] and *Marula*[147] each support the view that there is a distinction between mining and manufacturing; The English case of *Great Western Railway 1922*[148] slightly sheds light on this – it held that the mere fact that a heterogeneous mix of the earth has been extracted from the soil does not make it a mineral with commercial value. Properly construed, the phase of modifying the size and weight of the mineral to make it valuable is manufacturing. These are two separate processes and only one party can be responsible for mining, as the other is for manufacturing. The Commissioner argued that the above cases are legally distinguishable. This research submits that the SCA, mindful of this, used

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[140] *Benhaus* para 29; *Classic Challeng*e para 23.
[141] *Benhaus* para 30; *Classic Challenge* para 29.
[142] *Benhaus* para 32.
[143] *Matla Coal Ltd. v Commissioner for Inland Revenue* (22/85) [1986] ZASCA 120; Glazewski J., Plit L. *'Environmental Law in South Africa'* Chapter 17 Mineral and Petroleum Resources' ;
Mr Charles De Matos Ala, Lecture at Wits University dated 18 July 2023.
[144] *D & H Piping Systems (Pty) Ltd v Trans Hex Group Ltd. and Another* (119/05) [2006] ZASCA 29; *Rex v Harper* 1944 SR 113; Falcon Investments Ltd v CD of Birnam (Suburban) (Pty) Ltd & others 1973(4) SA 384 (AD).
[145] *Richards Bay Iron & Titanium (Pty) Ltd & Another v Commissioner for Inland Revenue* 1996 (1) SA 311 (A)
[146] *Commissioner for the South African Revenue Service v Foskor Limited* [2010] ZASCA 45.
[147] *CSARS v Marula Platinum Mines* (218/2015) [2015] ZASCA 121 (22 September 2016).
[148] *Great Western Railway Company on Behalf of WH Hall v Bater* (Surveyor of Taxes) (1922) 8 TC 231.

the cases to demonstrate that judicial recognition exists to show that the extraction process amounts to a mining operation and that the processing of ore is a manufacturing activity.

The SCA therefore held that the taxpayer legally performed the work on a contract basis incurring actual expenses and a sufficient degree of commercial risk by virtue of its equipment to be in the trade of mining.[149] Furthermore, the contractor need not be involved in the process of separating the mineral from the rock (manufacturing stages) and solely being involved in the first stage of extracting the mineral-bearing ore constituted *mining* under the Act.[150]

MINING INCOME

Section 36(7C) states that the "amounts to be deducted under section 15(a) from income derived from the working of any 'producing mine' shall be the amount of capital expenditure incurred."[151] In other words, the taxpayer may deduct 100 percent of its capital expenditure in the year of assessment as long as it can substantiate that the income was derived from a producing mine, that is, a mine which yields a return.[152]

The taxpayer Benhaus, relying on the *Gloucester Manganese Mines (Postmasburg) Ltd*[153] 1943 case, submitted that earnings that result from a mineral lease for the exploitation of those minerals ought to be 'income derived by it from mining operations'.[154] The High Court in *CIR v BP Southern Africa* corroborated Gloucester's view noting that: 'the phrase income derived from mining operations means income derived from the business of extracting minerals from the soil'.[155] In 2004, Conradie JA affirmed the above in *Western Platinum.*[156] The Commissioner's counterargument to the taxpayer's submission was the last kick of a dying horse, when it failed

[149] *Benhaus* para 41.
[150] *Benhaus* para 41.
[151] Section 36(7C) Income Tax Act.
[152] Heinrich Louw 'A groundbreaking victory for contract miners, won from the soil' Cliffe Dekker Hofmeyr article available at https://www.cliffedekkerhofmeyr.com/en/news/publications/2019/Tax/tax-alert-12-april-A-groundbreaking-victory-for-contract-miners-won-from-the-soil-.html , accessed on 16 February 2024.
[153] *Gloucester Manganese Mines (Postmasburg) Ltd v CIR* 12 SATC 229.
[154] *Benhaus* para 19.
[155] *BP Southern Africa (Pty) Ltd v CSARS* in para 20 of *Benhaus*.
[156] *Western Platinum Ltd v Commissioner for the South African Revenue Service* (2004) 67 SATC 1 (SCA).

to convince the court that the contract fee earned by a contract miner is not mining income.[157] In concluding its argument, the taxpayer quoted a passage from the *ITC 1455* case contending that its expenditure incurred on preparing the mineral bearing property is covered by the term 'mining operations'.[158] The SCA once again agreed with the position that mining income is not limited to the sale of minerals for a profit on the basis that the most important stages of mining operation had already been concluded.[159]

The key issues of the judgement have been expounded above. The SCA also addressed a last-minute issue regarding sections 36 (E) and 36 (F) relating to ring fencing.[160] Section 36(E) provides that the average amount of capex claimed under section 36(7C) shall not exceed the taxable income in any year in relation to any mine or mines. Section 36(F) ring-fencing allows a loss incurred in a particular year for one company to be set-off against another. The Commissioner argued that the taxpayer did not comply with the above provisions when it claimed all its capital expenses as one amount and not differentiating between the various mines it was servicing and the equipment used on those respective mines.[161] The Court set aside the Commissioner's complaints,[162] as these concerns were not pleaded in its statement of grounds (in terms of Rule 31(1) of the Tax Administration Act Rules).[163]

Lastly, the landmark case of *CIR v Lever Bros*[164] established that the source of income , per the definition of gross income, is determined by working out what the originating cause is, and by locating the originating cause.[165] Relying on the above test in *Benhaus*, the SCA resolved that the originating cause of the taxpayer's income are the service fees received in exchange for conducting the mining operation of extracting mineral-bearing ore.[166] Irrelevant to this finding, the SCA held, is whether the contract miner begins to earn income immediately or over a long

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[157] *Benhaus* para 41.
[158] *Benhaus* para 36.
[159] *Benhaus* para 41.
[160] *Benhaus* para 37.
[161] *Benhaus* para 37.
[162] *Benhaus* paras 38 and 39.
[163] South African Revenue Service Rules in GN R. 3146 *GG* 48188 of 10 March 2023.
[164] *Commissioner for Inland Revenue Appellant v Lever Bros and Another Respondents* 1946 AD 441.
[165] Ibid pages 449 and 450.
[166] *Benhaus* para 41.

term.[167] That is to say, a contract miner merely extracting a mineral from the soil is a mining operation; secondly the costs it incurs to perform its work and set up infrastructure counts as a capital expense and therefore it is entitled to the tax benefits under section 15(a) read with section 36(7C).[168]

Of greater importance to Lewis ADP's judgement, is Mocumie JA's concurring judgement. By acknowledging that case law – when contextually and purposively interpreted – entitles miners and contract miners to equally benefit from the capex accelerated deduction, Moncumie JA opines that the legislature needs to formally adopt a stance that will bring finality to the debate.[169] In her view, the capex deduction was designed to 'incentivize mining as opposed to components thereof, which is what contract miners do'[170] and a continued attempt by the courts to give purpose and effect to section 15(*a*) read with section 36(7C) may not be in line with the aims of the National Treasury/fiscus. While it is argued that the ambiguous definition of mining opens the proverbial 'back-door for wolves' for all to qualify, an amendment to the legislation should expressly specify the class intended to benefit from the deductions.[171] An amendment to the Income Tax Act, properly executed, will avoid an unintended class of beneficiaries claiming the deduction to the detriment of the ficus. Mocumie AJ thus calls for an amendment of the ITA to close the void between the meaning of mining operations and the resultant unintended consequences thereof.

It is commonly appropriate for the Courts to advise the Legislature to amend provisions of an act where the act does not properly reflect the policy of the State. We see this happening predominantly in tax as well with the draft taxation laws amendment bills being published more frequently. When interpreting tax legislation, courts have to make sense of the legislative intention and look at the policy reasons for the provisions in question. It is also important to note that SARS' interpretations may or may not always be informed by the policy objectives, which is

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[167] *Benhaus* para 41: "It is of no relevance that the contract miner immediately begins to earn an income from mining, and does not have to wait for the mine to produce over many years. - Lewis ADP"
[168] *Benhaus* para 41.
[169] *Benhaus* para 44.
[170] *Benhaus* para 44.
[171] *Benhaus* para 45.

debatable. Thus the call from the court to amend the legislation is not surprising but is also appropriate considering that it is a matter of interest to the industry as a whole.

Currently, SARS has not responded with updated information to support or refute its proposed amendment bill. The bill does not propose a new definition of contract mining, nor a way to distinguish it from mining. These should be addressed to ensure that there is mutual understanding and there are solutions that will not disrupt the various stakeholders.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

The aim of this dissertation was to assess the capital expenditure treatment of contract miners with reference to section 15(*a*) read with section 36 of the Income Tax Act. It was found that courts in past case law gave due regard to the meaning and interpretation of 'mining' and 'mining operation', despite there being contrasting views when it comes to the risk element and the stages of mining. However, an important finding was that for SARS to successfully close the loophole created by section 15(*a*), it is not enough to simply exclude contract miners from the provision but it is important that contract miners be accommodated in the mining laws namely the MPRDA and the ITA. Against this background, a proposed amendment to the aforementioned acts and a standardised or prescribed contract of agreement between mining right holders and contractors are suggested. This chapter summarises the key findings of this paper and details the aforementioned recommendations.

KEY FINDINGS

Chapter 1 introduced the subject and set out a background to the study. Chapter 2 looked into the evolution of the specific treatment of mining taxpayers in terms of section 15(a) read with section 36. In tracing the historical development, focus was placed on the mining sector and the laws relevant to mining namely the Mineral and Petroleum Resources Development Act.

Chapter 3 analysed South Africa's mining tax laws and policy considerations on capital expenditure including the draft TLAB 2020; Balancing the economic, legal and fiscal objectives.
Chapter 4 is a detailed case analysis on *Benhaus v CSARS*.[172]
Chapter 5 concludes and presents recommendations based on the research.

[172] *Benhaus Mining v Commissioner for the South African Revenue Service* (165/2018) [2019] ZASCA 17 (22 March 2019).

It should be accepted that contract miners do conduct mining operations for purposes of the Income Tax Act. The *Benhaus* judgment clearly deviates from the policy stance adopted in antecedent cases and looks at interpreting the law in light of the facts. Some scholars even debate that the SCA should have applied a literal meaning to the definition of mining.[173] Inconsistent interpretations by the courts widen the potential for contrasting decisions on the same or similar issues of fact. These shortcomings undermine the predictability of the law and ultimately go against the principle of legal certainty. The legal framework should therefore be extended to provide new provisions for contract miners. This will formalise their presence in the industry and give them full recognition as major contributors to the mining sector and increase of mining revenue.

There are three potential outcomes or ramifications one should look out for.
Firstly, should the National Treasury and SARS decide not to proceed with the proposed section 15(*a*) amendment as it is, and keep the Court's interpretation of the provision, then contract miners will continue attempting to claim the accelerated capex to the detriment of the revenue collector and unfortunately contract miners will remain unregulated in terms of our statutes. Secondly, should the National Treasury amend the Act as it currently stands, and contract miners cannot get allowances, it will result in contract miners having to review their contractual relationships with mining companies and or those entities with mining licenses. It might also cause a panic for contract miners to apply to the Department of Mineral Resources and Energy for a mining license as they will be deemed to be illegally operating, insofar as the section 11 requirement for the Minister's consent is concerned. Thirdly, if National Treasury proceed to amend the Act, but adjusting the provisions to include definitions for contract miners and create a detailed definition of mining that is in line with the industry norms and the MPRDA, then mining contractors will be regulated, the contracts will be better regulated and this might encourage SARS to consider a different type of incentive (not accelerated capex) to accommodate the mining contractors while regulating them rather than viewing them as opportunists. Ultimately this will change how the mining industry will operate in the future.

[173] Thambi K (2020).

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