

8.5 Scrapping allowance

A scrapping allowance in respect of machinery or plant used in a beneficiation process may be claimed. The scrapping allowance is, however, not available on buildings or improvements thereto used by the taxpayer for the purpose of carrying on therein any beneficiation process. The scrapping allowance in respect of buildings is only available to manufacturers, hotelkeepers and co-operatives (section 11(o)).

8.6 Machinery or plant

Unlike the wear and tear allowance, the beneficiation allowance is not restricted so as to exclude from machinery or plant such items which are structures or works of a permanent nature (C21.5 infra).

CHAPTER 9

MINERS

Mining operations

The mining industry is one of the largest and most important in South Africa. Revenues earned by the industry have contributed substantially to the national economy of the country. Understandably, therefore, the policy of the State has always been to encourage the exploitation of the Republic's mineral wealth. One of these methods of encouragement is contained in the Income Tax Act whereby certain capital expenditure incurred may be redeemed immediately from income derived by a taxpayer from mining operations.

Progressive changes in the methods by which gold mining companies have been permitted to redeem capital expenditure are of interest. Between 1899 and 1902 capital expenditure was redeemable over the estimated "life" of the mine in the form of equal annual amounts. Between 1902 and 1917 the capital redemption allowance was an amount, which, if paid by way of annuity over the "life" of the mine, would at 3% compound interest, produce an amount equal to the capital expenditure incurred. Between 1917 and 1946 the annual allowance was an amount obtained by dividing the unredeemed capital expenditure as at the end of the previous year of assessment by the estimated "life" of the mine. In 1946 the redemption of capital expenditure was permitted of an amount calculated by dividing the unredeemed capital expenditure by the "life" of the mine or of an amount equal to 20% of the unredeemed balance, whichever was the greater. The rate of 20% was increased in subsequent years. The current position as established

in 1973 in relation to all mines is that capital expenditure may be deducted from income derived from mining operations in full during the year of assessment in which it is incurred.

Apart from specific provisions contained in sections 15, 36 and 37, the general principles of the Act applies to taxpayers who derive income from mining operations.

9.1 The meaning of "mining operations"

It is relevant in relation to the capital allowances available to the mining industry under the Income Tax Act to consider the meaning of "mining operations". The meaning of the word "mining" must be dealt with in the context of the particular statute or contract being considered. "Mine" is defined in each of the following Acts: The Mining Rights Act; the Mines and Works Act and Regulations; and the Precious Stones Act. Although there is an overabundance of authorities under the common law dealing with the issue as to what constitutes mining, it is not the intention of this thesis to deal with these in detail.

The term "mining operations" is defined in section 1 of the Income Tax Act as: "'Mining operations' and 'mining' include every method or process by which any mineral (including natural oil) is won from the soil or from any substance or constituent thereof".

The use of the word "includes" in the definition indicates that the definition was not meant to be exhaustive. [In regard to the words "means" and "includes" in definitions see Jones & Co v CIR 1926 CPD 1, 2 SATC 7; Guernsey & Foreign Investment Trust Ltd v CIR 1938 CPD 158, 9 SATC 390].

In COT v Nyasaland Quarries and Mining Co [High Court of Nyasaland (February 1961), 24 SATC 579, an appeal from ITC 909, 24 SATC 97], Spencer Wilkinson CJ said at 582 that the court was "not concerned with the meaning of the expressions 'mining' and 'mining operations' in their everyday sense, and that the decision in this case must depend upon the meaning given to these expressions by section 2 of the Act.." And: "In my opinion there can be no doubt whatever that in defining the expressions 'mining operations' and 'mining' as it has done, the legislator intended to give these expressions, when used elsewhere in the Act, a meaning wider than the ordinary everyday meaning of those terms. Moreover, the extension of the usual meaning of those expressions is obviously intended to be a wide one, for the words used are very general. 'Mining operations' and 'mining' are to include every method or process by which any mineral is won. It is hardly possible to imagine more general words".

Primarily, the meaning of the word "mine" under common law was viewed by Innes J in Mutual Life Insurance Co of New York v Ingle (1910 TPD 540) as being: "A mine is an underground excavation or passage; and 'to mine' for minerals is to obtain ore in, or by means of, such an excavation or passage and take it to the surface". This restrictive interpretation was not followed in Boksburg Brick and Fire Clay Co Ltd v CIR (1941 TPD 232, 12 SATC 225). In that case a full bench of the Transvaal court held that the extraction of fireclay from an open working amounted to mining operations as defined in section 100 of the Union Income Tax Act, 1917, which was in terms identical to the present definition in the Income Tax Act. This interpretation was followed in a Zimbabwean case, [ITC 909 24 SATC 97, on appeal: COT v Nyasaland Quarries and Mining Co (February 1961), 24 SATC 579].

A person who, from the soil, obtains a substance which is not regarded as a "mineral" would not be carrying on mining operations under the Act. This is illustrated by the statement of Maritz J in the Boksburg Brick and Fire Clay case (supra): "It follows, on the facts of the case, that if 'fire clay' is a mineral, the plaintiff company is employing commercially a method or process by which fire clay is won from the soil; that is to say, it is engaged in mining operations for profit". (The meaning of "mineral" is discussed below in C9.8 infra).

Prospecting and exploration activities do not fall within the ambit of mining operations. The taxpayer in Murchison Exploration and Mining Co Ltd v CIR (TPD June 1938, 10 SATC 143) purchased a large number of mining claims. The exploration and prospecting activities by the taxpayer included cutting trenches, sinking exploration shafts (too small for mining operations), various buildings and the installation of machinery and plant. Maritz J held: "The Income Tax Act is concerned with the profits derived from carrying on a business and I fail to understand how a man can carry on the business of prospecting and exploring his own property. Such prospecting and exploration are merely means to an end; the end being whether, after these tests, the business of gold production can be profitably undertaken In so far as the Income Tax Act is concerned, mining is the process by which minerals are won from the soil for the purpose of profit. Prospecting and exploration and assaying work are merely methods adopted in order to test the property; in order to see whether it is worthwhile mining". The court concluded that the taxpayer did not carry on the business of mining for gold.

9.2 Mining operations v process of manufacture

A taxpayer's activities may include the following:

- a) Mining of the ore from the soil;
- b) purification of the ore into some sort of mineral;
and
- c) processing of the mineral into a manufactured article.

The question which arises is at what point do mining operations cease and processing begin. The question is crucial due to the two types of capital allowance available under the Act. The miner can claim a 100% deduction of capital expenditure incurred in year one while the aggregate allowances available to a manufacturer in terms of sections 12 and 13 amount to 130% and 120% respectively of cost of machinery or plant and buildings.

The South African courts have recognised the fact that both mining operations and manufacturing operations can be carried on by the same taxpayer. In Boksburg Brick and Fire Clay Co Ltd v CIR (1941 TPD 232, 12 SATC 225), a taxpayer derived a profit from the extraction of fire clay from the soil, its treatment and its manufacture into such articles as fire bricks, slabs, crucibles, furnace linings and retorts and the sale of the treated clay or the manufactured articles. The taxpayer contended that certain of the operations carried out by him constituted mining. It was held that the operations whereby the company extracted the clay from the soil constituted mining operations. The court did not have to decide the exact point at which the mining operations ceased and required the Commissioner to determine the amount of taxable income derived from mining operations. Maritz J held: "In my opinion, therefore,

the contention of the plaintiff company is correct, and a portion at least of its commercial activities is devoted to mining operations".

In cases where taxpayers carry on both mining and manufacturing operations a crucial question is where mining ceases and where manufacturing commences. The court in S R v Cape Lime Company Ltd [1967 (4) SA 226(A), 29 SATC 131] found that the production of lime by the taxpayer involves the following steps -

- . the extraction of the limestone from natural deposits;
- . the breaking up of this raw material into pieces of manageable size;
- . the subjection of the pieces of limestone to the calcination, hydrating and milling and separating process to produce the powdered lime; and
- . the packing into containers.

The issue which had to be decided was whether the process of manufacture commenced with the operations at the site or only with the later operations at the reduction plant. It was held that the breaking up of the raw material on the floor of the quarry was the commencement of the process of manufacture. (See C4.13 supra for a detailed discussion of that case).

Whether assets are used in a process of manufacture would depend on their relationship with the process (ITC 1266, 39 SATC 142). It follows that in the determination of the commencement of the process of manufacture one would have to consider all the assets which are used by the taxpayer and define the purpose of their usage in relation to the various activities of the taxpayer. This procedure will indicate whether certain

assets are used by the taxpayer directly in the process of manufacture. The "direct" use is an important requirement for machinery or plant to qualify for the capital allowances in respect of a process of manufacture under section 12 of the Act. Refer to C4.13 and 4.14 supra for a discussion on "commencement of the process" and "directly in a process of manufacture".

9.3 Mining v processing - common law

The main object of the plaintiff in Rand Refinery Ltd v Town Council of Germiston (1929 WLD 63) was the refining of gold. Firms engaged in mining operations in South Africa were eligible for membership. One of the issues which the court was called upon to decide was whether the work of refining gold was work which was incidental to mining operations. The plaintiff contended that the object of mining for gold and silver was to win those metals in their present form and that the work done for that purpose was work incidental to mining operations. On the facts of the case it was held that refining was a process which is carried on separately from ordinary mining operations. It was further held that "mining" in the ordinary sense of the term does not include more than the extraction of ore from the ground, and its reduction to a commodity easily disposed of, and that "mining operations" therefore cease when a mining company has produced its bars of bullion.

In Union Government v Nourse Mines Ltd (1912 TPD 24), Wessels J said at 930: "The ordinary meaning of the words 'to win gold' is to obtain or get the gold in the form of metal. To win gold includes all the operations necessary, not only to reach and extract the ore, but also to convert it into metal. There is no reason why

we should give to winning gold the technical meaning given to winning coal in Lewis v Fothergill. It might be different if the Legislature had spoken of winning ore". (A mining lease in Lewis v Fothergill 5 Ch 106 provided for a royalty on every ton of coal won and worked. "To win coal" was considered to mean to place the coal in such a position that it could be worked continuously in the ordinary way).

A company in Rex v Blom and Another [1951 (1) SA 708(T)], carried on the business of the winning of and quarrying of lime. The raw material was taken out of the ground, processed and turned into building lime. The question which arose was whether the company was carrying on the business of mining. Blackwell J came to the conclusion "that it was not correct to say that processed lime was in the same category as stone sand or clay. These are raw materials which are all about to be taken direct from the soil without any processing ...". Roper J concurred, and added at 710: "I just want to say that no distinction was drawn in the evidence or has been drawn in argument in this case between the operation of excavating limestone by quarrying operations and conveying it thereafter to the roasting kilns and the further operation of roasting the limestone and slaking it and so converting it into lime. It is possible that a distinction may be drawn between these two operations in other cases in which the meaning of 'mining' or 'mine' is 'in question'. Quarrying was therefore held to be an operation of mining and it was recognised that mining and processing can be carried on simultaneously by one business.

9.4 Mining v processing - foreign countries

A Zimbabwean taxpayer in ITC 1249 (38 SATC 74) processed all the iron ore mined, and sold it either in the form of the product pig iron, or in the form of steel blooms, steel billets or steel sections. The case concerned the depletion allowance available under the Zimbabwean Act, and the court was confronted by the above issue. The contention of the taxpayer was that as iron ore is not a saleable commodity it could never have been the intention of the legislator to deprive a taxpayer who mines this mineral and then processes it into a readily saleable form, from claiming a depletion allowance. The taxpayer conceded that his contention involved determining the extent to which the metal which derived from the mineral had been modified by the various processes to which it had been subjected. AR Gubbay SC replied at 77: "I did not understand him to suggest for instance, that the sale of a steel window section could be regarded properly as the sale of a mineral. But where is the line to be drawn? It seems to me that where a mineral is processed to the extent that it is converted into something - an alloy - which is not to be found within the earth's crust, it no longer retains its character as a mineral. This does not mean that any treatment of the mineral obtained would cause it to lose its character. For example, the separation of diamonds from a mineral by sluicing would clearly not do so. In my judgement the manufactured products sold by the appellant are so essentially different in character from the iron ore as to disentitle them from being regarded as minerals which have been deposited in the earth's surface by natural agencies".

The value of minerals produced for the purposes of a depletion allowance in Zimbabwe was the issue in ITC 1339 (43 SATC 178). The taxpayer was a producer of coal and also made coke from the coal it mined. Coke is made by heating washed and ground coal to a high temperature and without oxygen in special ovens. This process removes the volatile content and results in a residue of improved carbon content and better performance as a combustible, particularly in blast furnaces. The court found coke to be a mineral. The decision was based on expert evidence to the effect that if an igneous intrusion, occurred into an existing coal seam within the earth's crust, then adjacent to this intrusion there would be found coke, having been made in the same way as coke sold by the appellant - namely, by exposing the coal to intense heat in the absence of oxygen. The one mineral was therefore altered into another mineral which was not mined as such by the taxpayer. Squires J said that the word "winning" means "in its ordinary, normal use, the 'gaining, obtaining or getting', and 'any operations' designed to produce minerals from a substance or constituent of the earth, qualifies as a mining operation. That seems to me to express a very wide spectrum of activity and prime facie appears to safely include the process whereby the appellant's coal, as a substance of the earth, is treated. If the purpose of that treatment is to obtain coke, and coke is a mineral, as equally clearly it must be from the definition of 'mineral', unlike the pig-iron or alloys that were the subject of ITC 1249 (38 SATC 74), then the appellant's treatment of this coal to produce coke would be a mining operation in my view, if carried on in conjunction with proper mining, which also seems to be the case. For 'in conjunction' simply means in combination of events and circumstances; that is the appellants proper mining activities in digging coal out

of the earth, and preparing both coal and coke for sale, not only in the same complex but as part of the same enterprise with the same direction, management and expertise".

In a majority decision in the Australian case of Broken Hill Proprietary Company Limited v FCT (1969, 1 ATR 40), it was held that 'mining operations' "covers 'work done on a mineral-bearing property in preparation for, or as auxillary to, the actual winning of the mineral', but, with regard to the statement, that 'it extends to any work done on the property subsequently to the winning of the mineral (eg transporting, crushing, sluicing and screening) for the purpose of completing the recovery of the desired end product of the whole activity', we have a reservation. We do not doubt that to separate what is sought to obtain by mining from that which is mined with it, eg the separation of gold from quartz by crushing etc, or the separation of tin from dirt by sluicing, is part of a 'mining operation', but we would not extend the conception to what is merely the treatment of the mineral recovered for the purpose of the better utilisation of that mineral. Thus to crush bluestone in a stone crushing plant so that it can be used for road making, or to fashion sandstone so that it becomes suitable for building a wall or a town hall, is not, as we see it, a mining operation. Nor would the cutting of diamonds or opals which have been recovered by mining operations fall within the description of mining operations". The court also did not consider the conversion of brown coal into briquettes and the treatment in a refinery of naturally occurring hydrocarbons in a free state as part of 'mining operations'.

To obtain gold from gold-bearing material, ie slum dumps, by sluicing, screening, filtering and chemical treatment, was held to be a mining operation in FCT v Henderson (1969, 1 ATR 133). Dump recovery operations carried on by gold mining companies and by companies whose sole objects are that of dump recovery operations are regarded by the Commissioner in South Africa as carrying on mining operations.

The taxpayer company in COT v ICI Australia Ltd (1972, 3 ATR 321) obtained salt by causing bores to be driven into the ground and pumping brine containing the salt to the surface. Salt was produced by subjecting the brine to a series of evaporation processes. The issue in that case was whether the mining activity ceased at the time of the recovery of the brine from underground or at the time of the recovery of the commercial product salt. Barwick CJ, whose reasons were adopted by McTiernan J, said: "Of course, if the evaporation was of sea water or of salt water obtained otherwise than from below the surface of the earth, the evaporation process would not itself be a mining operation any more than the pumping of the water from the sea or from a lake would be mining operation. But though the evaporation process is similar in each case the facts that the brine is the immediate product, as I think, of a mining operation and that the recovery of the mineral raised by the mining operation is not complete until the evaporative process is itself so associated with the raising of the brine and the recovery of the metal, sodium chloride, as to be part of the mining operation". The mining operation was held to have ceased at the time of the recovery of the commercial product, salt.

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9.5 Summary of decisions under common law and in foreign cases

When mining operations cease and processing begins, has not yet been decided by the South African courts. A summary of the decisions under common law and in foreign countries may therefore act as a useful guide to South Africa taxpayers.

- . A taxpayer can carry on both mining and manufacturing processes simultaneously.
- . To "win from the soil" means extracting the metal into its finished state. If a process is required to render the ore (raw material) into its finished state, such process, in order to form part of mining operations must be so associated with the mining of the raw material so as to be considered part of the mining operation. Such a closely associated process must further in order to qualify as part of the mining operation, be carried on by the same taxpayer in conjunction with the mining operations.
- . Any process which, by the addition of another substance, results in a product which is essentially different in character to the raw material mined, will not be considered to be a mining operation.
- . The purification of minerals is not regarded as part of the mining operations.

9.6 Mining operations - uranium and natural oil

Prior to 1951, the Act provided that income derived from gold should include any income derived from silver, osmiridium and other minerals won in the course of mining for gold. No mention was made of uranium.

In 1947 General Smuts started negotiations with the United States of America and the United Kingdom with the view of supplying those countries with uranium. As a result of those negotiations which led to firm agreements, and in anticipation of the start of uranium oxide production, the word "uranium" was added to the list of other minerals won in the course of mining for gold.

Currently, therefore, for the purposes of determining a gold mine's income derived from mining for gold, there is included "any income derived from silver, osmiridium, uranium, pyrites or other minerals which may be won in the course of the mining for gold, and any income which, in the opinion of the Commissioner, results directly from mining for gold".

In 1957 the Act was further amended with retrospective affect to 30 June 1951, by the introduction of the following definition, which is also its current form: "'mining for gold' or 'to mine for gold' includes mining for uranium or to mine for uranium". This amendment was needed to cover the admission to the uranium production activities of mines which were primary producers of uranium without gold as a by-product.

The word "mine" in the two phrases "to mine for gold" and "to mine for uranium" is not used in the same context. Unlike gold, uranium cannot be extracted from the soil. Uranium is the product of a chemical process, and that being the case, can one argue that one is involved in a process of manufacture? Although this appears to be the case one will, however, for income tax purposes still be regarded as a mine extracting uranium from the soil.

What would the tax consequences be to a uranium producer who is not carrying on mining operations, should mine dumps be considered as a movable asset? Could the mine dump under these circumstances be considered as raw material to be consumed in a process of manufacture? It would appear that if a mine dump is classified as a movable the uranium producer could regard it as stock in trade which would then be governed by the rules of section 22 of the Act. The question of whether a mine dump is a movable or an immovable has not yet been decided by our courts. A mine dump consists of ordinary soil which is dug up from the ground and deposited on land. It is therefore a movable deposited onto an immovable. Van Winsen AJA in Theatre Investments (Pty) Ltd and Another v Butcher Brothers Ltd [1978 (3) SA 682 (A)] said: "A generally accepted test [see the cases referred to in Standard Vacuum Refining Co of SA (Pty) Ltd v Durban City Council 1961 (2) SA 669 (A) at 677] to be applied to determine whether a movable, capable of acceding to an immovable and which has been annexed thereto, becomes part of that immovable is to enquire whether the annexor of such a movable did so with the intention that it should remain permanently annexed thereto. Evidence as to the annexor's intention can be sought from numerous sources inter alia, the annexor's own evidence as to his intention, the nature of the movable and of the immovable, the manner of annexation and the cause for and circumstances giving rise to such annexation. The ipse dixit of the annexor as to his intention is not to be treated as conclusive evidence thereof but, should such evidence have been given, it must be weighed together with the inferences derivable from the other sources of evidence abovementioned in order to determine what, in the view of the Court, was in fact the annexor's intention. In cases where no evidence is forthcoming from the annexor, a court will

be constrained to determine the issue upon such inferences as may legitimately be drawn from the sources aforementioned. If a court, on a consideration of all the evidence, direct and inferential, were to conclude on a balance of probabilities that the annexor intended a permanent annexation it would hold that the movable had become part of the immovable. If on the other hand it were to conclude on a balance of probabilities that, in the light of such evidence, the annexor's intention was not to effect a permanent annexation or if it found itself unable to draw any inference one way or other as to the annexor's intention then it would conclude that the annexed movable had lost its character as such". Depending on the particular facts of the case, a mine dump could therefore be capable of being classified as either movable or immovable.

Section 5(2A)(d) provides: "For the purposes of this subsection where sulphur, salt or any other mineral is won by any company in the course of mining for natural oil (excluding gas) or natural oil in the form of gas, the income derived from the mining of such sulphur, salt or other mineral shall be deemed to be derived from mining for natural oil (excluding gas) or natural oil in the form of gas, as the case may be". It is submitted that this subsection only applies to taxpayers who, in addition to mining for oil, also refine the oil during which process the mentioned byproducts are produced. A separate taxpayer obtaining crude oil by other means than mining, and then carries on a refining process cannot, it is submitted, be classified as a person carrying on mining operations.

9.7 Mining operations v process of manufacture - conclusion

Mining tax in South Africa is very much a matter of practice than law. In South Africa there are only a few reported cases in relation to disputes between the mining industry and the Fiscus.

The issue is at what point do mining operations cease and processing begins in the following activities of a taxpayer -

- (a) mining of the ore from the soil;
- (b) purification of the ore into some sort of mineral;
and
- (c) processing of the mineral into a manufactured article.

The ordinary meaning of mining is the digging up of the soil which is the activity suggested in (a) only above. The Act is, however, not concerned with the method used as long as the intention is to extract a mineral from the soil. It is submitted that the dividing line between mining and processing is manoeuvrable. The activity under (a) above will always, because of its very nature, be an operation of mining. By using a separate tax entity the manufacturing process can be manipulated to commence after (a). To achieve this the miner sells the ore mined to, say, a separate company. This company would then carry out the activity suggested in (b) and possibly also (c) above.

In practice the Commissioner accepts that the dividing line between mining and processing is manoeuvrable. If a continuous process, covering all three above activities, is performed by the same taxpayer, the whole of the operation could be classified as a mining

operation. Needless to say, any scheme must be at arm's length and must meet the requirements of normality, otherwise one runs the risk of being trapped by section 103!

9.8 "Minerals" - under common law

Another factor which is relevant in relation to the capital allowances available under the Income Tax Act to the mining industry is the interpretation of the word "minerals". The emphasis in the definition in the Act of "mining operations" is on the winning of minerals. The relevant case law as regards the meaning of "minerals" under the common law is fully discussed in the Appellate Division decision in Falcon Investments Ltd v Birnam (Suburban) (Pty) Ltd [1973 (4) SA 384]. On whether a narrow meaning should be given to "minerals" as plumped for by the appellant in that case, or whether a wider meaning should be given, Rumpff JA said at 396: "From decided cases in our Courts, as well as from statutes of our Legislature, it also clearly appears that the word 'mineral' may be used in different senses and it follows that in order to decide what the meaning is that has to be given to the word in a particular case, it is necessary to determine the intention with which the word is used. In contracts between parties, for instance, the intention may have been to use the word in a 'narrow' sense".

In The Mining and Mineral Laws of South Africa, the authors, at page 34, summarise the meaning of "minerals" from legal decisions of the principal statutes and the common law as follows: (The principal statutes are: The Precious Stones Act 73 of 1964; the Mining Rights Act 20 of 1967; the Mining Titles Registration Act 16 of 1967; and the Atomic Energy Act 90 of 1967).

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"Two fundamental principles emerge from the decisions relating to the meaning of the word 'mineral' in the principal statutes, namely --

- (a) That in every case it is the intention with which the lawgiver in a statute used the word 'mineral' that must be ascertained: Falcon Investments case 1973 (4) SA 384 (A) at 400 B-C; Bellville-Inry case 1976 (3) SA 583 (C) at 585 H;
- (b) That the word 'mineral' (which in practical terms is confined to the expression "base mineral" because all other classes of minerals are precisely defined), as defined in the 1967 Mining Rights Act and the 1956 Mines and Works Act, is not used in the narrow sense of the ordinary or popular use of the word, but in the very wide sense indeed".

Although the decision of the courts are not harmonious they all accept that the word "minerals" is capable of an expanded or wide meaning, or of a restricted or what is commonly referred to as a "popular" meaning. The latter would be the meaning as understood in ordinary language, and would therefore exclude substances such as sand, stone and clay. In Ex parte Erasmus [1968 (4) SA 788 (T)] the meaning of the word "minerals", for the purposes of registration of mineral contracts in the Deeds Office, was held not to include stone. Yet in the Falcon Investments case (*supra*) the Appellate Division held that, for the purposes of a town planning scheme, stone was a "mineral".

9.9 "Minerals" - under tax law

The term "minerals" is not defined in the Income Tax Act. In addition to the absence of any definition there are very few reported decisions in respect of the

interpretation of the word under the Act.

The only reported case in South Africa concerning the interpretation of the term appears to be Boksburg Brick and Fire Clay Co Ltd v CIR (1941 TPD 232, 12 SATC 225). The court in that case held that fire clay is a mineral. The decision of the court was based on the following facts: "Fire clay is a simple, comparatively homogeneous natural substance found in practically all parts of the world and being, but for natural impurities, hydrosilicate of alumina. In its natural occurrence the hydrosilicate is always found associated with a very low percentage of such substances as iron oxide, magnesium oxide, calcium oxide and potash, but this percentage, being low (usually less than 1 per cent in all), does not affect the important commercial property of the hydrosilicate, namely the property of being highly refractory and capable of resisting very high temperatures (such as 1,500 degree centigrade or more) without fracture, fusion or softening. While the analysis of fire clay varies slightly in regard to the abovementioned impurities, depending upon the particular area in which it is found, the chemical composition of the hydrosilicate is definite and constant and the physical properties of the fire clay, such as specific gravity, varies only very slightly and then only in so far as the small percentage of the abovementioned impurities found in the natural hydrosilicate varies. Its hardness varies according to the extent to which natural disintegration may have set in. Fire clay is different from and very much more valuable than ordinary clay, which is a soft substance obtained by quarrying and is used for brickmaking".

It is submitted that whether a substance will be classified as a mineral is a question of fact. The following scientific connotation of the word "mineral" by

Professor McIver, an associate Professor of Geology at the University of the Witwatersrand at the time, was quoted in Falcon Investments Ltd v CD of Birnam (Suburban) (Pty) Ltd [1973 (4) SA 384 (A)]: "The following definitions of the terms 'mineral' and 'rock' are those accepted by geologists in both scientific terms and common parlance.

A mineral is a naturally occurring inorganic substance with a characteristic internal structure determined by a regular arrangement of the atoms or ions within it and with a chemical composition and physical properties that are either fixed or that vary within a definite range.

Rocks are aggregates of minerals and are made up of definite mineral assemblages.

In my opinion andesite is a rock and not a mineral in both scientific terms and common parlance".

9.10 "Minerals" - under foreign tax law

In a joint judgement Dixon CJ, Williams and Taylor JJ said in New South Wales Associated Blue Metal Quarries Ltd v FCT (1955 6 AITR 239): "Few words have occasioned the Courts more difficulty than 'minerals', but in some degree that is because in legal instruments it is seldom, if ever, used in its accurate or scientific sense, and yet the word possesses no secondary meaning at once accepted and definite".

"Mineral" was defined in Great Western Railway v Carpalla United China Clay Company (1909 1 Ch 218) as follows: "If I were rash enough to venture a definition of 'mineral' I should say that it is any substance that can be got from within the surface of the earth which

possesses a value in use, apart from its mere possession of the bulk and weight which makes it occupy so much of the earth's crust. I should not think that what, in engineering cases is usually known as 'contractor's muck' is a mineral. To dig out ballast and crush stone and earth, a mere mixture of heterogeneous portions of the earth's crust, for the purposes of making embankments, where the material goes from one position in the earth's crust to another without modification or being submitted to any process of manufacture, does not seem to me to be making use of minerals, although no doubt the things that you are handling were originally within the earth's crust. Such materials have not a value in use apart from their bulk and weight, and they are only used as being capable of forming a portion of the earth's crust in a new position. On the other hand, everything that has an individual value in use appears to me to be fairly called a mineral."

Gneiss as worked by the taxpayer in GOT v Nyasaland Quarries and Mining Co Ltd [February 1961 (High Court Nyasaland) 24 SATC 579], was held to be a mineral. The President of the court found the numerous decisions on the subject of little assistance, as "those authorities merely decide whether a particular commodity is or is not a mineral within the meaning of some particular statute or document, and it is noteworthy that a large number of things have in some cases been held to be minerals and in other cases held not to be minerals". Whether a particular substance is a mineral was viewed by the court to be a question of fact.

In a Zimbabwean case, ITC 1249 (38 SATC 74) the court adopted the "popular" meaning of the word mineral ie what is understood by the term in ordinary language. In that case it was held that the interpretation of the

word should not be widened to include a manufactured product, "albeit such product has its origin in a valuable crystalline substance which is deposited in the earth's surface by natural agencies". A "mineral" was found to be a substance which must be found naturally within the earth's surface.

9.11 "Minerals" - conclusion

- . It is submitted that under tax law -
 - . whether a substance is a "mineral" is a question of fact; and
 - . that a substance, in order to qualify as a "mineral" must be of such a nature as to be accepted as such by geologists in both scientific terms and by the layman. "Mineral" should be given the "popular" meaning which would result in a restrictive interpretation of the word.
- . Foreign decisions which may be of some guidance to South African taxpayers, can be summarised -
 - . the issue whether a substance is a "mineral" is a question of fact;
 - . all qualifying substances must have an individual value in use; and
 - . "mineral" should be given a meaning of what is understood by the word in ordinary language.

9.12 Capital expenditure incurred by a miner

Mineral deposits are classified as wasting assets, which when exhausted become worthless. There is no provision in the Act by which the cost of the acquisition of wasting capital assets may be deducted in the determination of taxable income. In CIR v George Forest

Timber Co Ltd (1924 AD 516, 1 SATC 20) the taxpayer acquired a natural forest for the purpose of its business as timber merchants and sawyers. The nature of the trees in the forest was similar to that of minerals in that they did not renew themselves. The taxpayer sought to deduct from its income a proportionate part of the cost of the forest relative to the timber felled in each year. The court held that the cost of the forest-bearing land was of a capital nature and that it was not permissible to divide the single purchase price of the property between the land and the forest.

The income earning assets of a miner taxpayer are the minerals he mines and which are irreplaceably consumed each year of assessment by his mining operations. Initially, capital expenditure (excluding the cost of land) incurred by a miner taxpayer was redeemable over the estimated "life" of the mine in the form of the deduction of equal annual amounts from income derived from mining operations. The reasons for this concession are: (not necessarily in the order of importance)

- . The cost of land containing mineral deposits is of a capital nature and therefore not deductible from income.
- . Mining operations which are site bound invariably necessitate substantial sums of money for the establishment of costly infrastructure in remote undeveloped areas.
- . Income from mining contributed substantially to the national economy of the country, and it was therefore in the interest of the State to encourage the exploitation of mineral wealth.

Currently, capital expenditure is deductible from income derived from mining operations in full during the year in which they are incurred.

Prior to the 1983 amendments the allowance in respect of capital expenditure was not limited to income derived from mining operations. The allowance could therefore have resulted in a loss which could have been set off against non-mining income. The new section 36(7E) limits the deduction of the allowance to taxable income derived by the taxpayer from mining [before the deduction of mining capital expenditure authorised by section 15(a)]

The Deputy Minister of Finance explains the reason for the introduction of the new section during the second reading of the Income Tax Act 1983 (House of Assembly Debates, 24 June 1983 Col 10274):

"During the past years the practice of one type of business making use of the tax allowances of another in order to reduce its own tax base, has become more and more prevalent, and in this regard the practice has developed for enterprises unrelated to mining to become partners in mining enterprises, and then to utilise losses resulting from the allowance of capital expenditure to the mining enterprise in determining their taxable income derived from non-mining income. The proposal will not affect mining companies as such but will affect non-mining companies who are involved in a mining enterprise, and then only as regards their non-mining income". (In terms of section 62 of the Income Tax Act 94 of 1983 effective as from the commencement of years of assessment ending on or after 1 January 1984).

In terms of section 15(a) of the Act there shall be allowed to be deducted from the income derived by the taxpayer from mining operations an amount to be ascertained under the provisions of section 36, in lieu of the following allowances -

- . wear and tear allowance [section 11(e)];
- . the allowance in respect of premiums paid for the right of use or occupation of land or buildings, plant or machinery, motion picture film and industrial or intellectual property [section 11(f)];
- . the allowance in respect of the cost of industrial or intellectual property [section 11(gA)];
- . the scrapping allowance [section 11(o)]; and
- . the machinery initial allowance [section 12(1) including section 12(1) as applied by section 12(3)]. The initial and investment allowances in respect of machinery or plant and buildings are not available to taxpayers carrying on mining operations (section 12 and 13).

Expenditure incurred by a taxpayer on prospecting operations (including surveys, boreholes, trenches, pits and other exploratory work preliminary to the establishment of a mine) are deductible under section 15(b) (C9.18 infra). The expression "capital expenditure", which specifically excludes prospecting expenditure in terms of section 15(b)(iii), is defined in section 36(11) as meaning -

- . expenditure on shaft sinking and mine equipment and, in the case of a natural oil mine, the cost of laying pipelines from the mining block to the marine terminal or the local refinery, as the case may be; ("expenditure on shaft sinking" includes the expenditure on sumps, pump chambers, stations and ore bins accessory to a shaft).
- . expenditure on development, general administration and management (including any interest and other charges payable after the thirty-first day of December 1950, on loans utilised for mining purposes) prior to the commencement of production or during any period of non-production; and

a special capital allowance to be included in capital expenditure. This allowance is a compound interest factor calculated on the unredeemed capital expenditure and is allowed in respect of certain gold mines and natural oil mines. The allowance is similar to the allowance in terms of section 26(2) of the Mining Rights Act (see "special capital allowance", C9.16 infra).

The mere fact that a particular item of expenditure falls within the definition of "capital expenditure" in section 36(11) does not necessarily mean that it must also be regarded as expenditure of a capital nature as envisaged by section 11(a) of the Act. This principle, as established in Sub Nigel Ltd v CIR [1948 (4) SA 580 (A), 15 SATC 381], was confirmed in Palabora Mining Company Ltd v SIR [1973 (3) SA 819 (A), 35 SATC 159]. In the latter case, the taxpayer, with the sole purpose of securing an adequate supply of water for its mining activities, undertook the erection of a barrage to impound the rainfall during the 1965 rainy season. The efforts and expenditure made by the taxpayer to complete the barrage resulted in the impounding of all water required to fill the dam completely during April 1966. The completion of the dam resulted in the avoidance of delay of approximately eight months in the taxpayer's earning of profits. The taxpayer made a loss in the erection of the barrage, which loss he claimed as a deduction from income. On the facts of the case the court held that as the taxpayer was trading for tax purposes, the loss was not of a capital nature and therefore deductible under section 11(a) of the Act. The decision was based on the fact that as the waterworks were not built on the taxpayer's property, neither an asset nor an advantage of an enduring nature was created by the expenditure so incurred. Ogilvie

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Thompson CJ said: "The deduction allowed by the provisions of section 15(a), in respect of income derived by a taxpayer from mining operations, is an amount 'to be ascertained under the provisions of section 36' and which is expressly stated to be 'in lieu of the allowances' referred to in the various sections of the Act listed in section 15(a). That list does not include section 11(a). It follows that the foregoing provisions do not impinge upon the ambit of section 11(a) of the Act. It would, in my opinion, indeed be remarkable if they did; and it is difficult to think that the legislature could have intended such a result".

9.13 The nature of capital expenditure

The meaning of "mine equipment" is very general and very wide in the South African sense, and includes all expenditure required to make a mine operate. These expenses would include the cost of buildings, machinery, plant, welfare facilities and any other expenses which would enable a mine to fulfil its function of extracting minerals from the soil. The deduction allowed under section 15(a) are in lieu of certain allowances as above. It could therefore be argued that the meaning of "equipment" should be restricted to the type of assets in relation to the allowances referred to in section 15(a). This argument was used by Hill J in ITC 1110 (29 SATC 169). The case was decided before the introduction of section 11(gA) (development and acquisition of industrial or intellectual property). The court held that the meaning of "equipment" "should be restricted to tangible things forming part of the apparatus or plant belonging to or controlled by the mining company.

In Union Government v Nourse Mines Ltd (1912 TPD 924) the question came up whether the equipment of a mine means anything constructed underground which is indirectly necessary for bringing the ore in a position to be treated, or whether it is something of a more special character. Wessels J said at 932: "The original meaning of the word 'equip' is to fit out, as to fit out a ship for a sea voyage, and the ordinary meaning which we give to 'equipment' today is the outfit required for a special purpose. Thus the supplies and arms form the equipment of a fleet, and the rolling stock and other apparatus necessary for the running of a railway are often called the equipment of the railway. We would not call the ships themselves the equipment of a fleet, nor would we call the road on which the rails are laid part of the equipment of a railway. In the same way the hole in the ground called a shaft is not part of the equipment of a mine any more than are the levels, drives, winzes or raises. The timbering, however, in the shaft, the pumps that pump up the water, the rails and trolleys for carrying ore, and generally all the apparatus that is necessary for carrying on mining operations may be called equipment of a mine". The same learned judge expressed himself as follows as regard the meaning of "shaft sinking":

"A shaft is a hole, either vertical or inclined, which serves as an approach from the surface to the various workings underground. It has to be furnished, according to law, with certain adjuncts, of which a sump is apparently not one. In sinking the shaft it may be that water is encountered, and then the water has to be pumped out. The cost of this pumping, whilst the shaft is being sunk, is no doubt part of the cost of shaft-sinking, but as the shaft proceeds down and various levels are thrown

out towards the reef the water collected in all these levels brought for convenience sake to the shaft and then pumped out in the ordinary way".

"Expenditure on shaft sinking" is now defined and "includes the expenditure on sumps, chambers, stations and ore bins accessory to a shaft".

A question which arises is whether a capital expense relating to an activity, such as marketing the mineral can be considered as mine equipment. Wessels J in the Nourse Mines case (supra) stated at 932 that the equipment of a mine would include "all the apparatus that is necessary for carrying on mining operations". The capital expenditure was restricted to those necessary for mining operations. It was concluded above (C9.5 supra) that to "win from the soil" means to extract the metal into its finished state, at which point mining operations would cease. If the conclusion arrived at is correct it would appear that capital expenditure relating to assets used in marketing activities would not qualify as mine equipment. The definition of "capital expenditure incurred" lends further support to this contention. The definition refers to capital expenditure incurred "in respect of any mine". If it can be said that a mine is a place where mining operations are carried on, it would also appear that the capital expenditure is restricted to those mining operations. This conclusion would appear correct if a narrow interpretation is given to the expression "mining operations". The situation should be compared to farming operations. van Winsen J held in Rex v Porterville Ko-op Landbou Maatskappy Beperk [1952(1) SA 44(C)]: "Die begrip 'boerderywerk' kan egter 'n wye betekenis hê en ook werk dek deur 'n boer of sy werknemers verrig in die produksie of verkoop van

plaasprodukte, afgesien van waar die verrig word". That case was, however, decided under the Liquor Act of 1928, and whether such a wide interpretation would be given under the Income Tax Act remains an open question. (See also: Dryburgh v The Lord Advocate 1926 Scots Law Times, page 99; Bryant v Minister of Labour and Minister of Justice 1943 TPD 205; and R v Sidersky 1928 TPD 109).

With reference to capital expenditure incurred in respect of any mine it should be noted that there is no requirement under section 36 that the mine equipment should be used during the year in order to qualify as capital expenditure. Section 11(e), on the other hand, requires that machinery, implements, utensils and articles must be used during the year of assessment in order to qualify for the wear and tear allowance.

Finally, it should be noted that "expenditure" is defined and "means net expenditure after taking into account any rebates or returns from expenditure, regardless of when such last-mentioned expenditure was incurred".

The Mining and Mineral Laws of South Africa by Franklin and Kaplan summarises capital expenditure on page 715: "Generally, the concept of what is included in capital expenditure is liberally interpreted. Buildings necessary for carrying on mining operations are regarded as part of the equipment of a mine; so also is housing, including housing in an established township provided that such housing is on land belonging to the mining company, and is required for mine employees. The land however is not included as 'equipment'" and at page 717: "Not included in capital expenditure is the cost of any mining claims, mineral rights, land or other similar

expenditure, although the assets or rights so acquired are wasting assets, as are other assets the cost of which is nevertheless included in capital expenditure".

9.14 Capital expenditure - multiple mining operations

In terms of section 15 of the Act an amount, as determined under section 36, is allowed as a deduction from the income derived by a taxpayer from mining operations. The latter section provides that such amount to be deducted from income derived from the working of any mine shall be - the amount of capital expenditure incurred. As stated above, this allowance is granted in lieu of certain specific capital allowances. (See C9.13 supra). The section further provides that the allowance is only available in the year when a mine commences production. In terms of these sections therefore, each mine must be considered separately in relation to the capital allowance. A taxpayer with two mines will have to allocate capital expenditure between the mines. The capital expenditure of the one mine cannot be off-set against the income from mining operations of the other.

The question which arises is whether these provisions would also apply to mines which are "contiguous" as envisaged by section 36(10). The Commissioner in practice, accepts that capital expenditure on a contiguous mine can be set off immediately (even if prior to production) against the mining income of an existing and operating mine. It is submitted that the concept of contiguity is historical. It refers to the situation which used to arise when a taxpayer had two mines and was writing off the capital expenditure over the life of each mine. The contiguity aspect was aimed at preventing the taxpayer from writing off the capital

expenditure over the period of the mine with the shorter life. Currently, capital expenditure is not written off over the life of a mine, and section 36(10) therefore applies to a situation which no longer exists in practice.

A further question is whether the extension of an existing mine by sinking another shaft would be regarded as a separate mine under section 36. The Act is silent on this aspect and there appears to be no reported cases on the subject in South Africa. As stated above, the Commissioner, in practice, allows the deduction of capital expenditure on a contiguous mine from the income of an operating mine. The rules which the Commissioner applies in determining whether a mine is contiguous are:

- . The leased or mining area must be adjacent to or adjoining the operating mine.
- . The infrastructure must, to a large extent, serve both the new and the operating mine.
- . The management structure must be integrated to the affect that one management structure would serve both mines.
- . The accounting system must be integrated.
- . As regards coal mines, the Commissioner considers to what extent the taxpayer has joint marketing facilities in relation to the various grades of coal.

9.15 Capital expenditure - locality of assets created

Capital allowances to the mining industry are available in respect of "capital expenditure incurred". The Act is silent as to whether such expenditure is restricted to the taxpayer's own property.

In Palabora Mining Co Ltd v SIR [1973(3) SA 819 (A), 35 SATC 159] the issue was whether the cost of the erection of a barrage was of a capital or revenue nature. The court quoted the following statement made by the special court: "Had appellant constructed the waterworks for its own benefit and its own account and not for the benefit and account of PWB it could not have been said that this was not an 'enduring advantage'. On this test it clearly would have been capital expenditure. It is difficult to see any difference in principle because the works were built on another's property to become the property of the other. The purpose was the same, ie to enable the copper mine to function. The dam was as essential as the rest of the plant and machinery".

Ogilvie Thompson CJ commented as follows on that statement: "It is no doubt correct - as is implicit in that passage and as was submitted by counsel for the Secretary in this court - that the mere fact that it is in respect of works situated upon the land of another that a taxpayer has incurred expenditure does not preclude that expenditure from being of a capital nature".

The issue in that case was whether the cost of the barrage was of a capital or revenue nature, and not whether the cost was capital expenditure for the purposes of mining. It is submitted however, that the reasoning in the above passage supports the view that capital expenditure under section 36 is not restricted to the taxpayer's own property.

In Boyce (Inspector of Taxes) v Whitwick Colliery Co Ltd (1934, ALL ER 706) Romer LJ said at 714: "A taxpayer can make a capital expenditure on the land of a third party; it is none the less a capital expenditure even if it is on the land of a third party and not on his own land".

It is submitted that "capital expenditure incurred", irrespective of whether the asset created by such expenditure is on the mining property of the taxpayer or some other person's property, should rank for the allowance under section 36.

Mining taxpayers may take advantage of section 11(g) of the Act. This section provides for relief in respect of improvements to land or buildings on household property. (C23 infra).

9.16 Special capital allowance

In terms of section 36(11)(c) a special capital allowance is to be included in "capital expenditure". This allowance is "calculated as nearly as may be in the manner prescribed for the calculation of the capital allowance provided for in section 26(2) of the Mining Rights Act, 1967", which reads: "If the lease provides for payment of a share of the profits, the State shall not participate in any profits until the holder of the lease shall first have been allowed in the determination of such profits a capital allowance, calculated from the last day of the month in which such capital was expended, equal to six per cent per annum on the amount of unredeemed capital expenditure incurred in prospecting and mining operations in the development and exploitation of the lease area by the holder of the lease and his predecessors in title, but excluding any interest and other charges on loans referred to in paragraph (b) of the definition of 'capital expenditure' in section 36(11) of the Income Tax Act, 1962 and the allowance so calculated shall be deemed to be capital expenditure incurred on the last day of the profit period".

The special capital allowance is calculated on the amounts expended each month by the following mines at nominal rates of interest as indicated in section 1 of the Act:

	<u>%</u>
"Post 1973 gold mines" or any "other deep level gold mine"	10
"Post 1966 hold mine"	8
"New gold mine" or any natural oil mine	6
"New deep level gold mines"	5

The special capital allowance is subject to the following:

- The amount on which the special capital allowance is determined is the unredeemed balance of the aggregate of:

- S 36(11)(c)(i): The expenditure referred to in S36(11)(c) and (b) excluding any interest and other charges on loans referred to in S36(11)(b), if the mine is a post 1973 gold mine, a post 1966 gold mine, a new gold mine, a new deep level gold mine or a natural oil mine, or the expenditure referred to in S36(11)(a), if the mine is any other deep level gold mine.
- S 36(11)(c)(ii): The amount (if any) allowed to rank as capital expenditure in terms of section 37.
- S 36(11)(c)(iii): Any expenditure incurred during any period of production on development on any reef on which at the date of such development stoping has not yet commenced.

S 36(11)(c)(iv): The amount calculated in terms of section 36(11)(c) up to the of the year of assessment immediately preceding the year of assessment under charge. The interest so allowed is therefore a compound interest.

. The effect of the allowance is that the mine will have taxable income only when income from mining operations will be sufficient to absorb the entire redeemable capital expenditure and the special capital allowance.

. For the purposes of the calculation of the special capital allowance, the unredeemed balance of capital expenditure is reduced each year by the profits of that year.

. S 36(11)(c)(aa): The allowance is not deductible for any period during which mining operations are not carried on in accordance with the terms of the relevant lease.

. S 36(11)(c)(bb): The amount of the special capital allowance as determined by section 36(11)(c) shall not be taken into account for the purpose of calculating the capital allowance provided for in section 26(2) of the Mining Rights Act, 1967, or for the purpose of determining the profits of which a share is payable to the State in terms of any mining lease.

. S 36(11)(c)(ff): An assisted gold mine is not entitled to the capital allowance in respect of any year of assessment during which it is an assisted gold mine.

9.17 Recoupment of capital allowances

The recoupment or recovery of capital expenditure previously allowed is brought to account under section 36 of the Act and not under the general recoupment section 8(4)(a). The latter section specifically excludes its application to taxpayers who derive income from mining operations.

In CIR v Wolf (1928 AD 177, 3 SATC 153) it was held that the gross amount received from the disposal of assets in excess of the balance of capital expenditure ranking for redemption is to be included in gross income.

A mining company in Grootvlei Proprietary Mines Ltd v CIR [1952 (4) SA 440(A), 18 SATC 231] purchased at a cost of £13 131 mine equipment which it sold a few years later for an amount of £60 000. The court held that the whole sum realised by the disposal of the capital asset was required to be brought into account in determining the balance of redeemable capital expenditure. Centlivres CJ said at 237: "In construing section 20 (currently section 36) the significance of section 7(f) [currently paragraph (j) of the definition of 'gross income'] treating as income what is really a receipt or accrual of a capital nature must not be lost sight of, for that provision in itself tends to show that the Legislature did not intend that, where capital assets used in mining operations are sold at a profit, such profit should be regarded as a receipt or an accrual of a capital nature and should in no way affect the amount of tax payable in respect of income derived from mining operations". (The words between brackets are mine).

The effect of paragraph (j) of the definition of gross income and section 36 is: The amount received from the disposal of assets, the cost of which was previously allowed as a deduction, must be applied in the reduction of the capital expenditure of the year in which the amount is received or accrued. If the amount is in excess of such capital expenditure, the excess is subject to tax under paragraph (j). This effect is confirmed in the Grootvlei Proprietary Mines case (supra) by Centlivres CJ: "What the Legislature intended by section 7(f) [currently paragraph (j) of the definition of 'gross income'] and section 20(1) (currently section 36) was that when a taxpayer, who derived income from mining operations, realised such assets as are referred to in section 20(10) [currently section 36(11)] the proceeds of such realisation should be regarded as reducing pro tanto the total balance of unredeemed capital expenditure and that if such proceeds should exceed such balance tax should be payable in respect of the excess amount. The Legislature never intended that in arriving at such an excess a detailed inquiry should be made as to what the original cost of each particular asset was. What it intended was that on one side of the account would appear the total balance of unredeemed capital expenditure and on the other side the amount realised on the disposal of either a particular asset or (as the case may be) the amount realised on the disposal of all the assets". (References in brackets to sections in the current Act, are mine).

Example

ABC Mine commences production in year 3 of its existence. At that point in time it has incurred R200 000 in respect of capital expenditure. From the

following additional information calculate the capital allowance:

	Capital Expend- ture	Sale of equipment
	R	R
Year 3	150 000	50 000
4	300 000	120 000
5	375 000	400 000

Solution

		R
Year 3	Capital expenditure	150 000
	Less sale of equipment	<u>50 000</u>
	Deductible in full as mining operations have commenced	100 000
Year 4	Capital expenditure (R300 000 less R120 000)	<u>180 000</u>
year 5	Capital expenditure (R375 000 less R400 000)	<u>NIL</u>
	Included in gross income -	25 000
	Sale of equipment 400 000	
	Less applied to capital expenses <u>375 000</u>	<u>25 000</u>

Note: The deduction is limited to the income derived from mining operations in terms of section 36(7E) of the Act.

9.18 Prospecting expenditure

Expenses incurred by a prospector, who prospects with the intention of exploiting any mineral deposits found, are of a capital nature. These capital expenses may be deducted under section 15(b) of the Act: "There shall be allowed to be deducted from the income derived by the taxpayer from mining operations - (b) any expenditure incurred by the taxpayer during the year of assessment on prospecting operations (including surveys, boreholes, trenches, pits, and other exploratory work preliminary to the establishment of a mine) in respect of any area within the Republic in respect of which a mining lease has not been granted by the State, together with any other expenditure which in the opinion of the Commissioner is incidental to such operations".

Prospecting expenses can be divided into three phases:

- . Looking for the mineral.
- . Developing the mine to the point of production, after having found the mineral.
- . Winning the mineral from the soil.

The question arises as to where prospecting activities cease and where development commences. There appears to be no South African authority on the subject. An Australian case of Mount Isa Mines v FCT (1955, 6 AITR 346) may be of some guidance to South African taxpayers. In that case the work was done during three different phases of the company's activities -

- . the period of prospecting and exploration;
- . following the decision to exploit the mineral resources, the period of preparatory work essential to commercial operations; and
- . the working of the mining property for profit.

Taylor J in discussing the expression "expenditure on development" said that "it is reasonably clear that, in general, prospecting and exploration work precedes the work of 'development' As a rule the former work is undertaken to ascertain, as far as possible, whether the commencement of mining operations would be justified or prudent. Prospecting work which is preparatory in this sense is, in my opinion, not embraced by the word 'development'. It is probable, however, that work which may broadly answer the description of prospecting, in one sense, may be carried on upon an established mining property for the purpose of determining the best means to be adopted to facilitate the winning of minerals, the existence of which is already known. Such work goes hand in hand with the development of the mining property and should, I think, be regarded as expenditure on development".

The deduction under section 15(b) is subject to two provisos:

- . With the exception of diamond mining, the Commissioner has an unappealable discretion to allow the deduction over a number of years "so that only a portion of such expenditure is deducted in the year of assessment in which it is incurred, and the residue in such subsequent years of assessment and in such proportions as the Commissioner may determine, until the expenditure is extinguished".
- . Where a taxpayer derives income from more than one class of mining operation, the deduction "shall be made from the income derived from such class or classes of mining operations and in such proportions as the Commissioner may determine".

Section 15(b) uses the term "any expenditure". In Hayne and Co v Kaffrarian Steam Mill Co Ltd (1914 AD 363) Innes CJ said at 371: "In its natural and ordinary sense 'any' - unless restricted by the context - is an indefinite term which includes all of the things to which it relates". The only restrictions to the term "any expenditure" in 15(b) are that the expenditure must be on "prospecting operations" and must be "in respect of any area within the Republic in respect of which a mining lease has not been granted". The expenditure referred to would therefore include both capital and revenue expenditure in respect of prospecting operations. Expenses incidental to such operations are included in such expenses at the discretion of the Commissioner.

9.19 Capital expenditure on change of ownership

Section 37 of the Act provides that "when ver a change of ownership of a mining property occurs the new owner shall be deemed to have acquired such preliminary surveys, boreholes, shafts, development and equipment (in this section referred to as the development assets) as are included in the assets passing by such change of ownership, at a cost equal to the effective value to the new owner of the development assets at the time the change of ownership takes place, and the said cost shall be deemed to be expenditure that is incurred by the new owner during the period of assessment during which the change of ownership occurs and to be capital expenditure which is in respect of such period required to be taken into account for the purposes of the definition of 'capital expenditure incurred' in section 36(11)".

The effect of the section is that the new owner is entitled to an amount to rank as capital expenditure for redemption and the previous owner is taxed on the receipt

or accrual of such amount under paragraph (j) of the definition of gross income.

The term "mining property" is not defined, neither is there any judicial interpretation of the expression as used in section 37 of the Act. An Australian decision may therefore be of some guidance as to the meaning of "mining property". That expression is used in section 122(1) of the Australian Income Tax Act. In Broken Hill Proprietary Company Limited v FCT (1969, 1 ATR 40) the following statement by Kitto J in the Australian High Court was accepted by the Full Court: "The word 'property' seems here to be used in its popular sense of land considered as a subject to private rights, and, accordingly, a 'mining property' may be defined as land which a person is mining in exercise of a private right, either his own right or (by licence) a right vested in someone else. I do not find in the section anything to confine the expression I see no reason why land which belongs, for example, to the Crown should not be considered a mining property if it is in fact being mined by a person by permission of the Crown. Whether or not the permission has a statutory basis, the Crown has allowed it to be made a mining property the Crown's mining property it may be, but still a mining property..... A problem which may be difficult, in some cases at least, is to decide how the extent of a given mining property is to be ascertained. It is a question of assigning limits to the land to which particular mining relates. It may conceivably relate, I should think, to a particular part only of a large tract of land although the mine operator has a right or permission to mine the whole, as where it is known that the rest of the land has none of the relevant minerals in it. Equally, it seems to me, several parcels of land, over each of which the person who is working a mine on one of them has

a right or permission to mine, may in some circumstances form one mining property if the workings or ancillary activities are such that they may be expected to spread in due course to the other parcels. I do not doubt that if a person who is carrying on mining upon a parcel of land, by permission of the owner or otherwise as of right, carries on upon other land operations which pertain to that mining both parcels together may in the circumstances be properly described as the mining property".

The Commissioner views a mining property to be a mine which has reached the production stage. The assets deemed to have been acquired for the purposes of section 37(1) are termed development assets which constitute "preliminary surveys, boreholes, shafts, development and equipment". The fact that section 37(2) deems these development assets under a change of ownership to be a disposal of those assets by the previous owner, for the purposes of paragraph (j) of the definition of gross income, indicates that the development assets consist of assets which would have qualified as capital expenditure to the previous owner.

The cost of the development assets for the purposes of section 37(1) is their effective value at the time the change of ownership takes place. "Effective value" is not defined in section 37. It is submitted that the "effective value" is the market value with reference to the productive use of those assets over their remaining life. Where the "effective value" in relation to market value is inadequate it seems that the Commissioner's remedy is either section 103 or section 58 of the Act. The latter section refers to donations and would only apply if the taxpayer is not a public company for the purposes of the Act. Section 37(4) provides that the

Government Mining Engineer shall allocate the effective value between development and other assets.

The proviso to section 37(1) reads: "Provided that if in a case in which consideration is given, the effective value of all the assets so passing exceeds the consideration, the amount of such cost and expenditure shall be deemed to be an amount which bears to the amount of such consideration the same ratio as such effective value of the development assets bears to the effective value to the new owner at the said time of all the assets passing."

Example

A Mine takes over the mining property of B Mine. The effective values are as follows on the date of takeover:

	R
Effective value - development assets	300 000
other assets	<u>100 000</u>
all assets passing	<u>400 000</u>
Purchase consideration	<u>200 000</u>

Solution

The cost of development assets which A Mines may consider as "capital expenditure" for the purposes of section 36:

Ratio of effective value of development assets:

effective value of all assets passing

= $\frac{(300\ 000)}{(400\ 000)}$

= 75%

Therefore cost of development assets to new owner
for the purposes of section 36 $(75\% \times R200\ 000) = R150\ 000$

"If the value of the consideration given or of the property passing where no consideration is given is in dispute, it may with the consent of the new owner be fixed by the Commissioner and shall failing such consent be determined in the same manner as if transfer duty were payable". [Section 37(3)].

CHAPTER 10

FARMERS

10.1 Farming operations

Farmers are, by means of capital tax allowances on items encouraged to improve their agricultural properties with the objective of increasing productivity. Rumpff CJ in Buglers Post (Pty) Ltd v SIR [1974 (3) SA 28 (A), 36 SATC 71] said: "(The) intention of the legislator was to encourage a farmer to improve his farm so as to increase its productivity and to allow a farmer the deduction of expenses incurred in the improvements of his farm, such expenses to include the costs of certain capital works erected on his farm".

Section 26(1) of the Act provides that "(the) taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as it is derived from such operations, be determined in accordance with the provisions of this Act but subject to the provisions of the First Schedule". The ordinary rules of the Act would therefore apply unless the provisions of the First Schedule apply. Running expenses for example, would be allowable as a deduction in the determination of taxable income under section 11 of the Act. Farmers are specifically prohibited from claiming the capital allowances under sections 12 and 13 (capital allowances in respect of machinery or plant and industrial buildings). Instead they are allowed to deduct specific expenses of a capital nature under paragraph 12 of the First Schedule.

There are two important issues to consider in relation to the capital allowances which are available to farmers:

- . When is a taxpayer regarded as carrying on pastoral, agricultural or other farming operations? In early court decisions the issue was resolved with reference to subjective tests. In later court cases an objective test has been added.
- . What type of income will be regarded as having been derived from pastoral, agricultural and other farming operations? This issue is important as a person carrying on such operations is allowed to deduct capital allowances only from his taxable income derived from farming operations.

The Act does not define "farming operations". It has been held that whether a person is carrying on pastoral agricultural or other farming operations is a question of fact (ITC 586, 14 SATC 123; ITC 1135, 31 SATC 228; ITC 1258 39 SATC 58 and ITC 1319, 42 SATC 263).

Although sometimes of little use, some assistance may be derived by the decisions in our courts dealing with the interpretation of "farming operations" under different statutes [R v Lombard 1948 (2) SA 31].

In Rex v Giesken and Giesken [1947 (4) SA 561 (AD)]: " ... the sale or distribution of milk obtained from other sources by purchase was not a farming operation, even if milk produced by the seller be added. Though the appellants were engaged in farming operations, the sale and distribution of milk was not a farming operation, and that was the case whether what was being delivered consisted of seventy per cent of milk purchased and thirty per cent of milk produced by their farming operations or vice versa".

In Rex v Porterville Ko-op Landbou Maatskappy Beperk [1952 (1) SA 44 (C)]: "... Waar art 96(2) van boerderywerk (farming operations) melding maak, verwys dit mi in die eerste instansie na werk op 'n plaas verrig met die bedoeling om te produseer. Die begrip 'boerderywerk' kan egter 'n wye betekenis hê en ook werk dek deur 'n boer of sy werknemers verrig in die produksie of verkoop van plaasprodukte, afgesien van waar dit verrig word. Ek is egter die mening toegedaan dat die begrip nie in so 'n wye sin toegepas kan word nie om werk te dek ivm plaasprodukte wat verrig word na die produksie daarvan en wel deur iemand anders as die produsent. In die eersgenoemde geval is die persone wat die werk verrig besig om van en uit 'n plaas te produseer, en in laasgenoemde geval nie".

In KWV v Industrial Council for the Building Industry & Others [1949 (2) SA 614 (AD)]: "Wine farming consists of a number of different operations, such as cultivation of vineyards, pruning of the grape vines, rendering the vines free from disease, gathering the crop, pressing the grapes into wine, and probably delivering the finished product to the 'first buyer'".

In Ambleside Tobacco Grading Company (Pvt) Ltd v Abrahamson NO [1959 (1) SA 295 (R)]: "... (The) occupation or undertaking of farming includes not only the growing of a crop but the necessary steps taken to place the farmer's primary product in a proper condition for useful disposal and then actually to dispose of it".

It is uncertain whether our courts, when called upon, will place a wide interpretation on the expression "farming operations" so as to include selling or marketing activities for the purposes of tax law.

Subjective and objective tests

The court applied a subjective test in deciding whether the taxpayer in ITC 208 (6 SATC 55) was carrying on farming operations. The taxpayer in that case was a teacher and did not derive his living from farming. On the facts of the case, however, the court was satisfied that although the taxpayer "at the present time is not making a living out of this property, still his genuine intention is to develop it as a farming proposition in the hope that it will ultimately pay".

This subjective test was again applied in ITC 937 (24 SATC 274) where the court held that the taxpayer "bought the property genuinely with the object of farming"

Smalberger J, in ITC 1319 (42 SATC 263) did not agree with an entirely subjective test as applied in the above cases. He said at 264: "It seems to me that before a person can be said to carry on farming operations there must be a genuine intention to farm, coupled with a reasonable prospect that an ultimate profit will be derived, thereby incorporating an objective element into the test". In the latter case a medical specialist purchased property which comprised heavily bushed virgin coastal land. His intention was to farm with pedigree Jersey stock and goats. He was unsuccessful in the venture and applied successfully for the subdivision of his property into two-morgen lots. Although he made substantial losses his income from farming never exceeded more than a few hundred rand annually. The court found that the taxpayer had no genuine intention to farm, and in addition: "There is nothing to show that the property initially was an economical farming unit which could sustain a profitable farming venture".; and: "Bearing in mind the losses he suffered over the years, the

problems he encountered, the limited scope for farming provided by the property, the apparent lack of facilities and development on the property, and the limited extent of his farming activities, the appellant has not shown that he had reasonable prospects of ultimately deriving a farming profit from the property."

The irregular sale of produce surplus to personal requirements is insufficient to constitute farming operations. In ITC 1324 (42 SATC 288) [on appeal as H v GOT 1981 (2) SA 310 (ZA), 43 SATC 22] it was held:

- . The incentives for the encouragement of farming are designed to assist those who pursue farming as a regular consistent trade from which the earning of income is a primary objective.
- . A grower or producer, even if he earns income thereby, is not a farmer when his activities are merely to sell produce surplus to his own requirements if and when such surplus is available.

That case concerned a Zimbabwean mechanical engineer who was employed by a Government department. He purchased land with the intention of having a home in the country with an attractive view and where he and his wife could keep their dogs, mainly German Shepherds, which they showed and occasionally bred. After acquiring a farmer's licence he unsuccessfully planted pyrethrum seed. He purchased two Jersey heifers, some chickens and rabbits. While there were periodic sales of eggs and butter in excess of domestic needs, no income was derived from the sale of rabbits. It was only subsequent to the tax years in issue that any real intention to farm the property might have been established by reason of regular sales of eggs, chickens and rabbits. Squires J said at 295: "The extent of the operations, therefore, seems to me to be

properly describable as small, and in nature they are as much, if not more, the adjuncts of the typical rural smallholding, as a serious attempt at farming.

So far as the intent and purpose with which they were carried on is concerned, the appellant, I regret to say, has not satisfied me that the primary objective of acquiring and increasing this stock, was not simply to supply the needs of his household. That they have eventually produced much more than he could consume, and that he earned income for the surplus produced is not in dispute, but this was incidental and secondary to the main purpose, and is really in the nature of a bonus which would to some extent reduce the cost of installing and carrying on these activities".

The learned judge further said that although the presence of regular income, however negligible, "may be of relevance if it is established that the primary intention of the activity is to make an income, it must first be shown that the activity was carried on first and foremost for the purpose of earning an income, and not, as in the present case, supplying ones own requirements" (at 295).

In a Zimbabwean case (ITC 1135, 31 SATC 228) the court viewed farming operations as follows: "The determination of an issue of this kind does not, therefore, depend upon whether the activities carried on can be regarded as farming operations but upon:

1. the nature and extent of the operations; and
2. the purpose with which the operations are carried out".

In another Zimbabwean case (ITC 1258, 39 SATC 53) the court emphasized that the conduct of one or two activities which might properly be described as farming

properly describable as small, and in nature they are as much, if not more, the adjuncts of the typical rural smallholding, as a serious attempt at farming.

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1. the nature and extent of the operations; and
2. the purpose with which the operations are carried out".

In another Zimbabwean case (ITC 1258, 39 SATC 58) the court emphasized that the conduct of one or two activities which might properly be described as farming

operations does not necessarily constitute the trade of a taxpayer as farming. AR Gubbay SC said at page 61: "What must be looked to is the intention with which such activity is conducted. If the appellant's activities were the result of a genuine intention to use and develop the property as a farming proposition in the hope of producing an income therefrom, then he has carried on a trade (see IT case No 208, 6 SATC 55 at 57), and it matters not that the income so derived was meagre". Reliance was placed by the court on two other Zimbabwean cases: ITC 1135, 31 SATC 228; and ITC 1177, 34 SATC 147.

10.2 Summary of judicial interpretations - "farming operations"

- . The subjective test is that there must be a genuine intention to farm. The objective test is that the farming activities must have a reasonable prospect of future profits. If either of these are absent the taxpayer concerned will not be classified as carrying on farming operations. (South African tax law).
- . The irregular sale of produce surplus to personal needs is insufficient to constitute farming operations. In other words the purpose must be to earn income. (Foreign tax law).
- . The nature and extent of the activities of the taxpayer is a factor to consider in determining whether farming operations are carried on. (Foreign tax law).
- . When the facts of the case can meet the subjective and objective tests, it matters not that the income derived from farming operations are meagre. (Foreign tax law).

10.3 Income derived from farming operations

In ITC 166 (5 SATC 85) the taxpayer was the owner of a certain farm. Two portions of the farm were let at fixed rentals while the third portion was farmed by a tenant who paid rent in the form of half the proceeds of the crops grown thereon in lieu of rent. The taxpayer incurred expenses in connection with the planting of vines on the farm and in the construction of a dam thereon, which expenses he sought to deduct from his gross income. The court had to decide whether the income derived by the taxpayer in the form of rental was derived from "pastoral, agricultural or other farming operations". The rental received from the two portions which were let at fixed rentals were held not to have been derived from farming operations. A Davis KC held at 86: "The fact that the rental is indirectly derived from farming does not affect the matter. The persons who actually carry on the farming operations are the lessees and not the lessor. His income springs simply from the fact that he is a landlord and not a farmer". The rental in respect of the third portion was seen in a different light. The court held that the taxpayer had a direct interest in the farming operations because he had the right to a proportion of the proceeds of the crops grown on that portion of the farm. The rent was therefore considered to be derived from farming operations. The taxpayer was legally a colonus partiarius. The contract entered into between the taxpayer and the lessee was held to be of a similar nature to the contract entered into in the case of Oosthuizen v Estate Oosthuizen (1903 TS 688). In the latter case a son paid rent in the form of a percentage of the crops to his father. Innes CJ said at 692: "The fixed amount of produce payable yearly would represent the rent. But this position was really that of a colonus partiarius, that is an occupier who

pays a certain portion of the yield varying as the crop vary - a position somewhat between that of a lessee and a partner". As regards a similar type of contract in Blumberg & Sulski v Brown & Freitas (1922 TPD 130) Wessels J confirming the statement by Innes CJ, said at 136: "I think the view of Sir J Rose-Innes is the correct one that it is a contract sui generis partaking in some respects of a lease and in other respects of a partnership".

Silke on South Africa Income Tax (10th edition, page 1008) on commenting on the decision in ITC 166 (supra) says: "For many years Inland Revenue has relied upon this decision for the view that if a rental takes the form of a percentage of the crops or livestock, the lessor must be deemed to be carrying on a farming operation in partnership with the lessee and is assessable as a farmer. But what the Special Court has held is that the lessor has derived his income from farming. The case makes no mention of a relationship of partnership, although it cites the view expressed in Oosthuizen v Estate Oosthuizen (supra) that the position of such a relationship is somewhat between that of a lease and a partnership. But in Du Preez v Steenkamp (1926 TPD 362) it was held that such an arrangement constitutes a lease, which runs counter to the view of Inland Revenue that the lessor is carrying on farming operations".

Rental received by a farmer from a lessee of a portion of his farm was held not to have been derived from farming operations in ITC 732 (18 SATC 108). In this case the court relied on the definition of "income derived from farming operations" as expressed by Ingram of The Law of Income Tax in South Africa, page 168: "To come within the section the income must be directly derived from

farming operations. Where income is only indirectly derived from farming operations, eg where a landlord derives rent from the lease of a farm, such interest is not sufficiently direct to bring the rent within the description". The President of the court quoted Stevens in the case of Barron and Others v Sachar [1947 A.C. 1049 at 1053]: "Premises cannot be a 'farm' unless used for farming purposes and in terms of the definition a 'farm' must be deemed to be something distinct from the connotation of 'business premises', and to be premises where farming and not other mercantile operations are primarily conducted. If dual operations are conducted on farm property it may well be that a portion of such property must be regarded as a 'farm' and the rest as 'business premises' ..."

It could be argued that the principles established in the above cases as regards the letting of farms should be extended to the letting of livestock and produce. Where however the livestock and produce are let under a "sheep lease", the lessor is required to bring into account the value of such livestock or produce in terms of paragraph 3(3) of the First Schedule. The income from letting livestock or produce under a "sheep lease" or the proceeds from the disposal of livestock or produce subject to a "sheep lease" would be regarded as income derived from farming operations. Should the taxpayer discontinue his farming operations section 26(2) of the Act becomes operative: "In the case of any person who has discontinued carrying on pastoral, agricultural or other farming operations and is still in possession of any livestock or produce, or has entered into a 'sheep lease' or similar agreement relating to livestock or produce, which has been taken into account and in respect of which expenditure under the provisions of this Act or any previous Income Tax Act has been allowed in the

determination of the taxable income derived by such person when such operations were carried on, the provisions of this Act, but subject to the provisions of paragraphs 1,2,3,4,5,6,7,9, or 11 of the First Schedule, shall continue to be applicable to that person in respect of such livestock or produce, as the case may be, until the year of assessment during which he disposes of the last of such livestock or produce, notwithstanding the fact that such operations have been discontinued". The recipient of such income on discontinuing farming operations would therefore not be entitled to offset against such income any capital expenditure the deduction of which is available under paragraph 12 of the First Schedule.

10.4 Speculation in livestock

In ITC 586 (14 SATC 123) the court held that the income of a speculator in livestock constitutes income derived from farming operations. In reaching this decision the court relied on the evidence of two expert witnesses. From the evidence of the first witness the court came to the conclusion that the term "farmer" is a comprehensive term and that it would include any activity carried on on land. The Commissioner contended that the taxpayer was carrying on the business of a speculator. According to the evidence of the second witness: "A speculator is really concerned with the marketing of animals, he does not usually retain those animals for a long time"; and "he certainly does not do anything to improve the quality of those animals". In this case the taxpayer bought a particular type of beast (store cattle) which was capable of improvement. For the purpose of improvement, the taxpayer leased a farm, where the beasts ran for periods varying between six weeks and six months. During this period the taxpayer would exercise skill on the cattle

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