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Analysis of Mining Taxation in South Africa

Callous Shikwambana

Ethics Number: CACCN/1010

A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation)

Johannesburg, 2011

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Abstract

Mining is one of the principal industries in the South African economy, and thus fulfils an important role from the perspective of the fiscus. Mining is a high-level risk investment which involves massive capital expenditure as well as prolonged periods of non-production of mining income. It is because of this that mining taxation receives special treatment.

The term 'mineral' is central to determining whether or not a taxpayer can be regarded as being carrying on mining operations in South Africa. A mining process usually involves different stages before minerals are obtained, being prospecting and pre-production stages, followed by the production and post-production stages.

Income is earned and expenditure is incurred in all the different stages in the life of a mine. The research report will critically evaluate what is meant by 'mining and mining operations' as defined in the Income Tax Act 58 of 1962 ('the Act'). The research report concludes with an analysis and evaluation of how income earned and expenditure incurred in the different stages in the life of a mine are treated in determining the taxable income in respect of a mining taxpayer.

Keywords: Mineral, Mining operation and Mining, Mining income, Mining expenditure, Contract Mining, Prospecting, Mining rights, Assessed losses, Shaft-sinking, Full Annual Redemption, Partial Annual Redemption, Capital expenditure incurred, Recoupment, Environmental Rehabilitation Trust

DECLARATION

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.



Callous Shikwambana

11th day of May, 2012

I would like to thank the following people:
My wife and son for their understanding and sacrifices made
My dad for his everlasting words of encouragement and motivation
And the rest of my family for being there for me through this long journey

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CHAPTER 1

1. Introduction

1.1 Background

There is ample evidence to suggest that mining of base minerals and gold by the indigenous peoples of South Africa has been taking place since ancient times. Following European settlement in South Africa in the seventeenth century, many attempts were made by the settlers to locate viable deposits, and in the periods leading up to the mid-nineteenth century, various base minerals were exploited, including asbestos, copper and lead. The twentieth century also witnessed a significant growth in the mining of platinum and base minerals, with the discovery of substantial deposits of a wide variety of minerals. In these circumstances, it is not surprising that the first serious attempts to raise significant income taxes were aimed at the mining sector and these taxes have been historically more onerous than those imposed on other sectors. At the same time, the mining tax system has been fine-tuned to a degree not attempted in other sectors of the economy, in order to accommodate mining risks and changing circumstances (Van Blerck 1992:1-2[1]).

The mining sector represents 19% of the GDP and employs close to 500 000[2] workers. According to Mntuyedwa (2011), South Africa is the top producer of platinum, the number two producer of gold, the world's largest producer of chrome, manganese, platinum, vanadium and many more mineral resources. The 2010/2011 SARS audited Annual Financial Statements provided evidence that this sector contributed some R17.7 billion in taxes to the fiscus in respect of the 2010/2011 fiscal year, in the form of company taxes. It is apparent that mining remains a vitally important factor in the South African economy, both from the fiscal and socio-economic perspectives.

The Act prescribes the mechanism of determining the tax liability of taxpayers, including taxpayers involved in mining activities. The term 'mineral' is central in

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[1] Due to the unusual numbering used by Van Blerck in his book, the referencing used in this report indicates the chapter as well as the page number (i.e. page 2 of chapter 1 in this instance).
[2] From an article by Mntuyedwa N titled '*South Africa: Past, Present and the Future*'.

determining whether or not a person is conducting mining operations for income tax purposes. This particular term, is however not defined in any direct or indirect tax legislation in South Africa. The onus has been placed on the courts to interpret the meaning of the word 'mineral' for income tax purposes. The term is defined in other statutes such as the Mineral and Petroleum Resources Development Act 28 of 2008 ('MPRDA'). It remains imperative to establish whether a person is carrying on mining operations to prevent the abuse of the special privileges afforded to companies carrying on mining operations. For instance, a taxpayer conducting mining operations is allowed, in terms of the Act, to deduct accelerated allowances amounting to 100% of the capital expenditure incurred to acquire certain capital assets. As such, it is vital that the tax privileges afforded to the mining industry not be abused.

The research will focus primarily on what is meant by 'mining operations' and 'mining' as defined in the Act.

According to Van Blerck (1992:10-2), a mining company may have taxable income (or an assessed loss) both from mining and non-mining operations and pay tax on these categories of taxable income at different rates. In addition, certain ring-fencing restrictions apply to mining income while others apply to non-mining income. The research will analyse and determine the correct tax treatment of income that a mining company may earn or receive.

Another question that will be examined is the classification of income earned before full production. Can this kind of income be classified as mining income?

A mining investment usually involves extensive periods of non-production, as various stages of development must be undertaken before a mineral can be obtained or extracted. It is important to note that an investment in a mine requires substantial capital expenditure. The research will identify the different stages in a life of a mine and also focus on the tax treatment of expenditure incurred in each stage.

1.2 Research Problem

1.2.1 Statement of the Problem

The purpose of the research is to critically examine the taxation of taxpayers deriving income from mining operations in South Africa.

1.2.2 Sub-Problems

The first sub-problem is the concept of 'mining operations' and 'mining' as defined in the Act. The research will focus on the definition of the term with reference to other legislation. Domestic and foreign courts have dealt with the issue of 'mining operations' and 'mining' in numerous instances. Such case law will be reviewed to help further understand this term.

The second sub-problem in the research will be to assess the definition of the term 'mineral' as it relates to the definition of 'mining operations' and 'mining'. The term 'mineral' is central in determining whether or not a taxpayer can be said to be involved in mining operations. This term is however not defined in the Act. The meaning of the term as defined in other legislation will be considered. Case law will be reviewed in detail to ascribe a meaning to the term 'mineral'.

The third sub-problem will focus on the principles of 'mining income' and 'mining expenditure'. These are important concepts as they are used in the determination of taxable income from mining operations. The research will examine the distinction between 'mining income' and 'non-mining income' received by a taxpayer in the different stages of a mine development, as well as 'mining expenditure' and 'non-mining expenditure' incurred in those different stages. Taxpayers deriving income from mining operations are allowed to deduct from that income 100%, if certain capital expenditure incurred (i.e. accelerated capital allowances). The Act will be used to analyse the concept of capital allowances to be deducted by taxpayers from income derived from mining operations.

The fourth sub-problem relates to expenditure incurred by mining taxpayers upon mine closure. Mining rights holders are obligated by legislation to continuously rehabilitate the land which is being mined. Expenditure incurred for such purposes will be examined and its tax treatment evaluated by reference to specific sections in the Act.

1.3 Definitions of Key Terms

Key definitions are discussed below:

'assessed loss' As defined in section 20 of the Act, 'assessed loss' refers to any amount by which the deductions admissible under section 11 exceeded the income in respect of which they are so admissible.

'capital expenditure incurred' As defined in section 36 of the Act, 'capital expenditure incurred' refers to the amount (if any) by which the expenditure that is incurred during such period in respect of such mine and is capital expenditure, exceeds the sum of the amounts received or accrued during the said period from disposal of assets the cost of which has in whole or in part been included in capital expenditure taken into account (whether under this Act or any previous Income Tax Act) for the purposes of any deduction in respect of such mine under section 15(*a*) of this Act or the corresponding provisions of any previous Income Tax Act.

'environment' As defined in chapter 1 of the MPRDA, 'environment' means the environment as defined in the National Environmental Act 107 of 1998.

'expenditure' As defined in section 36 of the Act, 'expenditure' refers to net expenditure after taking into account any rebates or returns from expenditure, regardless of when such last-mentioned expenditure was incurred.

'holder' As defined in chapter 1 of the MPRDA, in relation to a prospecting right, mining right, mining permit, retention permit, exploration right, production right, reconnaissance permit or technical co-operation permit, means the person to whom such right or permit has been granted or such person's successor in title.

'income' As defined in section 1 of the Act, 'income' means the amount

remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax.

'mine' As defined in chapter 1 of the MPRDA, a mine is any operation or activity for the purposes of winning any mineral on, in or under the earth, water or any residue deposit, whether by underground or open working or otherwise and includes any operation or activity incidental thereto.

'mineral' As defined in chapter 1 of the MPRDA, means any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process and includes sand, stone, rock, gravel, clay, and any mineral occurring in residue stockpiles or in residue deposits but excludes:

(a) water, other than water taken from land or sea for the extraction of any mineral from such water;
(b) petroleum;
(c) peat.

'mining right' As defined in chapter 1 of the MPRDA, 'mining right' is the right to mine granted in terms of section 23(1) of the MPRDA.

'mining operations' and 'mining' As defined in section 1 of the Act, 'mining operations' and 'mining' include every method or process by which any mineral is won from the soil or from any substance or constituent thereof.

'prospecting' As defined in chapter 1 of the MPRDA, 'prospecting' entails intentionally searching for any mineral by means of any method:

(a) which disturbs the surface or substance of the earth, including any portion of the earth that is under sea or under water;

(b) in or any residue stockpile or residue deposit, in order to

establish the existence of any mineral and to determine the extent of economic value thereof;

(c) in the sea or other water on land.

'prospecting operations' — As defined in chapter 1 of the MPRDA, 'prospecting operations' involve any activity carried on in connection with prospecting.

'residue deposit' — As defined in chapter 1 of the MPRDA, a 'residue deposit' means any residue stockpile remaining at termination, cancellation or expiry of a prospecting right, mineral right, mining permit, exploration right or production right.

'residue stockpiles' — As defined in chapter 1 of the MPRDA, 'residue stockpiles' include any debris, discard, tailings, slimes, screening, slurry, waste rock, foundry sand, beneficiation plant waste, ash or any other product derived from or incidental to a mining operation and which is stockpiled, stored or accumulated for potential re-use, or which is disposed of, by the holder of a mining right, mining permit or production right.

'shaft-sinking expenditure' — As defined in section 36 of the Act, 'shaft-sinking expenditure' entails the expenditure on sumps, pump chambers, stations and ore bins accessory to a shaft.

'tax' or 'the tax' or 'taxation' — As defined in section 1 of the Act, 'tax' refers to any levy, tax leviable under this Act or administrative penalties imposed in terms of section 75B, and for the purposes of Part IV of Chapter III includes any levy or tax leviable under any previous Income Tax Act.

'taxpayer' — As defined in section 1 of the Act, a taxpayer is any person chargeable with any tax leviable under the Act and includes every person required by the Act to furnish a return.

'year of — As defined in section 1 of the Act, 'year of assessment' means any year or other period in respect of which any tax or duty leviable

assessment' under this Act is chargeable, and any reference in this Act to any year of assessment ending the last or the twenty-eighth or twenty-ninth day of February shall, unless the context otherwise indicates, in the case of a company be construed as a reference to any financial year of that company ending during the calendar year in question.

1.4 Assumptions

The following assumptions are applicable for the purpose of this research:

No distinction is made between mining for gold or natural oil and mining for any other minerals. It is assumed that no special dispensation exists in respect of gold or natural oil mining.

Foreign case law will be of authority in the absence of domestic case law in respect of a particular principle of law.

1.5 Research Methodology

The research report adopted a Literature Review in terms of books, articles, as well as domestic and foreign case law. The Literature Review was performed to examine the taxation of taxpayers deriving income from mining operations from a South African perspective, as well as a review of the applicable legislations governing mining taxpayers in South Africa

Mining operations involve the winning of minerals from the soil. Numerous case law judgments were reviewed and analysed to determine the meaning of the term 'mineral'. This important term is not defined in any of the tax legislations in South Africa, and for this reason, emphasis had to be placed on domestic and foreign case law to attach a meaning to it. Discrepancies in respect of judgments reached by different courts in relation to the interpretation of the term 'mineral' were identified and highlighted in this research report. All the sub-problems identified above were addressed by means of a Literature Review.

1.6 Organisation of Report

Chapter 1 of the research report provides an introduction, and contextualises the research problem and sub-problems, definitions of key words, assumptions used in the research report, and the research methodology adopted.

Chapter 2 contains an in-depth analysis of the meaning of the term 'mining operations' and 'mining'. The concept of 'mineral' is also critically examined in this chapter. Crucial court judgments on the meaning of 'mining operations' and 'mining', and 'minerals' are also critically evaluated.

Chapter 3 considers the different stages involved in the life of a mine.

Chapter 4 gives an overview and discussion of the classification and tax treatment of mining and non-mining income.

Chapter 5 of the report considers the classification and tax treatment of mining expenditure in the different stages of a life of a mine.

Chapter 6 discusses the environmental rehabilitation of mined land.

Chapter 7 summarises the findings of the research problem and the sub-problems and conclude on such findings.

Chapter 8 discusses recommendations based on the findings of the report and also proposes related topics for future research.

CHAPTER 2

2 Mining Operations and Mining

2.1 Introduction

The nature of the definition of 'mining operations' and 'mining' in the Act makes it clear that minerals must be won from the soil for a person to be considered to be carrying on mining operations. It is important to note that none of the tax legislation in South Africa defines what is meant by the term 'mineral' as contained in the definition of 'mining operations' and 'mining'. It is thus important to first determine what is meant by the term 'mineral' before it can be determined whether a taxpayer is conducting mining operations for income tax purposes.

2.1.1 Statutory Meaning of 'Mineral'

Though not defined in the Act as aforementioned, the term 'mineral' is defined in section 1 of the Minerals Act 50 of 1991 ('Minerals Act') as follows:

> 'Mineral means any substance whether in solid, liquid or gaseous form, occurring in or on the earth, in or under water or in tailings and having been formed by or subjected to a geological process, excluding water but including sand, rock, gravel and clay, as well as soil, other than topsoil.'

In his analysis, Van Blerck (1992:7-3) noted the specific exclusion of 'topsoil'. He states that the term 'topsoil' is not defined in either the *Oxford English Dictionary,* or *Webster's Third New International Dictionary*. The *McGraw-Hill Dictionary of Scientific and Technical Terms* define 'topsoil' as:

> 'soil, presumed to be fertile and used to cover areas of special planting; and as surface soil, as distinguished from subsoil'.

It is unlikely, though not impossible, that minerals in payable quantities may be present in topsoil, but it is nevertheless difficult to envisage why the exclusion of topsoil from the definition was thought necessary, as it would be near impossible for a miner (or for that matter, authorities) to distinguish the output of a mining operation

between that which emanated from topsoil and that which did not (Van Blerck 1992:7-2).

In 2002, the MPRDA was introduced to replace the Minerals Act. The MPRDA defines the term 'mineral' as follows:

> 'Mineral means any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process and includes sand, stone, rock, gravel, clay, and any mineral occurring in residue stockpiles or in residue deposits but excludes:
>
> (d) water, other than water taken from land or sea for the extraction of any mineral from such water;
> (e) petroleum;
> (f) peat.'

The MPRDA definition of 'mineral' is more specific, in that it provides what is included and what is excluded from the term, whereas the definition in the Minerals Act was much wider.

Meyerowitz (2008) states that the word 'mineral', though not defined in any tax legislation, could have a wide or narrow meaning according to the context in which it is employed.

2.1.2 Case Law Interpretation of 'Mineral'

One of the more important cases that deal with the interpretation of the term 'mineral' is the *Great Western Railway Company v Carpalla United China Clay Company.*[3] The interpretation adopted by the court in this case has become the standard. This was an appeal from a decision of Eve J which raised the question whether the China clay, under a piece of land in Cornwall purchased by a railway company for the purposes of its undertaking, was a 'mineral'. In that case, Fletcher-Moulton LJ commented as follows:

[3](1909) 1 Ch 218 at 231.

> '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 bulk and weight* which makes it occupy so much of the earth's crust ...To dig out ballast and crush stone and earth...for the purpose of making embankments, where materials 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...such material have not a value in use apart from their bulk and weight... On the other hand, everything that has an individual value in use appears to me to be fairly called a mineral'. (*My emphasis*)

China clay was held to be a mineral, because it is one of those materials which are usually worked with the object of making a profit. The principle of 'value in use' was established in this case, and has been used in various judgments to decide whether or not a material constitutes a mineral.

Similar views were held in the case of *COT v Nyasaland Quarries and Mining Co Ltd,*[4] where the company carried on the business of quarrying a form of rock known as gneiss, which was sold subsequent to being crushed and screened in the required sizes. It was held that the question whether a particular substance was a mineral was a question of mixed fact and law. In that case, Spencer Wilkinson agreed with the interpretation of 'mineral', as set out in the *Great Western Railway* case, and as such gneiss was correctly held to be a mineral. Van Blerck (1992:7-9) states that, in light of the decision in the *Nyasaland Quarries* case, the term 'mineral' must be afforded a fairly wide interpretation for income tax purposes.

In another case, *Boksburg Brick and Fireclay Co v CIR,*[5] fire clay that was extracted from the soil was held by the court to be mineral for income tax purposes. The court held that fire clay had a specific use, and was therefore a mineral and the extraction thereof amounted to mining operations.

In ITC 1249[6] it was held that:

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[4]High Court of Nyasaland, February 1961, 24 SATC 579 at 579.
[5]1941 TPD 232, 12 SATC 225.
[6](1976) 38 SATC 74

> 'to qualify as a "mineral" the substance must be found naturally within the earth's surface, that appellants', although having their origin in iron ore, do not so qualify. 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'.

In this case, the company purchased iron ore (a mineral) from third parties and processed the iron ore into pig iron, steel blooms, steel billets or steel sections which it sold at a materially enhanced price. The issue at hand was whether the said products could also be defined as 'minerals'. The court concluded that no justification exists for extending the definition of 'mineral' to include manufactured products.

With the introduction of the broadly-framed definition of the term in the Minerals Act, and with the consolidation of most mining legislation within the Act, the income tax courts would in future find it increasingly difficult to interpret the meaning of the word 'mineral' as restrictively for tax purposes as had sometimes been done in the past. Future decisions of the court would have to be awaited to obtain clarity but given the new definition in the Minerals Act, taxpayers who conducted quarrying operations could well have been tempted to test the matter in court (Aiken and Peat 1993:5).

2.1.3 Statutory Meaning of 'Mining Operations' and 'Mining'

'Mining operations' and 'mining' is defined in section 1 of the Act as follows:

> 'includes every method or process by which any mineral is won from the soil or from any substance or constituent thereof'.

Meyerowitz (2008) states that this definition is a very wide one, and by its reference to 'every method or process', makes it clear that it is not confined to underground workings but also to surface excavations and it will include the winning of minerals from the sea bed by way of dredging or other processes.

The term 'win' means, in terms of the *Concise Oxford Dictionary*, 'to obtain (ore) from a mine'.

The term 'win' was interpreted in the *English Clays Lovering Pochin& Co v Plymouth Corporation*[7] case as follows:

> '[O]ur view is that to "win" a mineral is to make it available or accessible to be removed from the land and to "work" a mineral is to remove it from its position in the land.'

The term 'win' was interpreted more broadly in *Union Government v Nourse Mines*[8] where Wessels J held that:

> '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 operations necessary, not only to reach and extract the ore, but also to convert it into metal.'

It is submitted that minerals must be won from the soil by the person for his benefit for the process to constitute mining operations for income tax purposes. Where minerals are extracted by one person for the benefit of another, the former is likely not to be conducting mining and mining operations as defined, depending on the contractual arrangement between the two parties. This will be examined in detail under 'contract mining' below.

2.1.4 Case Law Interpretation of 'Mining Operations' and 'Mining'

Over the years, the courts have dealt with the interpretation of the term 'mining operations' and 'mining', both domestically and internationally, especially in Australia.

Van Blerck (1992:7-25) considers that what is of interest from the judgments of most relevance (including that in the *Boksburg Brick* case) is that the dominant question is whether or not the substance in question constitutes a mineral. He further add that due to the nature of South African income tax and the definition of 'mining operations' and 'mining', if the answer to the question is in the negative, the process cannot constitute a mining operation, while if the answer is positive, the wide nature of the

[7] 1973 2 ALL ER 730.
[8] 1912 TPD 924.

definition of 'mineral' usually automatically results in a decision that the process constitutes a mining operation.

In *Mutual Life Insurance Co of New York v Ingle*[9] Innes CJ held that:

> 'a mine is an underground excavation or passage, and that the term "to mine" for a mineral is to obtain ore in, or by any means of, such excavation or passage and take it to the surface'.

In *Rex v Harper*[10] the court found that the term 'mining operation' as used in the Rhodesian Mines and Minerals Act means 'more than merely digging or excavation and includes all operations immediately directed to the excavation and recovery of the mineral sought'. This case held that the process of recovering gold through the process of cyaniding which was used to extract gold from a dump was akin to mining operations.

In the *Nyasaland Quarries* case, which was an appeal from ITC 909,[11] quarrying was held to be akin to mining operations. Respondent company carried on the business of quarrying a form of rock known as gneiss. In dismissing the appeal, Spencer Wilkinson CJ held that as follows:

> 'in my opinion there can be no doubt whatever that in defining the expression "mining operations" and "mining" as it has done, the legislator intended to give the ordinary everyday meaning of those terms'.

The court held that in view of the processing for special purposes carried out by the respondent company, the rock extracted by it must be regarded as included in the term 'mineral' as used in the definition of 'mining operations' and 'mining' contained in the Act, and consequently, having regard to the extensive meaning to be placed on the definition, the work of quarrying as conducted by the company constituted mining operations which entitled the company to the allowances provided for by the statute.

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[9]1910 TPD 540.
[10]1944 SR 113.
[11](1960) 24 SATC 97 (F).

In the *North Australian Cement Ltd v FCT*[12] case, the extraction of limestone by a taxpayer using open-cast mining for the production of cement was held to be a mining operation in Australia. After considering various authorities Spender J overruled the 1969 judgment and concluded that the extraction by the taxpayer of limestone for the manufacture of cement was properly to be characterised as mining operations. Spender J appeared to accept the view that the terms 'mining' and 'quarrying' were mutually exclusive, but that the taxpayer's activities nevertheless constituted a mining operation. His conclusion is given in Van Blerck (1992:7-14) as follows:

> 'It seems to me that... the word "quarry" is properly to be applied to an excavation or pit for the obtaining of stone or other bulk material such as sand, blue metal or slate *for building or road marking purposes*, and extraction of limestone for the purposes of manufacturing cement would not ordinarily be described as a "quarrying" operation.'

According to Van Blerck (1992:7-14) the very general nature of the definition of *mining operations,* in particular the use of the words 'every' and 'any' makes the matter much simpler in South Africa compared to countries such as Australia. Once it is determined that the material involved constitute a mineral, and that is being won, there is no need to look further. It is thus not relevant, as it is in Australia, that the operation may be classified as a quarrying operation (Van Blerck 1992).

In *Murchison Exploration & Mining Co Ltd v CIR*[13] the court held as follows:

> 'Insofar as the Income Tax Act is concerned, mining is the process by which minerals are won from the soil for the purposes 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.' (Aiken and Peat, 1993:14)

It follows therefore that prospecting operations does not constitute mining operations since the process employed does not involve the winning of minerals from the soil.

In *Finbro Furnishers (Pty) Ltd v Register of Deeds, Bloemfontein, and Others,*[14] Hoexter JA concurred with the views expressed in the *Great Western Railways* case where he held as follows:

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[12](1969) 1 ATR 225.
[13]Transvaal Provincial Division, June 1938, (10 SATC 143).

> 'It is obvious of course, that not every stone and pebble or every deposit of rock has appreciable value. But since it is no less clear that certain types of stone do have a considerable value it follows, I think, that in any discussion as to the possible status of stone as a mineral the factor of value must of necessity loom large.'

It is submitted that this line of reasoning should not only apply to stone but to every material that can be got from the earth which has a value in use as determined in the *Great Western Railway* case. It is further submitted that where the object of extracting such material is for return of profit, such activity must constitute mining operations for income tax purposes. Meyerowitz (2007-2008) cites *Falcon Investment v C D Birnam (Suburban) (Pty) Ltd and Others*[15] where it was held that the word 'mineral' had to be given a wider meaning and that andesite, a kind of rock suitable for use in concrete and for road-making purposes was a mineral. He also add that 'mining operations' and 'mining' are not confined to the winning of precious stones or base metals such as manganese, coal, tin, tungsten, salt, limestone, but includes clay used for brick-making, or granite or stone or slate used buildings.

(i) Contract Mining

It is apparent in many cases that the mine 'owner' or mining right holder sub-contracts all or portion of the mining operations to a third party. For example, a contacting arrangement could require a third party to use earthmoving equipment to win ore by opencast mining methods and transport this ore to a processing plant. In such circumstances, the question arises whether it can be said that the operations of the sub-contractor are akin to ' mining operations' and 'mining' as defined in the Act?

In the case of *Gloucester Manganese Mines v CIR,*[16] the taxpayer company had in terms of a registered mineral notarial lease granted a third party the sole right to mine (amongst other things) manganese ore on a certain property. In return, the taxpayer was entitled to a lease charge of 25% of net profits from mining operations. The taxpayer contended that the royalties received constituted income from mining

[14]1985 (4) ALL SA 388 (AD).
[15]1973 SA 384 (AD).
[16]12 SATC 229.

operations. It was held by the court, that in this case, although the lessee carried on mining operations, the lease did not constitute a partnership and the lessor as a consequence was not conducting mining operations. The court held as follows:

> '...the same, in my view, is the case of a mine manager who works on a basis of remuneration in the form of a percentage of net profits. These persons may be interested directly or indirectly in the mining industry or the conduct of mining operations. But their income is not derived from mining operations, it is derived from the letting of services to the lessee company. The position of the plaintiff company is precisely the same'.

It was correctly held by the court that the royalties received by the lessor were rental income earned on the lease of the land containing manganese, among other minerals.

It is imperative to establish the person actually conducting mining operations, where a lessee and lessor relationship exists, in order to ensure the correct classification of income and expenditure, as well as the correct determination of tax liability. The following factors should be considered in determining the party who is conducting mining operations for income tax purposes:

Who owns the mining rights?

It is important to note that it is illegal in South Africa to extract minerals without being granted permission by the DMR. Where the contractor is only extracting minerals on behalf of the 'mine owner', the activities of the contractor would likely not be mining operations. Where, however, the contractor is granted a right to extract minerals by the 'mine owner', and for the benefit of the contractor, the activities of the contractor in such case would be mining operations as defined in the Act. The latter scenario is similar to the *Gloucester Manganese* case discussed above.

Who is responsible for environmental rehabilitation?

A mining right holder is obligated, in terms of the MPRDA, to rehabilitate the environment upon mine closure. This obligation cannot be transferred and can only be performed by the person conducting mining operations. It is submitted that the

rehabilitation work or activity can be outsourced to a third a party. It is further submitted that this (i.e. the outsourcing of the obligation) does not imply that the obligation to rehabilitate is transferrable to a third party. The obligation to rehabilitate the mined land lies with the party that carried on mining operations upon such land. It can therefore be concluded that, between the 'mine owner' and the contractor, the party obligated by legislation to carry out such environmental rehabilitation is the party carrying on mining operations for income tax purposes.

Who is being compensated?

Where, on the one hand, the contractor is remunerated, it would appear that such payment is for services rendered, being the extraction of minerals by the contractor on behalf and for the benefit of the 'mine owner'. Where, on the other hand, the contractor pays the 'mine owner' to work the mine and extract minerals, it is submitted that such payment constitutes a royalty, and that the contractor is conducting mining operations.

To determine who is conducting mining operations is a question of fact, and each case must be decided on its merits.

Van Blerck (1992:7-21) states that since the right to mine precious stones and precious metals vests in the State and since all those who wish to undertake these activities must obtain a lease from the State, it can be said the major portion of mining conducted in South Africa is on a 'contract' basis. He adds that lessee mines in these circumstances are conducting mining operations.

(ii) The Overlap between Mining Operations and Manufacturing Process

Van Blerck (1992:7-15) establishes that a rather more difficult question, assuming that a process is a mining process, is where does that process end? *The Rand Refinery Ltd v Town Council of Germiston*[17] is of relevance, as identified by Van Blerck (1992:7-17). At the time of the case, as at present, the Rand Refinery operated as a separate company, with the primary objective of refining the gold of member

[17] 1929 (WLD 63).

companies into purer form. Feetham J expressed the opinion that the term *mining operation* used in the ordinance was meant to be read in a restricted sense as referring only to mining operations 'locally carried' on (i.e. adjacent to the mine) and, thus, did not apply to the Rand Refinery, which refined gold produced elsewhere. The strong implication was that the term would definitely embrace refining carried on by the mining company itself adjacent to its mine; this is reinforced by the following extract from the judgment:

> '...it is difficult to say that the processes of reduction so far as they are incidental to mining operations must necessarily stop short at the production of gold bullion, and cannot include the work of refining, which is required before the gold becomes readily marketable'.

The overlap of mining and manufacturing activities was dealt with again in *Zaaiplaats Tin Mining Co Ltd v Union Government.*[18]The case involved a dispute over the amount on which a royalty payable by the company to the Government should be based. According to the royalty agreement, the company was to pay 10% of the net produce obtained from mining tin-bearing ore. The company's normal process comprised the mining of tin ore and the subsequent reduction of this ore to tin ore concentrates. The concentrates were thereafter disposed of to third parties who smelted them. In 1940, the company commenced smelting operations on a large scale, not only catering for its own output but also for the output of all South African tin mines. For its 1941 assessment, the company contended that the profits from the smelting operations should be excluded when determining the royalty payable. The Union Government assessed the company on profits including that from the smelting activities. Murray J held that smelting of this nature could not be distinguished from any other process of reduction. The court held, in upholding the contention of the defendant Government, that:

> 'Though smelting may be carried on as a separate business it is obviously different from the business of turning metallic tin into manufactured tin articles. When smelting forms part of the full process adopted by the lessee of reducing to marketable form the mineral content of the claims, it seems to me that would be an answer by the lessee to the

[18](1944) TPD 42.

> defendant, when royalty is claimed at the tin concentrate stage, that the process of production selected by him is incomplete and that royalty is not claimable.'

It is submitted that the court viewed the smelting activities as the continued process of winning the tin ore, and that this process constituted mining operations.

In *Cape Lime Company Ltd v SIR,*[19] the taxpayer produced lime from raw material available on its land in the form of natural deposits of limestone. It utilised a reduction plant two and half miles away from the quarry. It had purchased two new Lorries for use in the carriage of the limestone from the quarry to the reduction plant. The question for decision was whether the Lorries had been brought into use by the taxpayer 'for the purposes of his trade and used by him directly in a process of manufacture', within the meaning of the then section 12(1) of the Act, thereby entitling it to the deduction provided for. At the reduction plant there were crushers that broke up the limestone to a size that would enable it to be fed into kilns. The court held that the breaking up of the raw material on the floor of the quarry was the commencement of the process of manufacture.

Views similar to the *Cape Lime* Company case were expressed in *Broken Hill Proprietary Company Limited v FCT,*[20] where the court stated:

> '(W)e do not doubt that to separate what is sought to obtain by mining from that which is mined with it, e.g. 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 it can be used for road marking, 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.' (Aiken and Peat, 1993:16).

The process of crushing bluestone was therefore held to be a manufacturing process.

The question whether the processing of coal to produce coke was a mining operation was dealt with in ITC 1339.[21] The coke in question was produced by heating the coal

[19]1967 SA 226 (A), 29 SATC 131.
[20](1969) 1 ATR 40.

that the taxpayer had mined at high a temperature. The court held that, since coke was a mineral, the treatment to obtain it from coal constituted a mining operation.

In ITC 1455,[22] the court was once again required to separate mining and manufacturing operations, whereby the appellant company conducted open cast mining operations for magnetite ore at B (where ore was crushed, washed, screened and stockpiled) and an industrial plant at A (where the ore was processed to produce liquid pig iron and vanadium bearing slag). The processes carried out at the plant were summarised as follows (Van Blerck 1992:7-20):

Opencast mine

I	Process	-	magnetite ore mined, crushed, washed, screened and stockpiled and then transported to processing plant

Processing plant

II	Process	-	ore mixed with coal and fluxes, then
III	Process	-	heated in a pre-reduction rotary kiln, then
IV	Process	-	smelted in an electric furnace, then
V	Process	-	treated in a shaking ladle, then
VI	Output	-	vanadium slag sold to other steel producers, and molten pig transported to the steel plant

Steel plant

VII	Process	-	own steel production

The appellant contended that its mining operations ended before process II had begun, and that only a manufacturing enterprise was conducted thereafter. The Commissioner contended that the mining operations extended up to and including the shaking ladle. The court held that iron is produced by an industrial process, and not a mining process, and having regard to the ordinary meaning of 'mining operations' the meaning of the 1979 schedule was that process IV was the beginning of a manufacturing process. Van Blerck (1992:7-19) asserts that the decision taken in ITC 1455 is in accordance with the judgment taken in the *Zaaiplaats* case referred to above.

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[21](1981) 43 SATC 178.
[22](1988) 51 SATC 111.

In the recent case of *C: SARS v Foskor (Pty) Ltd*,[23] the court was called upon to decide whether or not the processing of ore bearing material was akin to a process of manufacture, and whether or not the acquisition by Foskor (Pty) Ltd ('Foskor') of the ore bearing material constituted 'trading stock' as defined in section 22 of the Act. Foskor's main business is mining, although income was also derived from non-mining operations as well. During 1963 Foskor entered into an agreement with Phaloborwa Mining Company ('PMC') where the latter was to extract foskorite, a by-product of its copper mining operations, and deliver the ore to Foskor for an agreed fee. Upon delivery of the ore, Foskor became the owner. Foskor extracted phosphates and other minerals from the ore dumped by PMC, by way of the following processes:

- the phosphate-bearing ore is loaded and hauled to a primary crusher and then conveyed to secondary and tertiary crusher for further crushing;
- the crushed material is then conveyed to Rod and Ball mills for the milling to liberate the mineral particles from the ore;
- the pulp containing the mineral is then pumped to a floatation plant where the minerals of economic importance are separated by means of three metallurgical processes, namely, a froth floatation process, a magnetic concentration step and a gravity process;
- the products from these processes are various concentrates. The phosphate concentrate which is the main object of the enterprise is then dried and stockpiled.

It was common cause in the case that the ore is not saleable before it was subjected to the process described above. The court, in coming to its decision, had regard to ITC 1052[24] where the following was stated:

> 'the article claimed to have resulted from a process of manufacture must be essentially different from the article as it existed before it had undergone such process'.

The court further stated as follows:

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[23]2010 SCA (3) ALL SA 594.
[24](1963) 26 SATC 253.

> 'it is true that when a mining house extracts gold ore and then subjects it to processes including refinement one would be hard-pressed not to concede that the mining house in question has mined gold'.

The court held, in deciding that the activities conducted by Foskor constituted a process of manufacture, thereby upholding C: SARS' appeal, that:

> 'in the present case, the mining is done by PMC. The ore, after it is acquired by Foskor, is subjected by it to what is set out above as part of a process towards the ultimate end, namely, the fertilizer produced by its customers. The foskorite ore is acquired by Foskor for the purpose of manufacture towards that final object. The fertilizer, although it contains phosphate, is a product substantially different to the foskorite ore. One would not in ordinary parlance speak of mining fertilizer, particularly where the mining institution and the producers of the intermediate and end products are distinct'.

It is difficult to see how the court arrived at such a decision. The process employed by the respondent company is similar to the *Henderson* case, where the taxpayer was held to be winning minerals, and therefore carrying on mining operations. It is interesting to note that the fact that Foskor had received mining income was not in dispute. The process applied by Foskor appears to be akin to a continuation of winning a mineral from the soil or constituent thereof, and not a manufacturing process. It is submitted that the judgment in the *Foskor* case is in conflict with what was held in ITC 1249 where the court said the following:

> '...This does not mean that any treatment of the mineral obtained would cause it to lose its character. For example, the separation of dirt from a mineral by sluicing would clearly not do so.'

It is apparent that the process applied by Foskor as described above was to separate the phosphate concentrates from the other minerals. The judgment in the *Foskor* case is likely to set a precedent since the decision was made by the SCA.

According to Van Blerck (1992:7-21) indications are that, in the absence of a definition of *mining operations* there is only a small degree of overlap between what in common parlance would be considered mining and manufacturing.

It is apparent from the judgments above that, in deciding whether the process is mining or manufacturing, the court considers whether the further processing is conducted by the party that mined the material or by a third party. In ITC 1339, where further processing of the coal to produce coke was conducted by the same person who had mined the coal, the process was held to constitute mining operations. The smelting process in the *Zaaiplaats* case was also held to constitute the carrying on of mining operations. In the *Foskor* case, however, the further processing of the foskorite-bearing ore was held to constitute a manufacturing process, presumably because the material was extracted by another party, namely PMC. Is this the correct approach to draw distinction between mining operations and manufacturing activities? The answer appears to be in the negative, especially when considering the findings in the other court judgments above.

Van Blerck (1992:7-17) provides the following example: a company mining ore and chrome, for example, could seek to maximise its profits by refining the ore, producing stainless steel and, finally, manufacturing stainless steel articles such as vehicle components, pots and pans. It is apparent that this final leg in the process could not be regarded as a mining process, as is the fact that the original winning of the ore itself is a mining process, but where does the winning of the mineral (and thus mining process) end? The answer to this question, according to Van Blerck (1992), will depend on the facts of each case. Van Blerck (1992:7-25) states that a rough guideline is that the winning process ceases where the material won undergoes a process which results in its transformation into a manufactured product.

It is submitted that capital allowances on assets used for mixed purposes (i.e. used for both mining and manufacturing activities) should be apportioned between the two activities to ensure the correct determination of taxable income. Capital allowances on the portion of the asset used for mining operations is determined in terms of section 36 of the Act, while on the other hand, capital allowances on the part of the asset utilised for manufacturing purposes is determined in terms of section 12C[25] of the Act.

[25] Expenditure to acquire plant and machinery used by a taxpayer in a process of manufacture or process which in the opinion of the Commissioner is of a similar nature, is allowed to be deducted from

(iii) Care and Maintenance

It is possible that a mine or a portion of a mine becomes uneconomic to operate but that management may believe that these circumstances are temporary. The mine may then be placed on a 'care and maintenance' programme which would involve the expenditure of the minimum possible amount of money to ensure that the mine's workings do not deteriorate too significantly, in order to enable production to commence without extraordinary additional costs at some future stage. Van Blerck (1992:7-22) raises the question of whether mining operations are being conducted in such circumstances. In *FCOT v Broken Hill South Ltd*[26] the court supported a decision of a board of review that: the common understanding of the expression 'mining operations' covered activities in connection with a mine additional to the mere extraction of ore. The maintenance of plant both above and below the surface and the work connected with the protection and safety of the mine was held to be mining operations.

(iv) Tailings Operations

Another interesting issue that has come before the courts relates to the treatment of tailings to recover or extract minerals. It is worth noting that no domestic case law has been brought before the courts regarding the treatment of tailings. Van Blerck (1992:7-23) enquires whether the process of winning minerals from tailings is akin to a mining operation.

In *Golden Horse Shoe Ltd v Thurgood,*[27] the taxpayer company was formed specifically for the purpose of purchasing certain Australian tailing dumps with the objective of working and re-treating them, so as to recover the gold therefrom. The issue was whether the expenditure on the dumps was deductible. The tax authorities contended that the expenditure was of a capital nature, on a wasting asset, and in the context of a mining company such expenditure was not deductible. The company

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income over a period of 4 years. The deduction is calculated at 40% of the cost of the asset to the taxpayer, 20% in each of the three subsequent years of assessment.

[26](1941) 65 CLR 150, 2 ATR 257.

[27](1934) HMIT I KB 548 (CA).

contended that their business was not mining for gold, but only treating the dumps known to contain gold so as to recover the gold, and that in this context the tailing comprised raw material. In ruling that the expenditure was in fact deductible, Lord Hanworth MR implied that the operation was akin to a manufacturing business applying a process to raw material already won (Van Blerck 1992:7-23).

To obtain gold from gold-bearing material (i.e. slime dumps), by sluicing, screening, filtering and chemical treatment, was held to be a mining operation in the Australian case of *Henderson v FCT.*[28] The court held that to obtain gold from gold-bearing material was a mining operation. 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 (Aiken and Peat, 1993:16-17). Van Blerck (1992:7-23) adds that the findings in this case indicate that the operations would still constitute mining operations even when conducted by a person who did not undertake the original mining of the gold-bearing ore.

There appears to be some conflict regarding the judgments of these two immediately preceding cases. This inconsistency or uncertainty was settled in *Parker v FCOT*[29] as established by Van Blerck (1992:7-24). The case dealt with an Australian tailings operator who processed on a certain property, both tailings derived from that property, as well as tailings purchased and transported from other properties. The primary issue was whether the latter operation constituted 'the working of a mining property'. The finding in this regard was negative, a finding of no real consequence in the context of the Income Tax Act, but of more interest was the secondary finding that the treatment concerned could correctly be classified as the 'carrying on of mining operations' (Van Blerck 1992:7-24).

Van Blerck (1992:7-24) states that the South African tax authorities apply the principles established in the *Parker* case, meaning that tailings operations are treated as mining operations for income tax purposes, whether or not they are located at the mine of origin.

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[28](1943) 2 AITR 440.
[29](1953) (5) AITR.

The judgment in the *Henderson* case will be of interest to mining companies in South Africa, including Black Economic Empowerment ('BEE') companies, which were recently granted mining rights by DMR to process old mine dumps which contain vast amounts of gold-bearing ore, for example. The Elsburg mine dump, situated in the east of Johannesburg, is estimated to contain some 1.3 million ounces of gold.[30] The value of the gold-bearing ore contained in the Elsburg mine dump is approximately R18.6 billion.[31] Does the processing of such mine dumps constitute carrying on of mining operations for income tax purposes, or are the activities akin to a manufacturing process? The processing of such mine dumps to extract the gold contained therein can be argued to be akin to a mining operation when one considers the outcome of the *Henderson* and *Parker* cases. In addition, the companies in question have been granted mining rights to win or recover the minerals contained in those mine dumps.

It is submitted that the 're-mining' of mine dumps will constitute mining operations for income tax purposes where the material extracted possesses value in use as established in the *Great Railway* case. It is worth noting that the material is not limited to gold only but can include any material that can be classified as a mineral in line with the decision taken by the court in the *Falcon Investment* case. This will include the 're-mining' of vast amounts of chrome bearing ore as well as diamond bearing mine dumps, amongst other minerals.

(v) The Overlap between Prospecting and Mining Operations

Van Blerck (1992:9-2) determines that the popular concept of prospecting envisages a search for minerals in a totally unexploited area, but prospecting is also carried out on a very large scale by existing mines, both within and outside their mining areas, and in the former case such prospecting frequently occurs kilometres below the surface of the earth.

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[30] According to an article titled *Rich pickings on gold mine dumps*.

[31] Determined at a gold price of $1713.40 an ounce and at an exchange rate of R8.36 to the dollar. These were the commodity prices quoted at the date of the completion of this report.

Technological advances in geophysics and geochemistry as well as in the evaluation of mineral deposits have dramatically changed the face of prospecting. A typical large-scale prospecting operation may involve computer-enhanced analyses of satellite photographs, sophisticated geophysical analysis conducted by instruments on dedicated survey aircraft supplemented by computer analysis, complex geochemical evaluation of surfaces in promising areas, diamond core drilling to depths of more than three kilometres and the application of advanced evaluation methods to identify mineral deposits (Van Blerck 1992:9-2).

There may be situations where mining and prospecting operations overlap, as determined by Van Blerck (1992:9-3), who further establishes that even though the term 'prospecting' is not defined in the Act, the definition of the term 'mining operations' and 'mining' in the Act is very broad and that there is to be little doubt that at times prospecting does constitute mining operations for income tax purposes.

Where a prospecting company is in the business of prospecting for speculative reasons, that is, in order to sell successful prospects at a profit, it is not conducting mining operations. This should be distinguished from the prospecting operations by a mining company in order to attempt to expand its existing mining operations. Such prospecting must inevitably be considered to be mining operations where minerals are won. This is supported by the *Murchison Exploration* case, referred to above. The taxpayer, in this case, incurred substantial exploration and prospecting costs in its initial year of operation to September 1935. During the period the company earned interest on its funds which had been placed on call, and which the tax authorities sough to tax at the higher tax rate applicable to gold mining income, rather than the lower rate of tax applicable to other income. Maritz J held that the interest was not taxable at the higher rate because the company's prospecting and exploration activities did not constitute 'mining operations' (Van Blerck 1992:9-3).

According to Van Blerck (1992:9-3), the decision of the court is correct in the context of a newly-established company which is involved exclusively in basic prospecting and exploration, but should the prospecting activities move into a phase whereby an appreciable quantity of minerals are recovered, it could be that, in the light of the

current wide-ranging definition of 'mining operations' in the Act, an overlap would occur.

It is clear from the above that in order to decide whether or not the prospecting operations are akin to mining operations one needs to establish the intentions of the prospector in relation to the prospecting operations conducted, as well as the merits of each case, as well as determining whether any minerals are won from the prospecting activities employed.

2.2 Conclusion

It has been established that the term 'mineral' is central in determining whether or not a taxpayer is carrying on mining operations, and the importance of this term cannot be stressed enough.

The definition of the term 'mineral' contained in the Minerals Act specifically excludes topsoil. The courts have held that mineral includes any material got from the soil which has value in use. Can a taxpayer be held to be conducting mining operations where the process involves the winning of topsoil which has 'value in use'? The answer appears to be in the positive if one considers the principles established in the *Great Western Railway* case, amongst others.

Some materials, such as gold and coal, have long been held to constitute minerals since they possess value in use. Some materials, such as common clay, stone, gravel, sand and granite have, however, been held by the courts not to be minerals.

The lack of a definition of the term 'mineral' in tax legislations has created an uncertainty regarding the classification of materials as minerals for income tax purposes. It is submitted that to distinguish materials between minerals and those that are not minerals is very subjective when taken in view of the court cases discussed above. Van Blerck (1992:7-9) states that a wide interpretation of the term 'mineral' must be adopted for income tax purposes in light of the decision taken in the *Nyasaland Quarries* case.

It is also submitted that the general rule is that 'mining operations' and 'mining' cease when minerals have been won from the soil. Any further processing of such mineral would signify the beginning of a process of manufacture. The cut-off point between mining operations and manufacturing process can be separated by a very thin line as was established in the *Rand Refinery* case, amongst others. Aiken and Peat (1993:17) submit that the dividing line between mining operations and the manufacturing process is manoeuvrable.

In conclusion, it is submitted that a question of whether a person is carrying on mining operations for income tax purposes is one of fact. Each case must be decided on its own merits to determine whether or not the activities employed by a taxpayer to extract materials from the soil constitute mining operations for the purposes of South African income tax.

CHAPTER 3

3 Stages in the life of a mine

3.1 Introduction

A traditional mine usually consist of five different stages in its life, namely:

1. Prospecting stage;
2. Pre-productions stage;
3. Production stage;
4. Non-production stage; and
5. Post-production stage.

The correct tax treatment of income received and expenditure incurred by a mine is largely dependent on the:

- stage in the life of the mine; and
- the nature of the receipt or expenditure.

Below is a detailed discussion of activities which occur in the respective stages of the life of a mine.

3.2 Prospecting Stage

Prospecting is the search for mineral deposits in the earth's crust. It is important to note that prospecting operations do not dictate that a mine will be developed. Aiken and Peat (1993:7) state that before mining can commence, it is necessary to find a payable mineral deposit and continue to say that this is a time consuming and often costly exercise, often involving mineral exploration in underdeveloped and sometimes desolate areas. Depending upon the intention of the prospector, the prospecting expenditure incurred may be either capital or revenue in nature.

As previously discussed, prospecting activities could conceivably overlap with mining operations. It is possible that a prospector receives income during the prospecting

stage of a mine and the question to ask is how such income should be treated for income tax purposes.

3.3 Pre-production Stage

This stage refers to a period prior to commencement of full mining production. This stage in the life of a mine usually involves setting up the mine infrastructure, such as sinking shafts, constructing capital assets and investing in other mine equipment. Development operations in underground mining would entail the establishment of access routes from the shaft and the drilling of tunnels into the reef, amongst other activities.

The concept of 'development prior to production' was dealt with in the *Broken Hill* case where Kitto J stated the following:

> 'It (the phrase "development of the mine property") covers, I think, any preparation, adaption or equipment of the property for the exploitation of an inherent potentiality which cannot be exploited, or fully exploited, without some such preliminary treatment.'

A mining company might receive income and incur expenditure during the pre-production period. It is important to understand the nature as well as classification of any income received and expenditure incurred in this stage of a mining operation.

3.4 Production Stage

This stage of a mine is also referred to as the mine construction stage. This stage of a mine can last well over 100 years, depending on the mine operations. The production phase involves extracting, processing, producing and transporting the minerals extracted.

Mining and non-mining income is received and mining and non-mining expenditure is incurred in this stage of a mine operation. The majority of the income earned in this stage will be from the sale of minerals. Mining capital expenditure incurred by a mine during the pre-production stage is redeemed in the production phase.

It is during this stage of a mine where taxpayers are confronted with challenges of establishing whether the activities carried out are 'mining operations' and 'mining' as defined, or whether the activities are akin to a process of manufacture. It is important to understand the tax treatment in respect of the different streams of income received and expenditure incurred to accurately determine the taxable income of a taxpayer conducting mining operations, as well as non-mining related activities.

3.5 Non-production stage

Non-production refers to situations where mining operations are temporarily suspended for one reason or the other. It could happen that a taxpayer is compensated for temporarily suspending its mining operations.

An example would be where a mining taxpayer is compensated for temporarily halting its mining operations due to damages to mine equipment. Expenditure could also be incurred during this stage of a mining operation. The income and expenditure should correctly be categorised to ensure the accurate computation of taxable income.

3.6 Post-Production Stage

This represents the last stage in a lifecycle of a mine. A mine closure is an on-going activity and its span is largely dependent on the extent to which the environment was impaired. Post-closure water treatment and control may require monitoring and funding long after mining operations have ceased. The process of converting an operating mine to a closed operation involves the following:

- dismantling of site structure and rehabilitation of any contaminated areas of the site;
- completion of the restoration of the mined areas;
- monitoring the success of the restoration process, including long-term treatment.

How should a mine treat the expenditure incurred in this stage of a mine for tax purposes bearing in mind that no mineral is won? A mine could earn income on the disposal of mined minerals as well as mining and non-mining capital assets. It is

important to establish the correct income tax treatment of expenditure and income in this stage of a mine.

3.7 Conclusion

Income received and expenditure incurred during the different stages of a mine must be classified and categorised correctly for income tax purposes. It is submitted that the correct tax treatment as well as classification of income received and expenditure incurred will result in the accurate computation of the tax liability.

CHAPTER 4

4 Mining and Non-Mining Income

4.1 Introduction

Van Blerck (1992:10-2) establishes that a mining company may have taxable income (or an assessed loss) from both mining and non-mining streams, and suggests that where there is income derived directly from the utilisation of mining assets (including intangible assets such as mining rights for the purposes of the taxpayer's own mining operations), such income will be mining income. However, where income is only indirectly derived from such assets, or is derived from other assets, this income would tend to be non-mining income.

It is important to determine the correct classification of income between mining and non-mining streams earned or received during the different stages of a mine. It is submitted that the correct tax treatment of income earned or received and the computation of the tax liability is dependent on the correctness of such classification.

4.2 Prospecting Phase

The intention of the prospector is important in determining whether the income earned on the disposal of prospecting rights is capital or revenue. The case of *CIR v Booysens Estate Ltd*[32] involved a company which, soon after its formation in 1899, had purchased 258 claims on the farm Booysens Estate and Turffontein. The company never undertook mining operations on these claims (i.e. rights). In 1906 the company sold 33 claims to Village Deep Ltd and in 1915 the remaining claims were sold to Robinson Deep Ltd. The Commissioner for Inland Revenue assessed the company to tax on the profit made on the latter sale and the company objected to this.

The Transvaal Provincial Division held against the Commissioner, on the grounds of the Commissioner's admission that the primary object of the company's formation was mining for gold; and the absence of any evidence that the company has at any

[32] 1918 AD 576, 32 SATC 10.

time carried on the business of buying and selling land or mineral rights. The Appellate Division dismissed the Commissioner's appeal, confirming the ruling in the Transvaal Provincial Division, despite the fact the company at all times had insufficient capital to conduct mining operations (Van Blerck 1992:9-11).

Similar views were held in *SIR v Smit,*[33] where the taxpayer acquired certain mineral claims which he attempted unsuccessfully to exploit over many years. Eventually lack of funds forced him to dispose of the claims. The Appellate Division held that the intention had never changed and the profit on the disposal of such mineral claims was capital in nature and thus not taxable (Aiken and Peat 1993:12).

The case of *SIR v Strubens Minerals (Pty) Ltd*[34] revolved around a company formed in order to dispose of mineral rights inherited by its shareholders. With the objective of eventually disposing of the rights, the company granted a prospecting contract with an option to purchase in return for certain annual option money. The court found that the company was merely fulfilling the purpose for which it had been formed and that it was not a profit making scheme. The options were consequently receipts of a capital nature (Aiken and Peat 1993:12).

Different views were expressed in ITC 118,[35] where income earned by a taxpayer on the disposal of options was held to taxable. The case involved an attorney's clerk who, in the 1920's platinum boom, purchased options over ground near Rustenburg which was believed to have platinum deposits. The options were sold at a profit shortly thereafter and the taxability of these profits was in question. The court held that the income was revenue and taxable since the taxpayer had insufficient capital to carry on mining operations and the evidence pointed to a scheme for exploiting options for profit (Van Blerck 1992:9-12).

In the case of *Lydenburg Platinum Ltd v CIR,*[36] the company had, among its objects, both mining and prospecting. The company commenced the mining development of its properties but encountered technical difficulties. It also bought additional nearby

[33]1965 (3) SA 591 (A), 27 SATC 89.
[34]1966 (4) SA 582 (A), 28 SATC 248.
[35](1928) 4 SATC 71.
[36]1929 AD 137, 4 SATC 8.

properties on which platinum had been discovered. The company's remaining funds were inadequate to exploit the latter properties which were subsequently sold. The Appellate Division found that both mining and resale of the property were business methods of making gains authorised by the company's memorandum. The court held that profit on the disposal of the properties was capital in nature and not taxable (Aiken and Peat 1993:12).

Van Blerck (1992:9-13) found it interesting that in another case, that of ITC 336,[37] the court held that income on the disposal of mineral options and other properties was taxable after some three decades of ineffectual gold prospecting, in spite of the relatively similar circumstances in the *Booysens* case, where the court had earlier held that income in that case was capital in nature.

The aforementioned court cases highlight the importance of the taxpayer's intention in acquiring prospecting and mineral rights, and the classification of proceeds on the subsequent disposal of such rights between revenue and capital. The application of the intention test is not always consistently applied by the courts, as evidenced by differing judgments held in ITC 336 and the *Booysens* case. It is submitted that income on the disposal of mining rights during the prospecting stage of a mine does not constitute 'mining income' since the income does not involve the winning of minerals from the soil. It is further submitted that, where the proceeds are capital in nature, the provisions of the Eighth Schedule[38] to the Act would apply. Any capital gains on the disposal of prospecting rights will be subject to capital gains tax ('CGT') from non-mining operations.

4.3 Pre-Production Phase

It was established in Van Blerck (1992:10-3) that mining companies raise much of the capital required for a new development in advance. Surplus funds are usually invested in short-term interest-bearing deposits. As confirmed in the *Murchison Exploration*

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[37](1935) 8 SATC 344.

[38] Effective from 01 October 2001. A taxable capital gain on the disposal of capital assets is included in taxable income in terms of section 26A of the Act. The capital gain is determined by subtracting the base cost from the proceeds received. The capital gains tax rate ranges between 25% and 50%, depending on the type of a taxpayer.

case, such interest income is non-mining income since the mining operation has not commenced.

Pre-production income may flow from minerals won in the development phase. The question arises whether this is mining income, and, if so, whether it should be credited against working capital expenditure as a recoupment. Income from mineral sales during the period preceding full production should be treated as mining income rather than as a reduction of mining costs (Van Blerck 1992:10-9). It is apparent that this income is derived from mining operations, being the sale of minerals won from the soil.

4.4 Production Phase

For it to be regarded as mining income, such income must be derived from mining operations or activities. According to Van Blerck (1992:10-2), the phrase 'derived from' has not been interpreted in any depth in a South African court case. The phrase was quoted in *Port Elizabeth Municipality v Union Government*[39] where the court said the following:

> 'the income of a trading business is not derived from the shop in which it is carried on, but from the sales there transacted'.

In ITC 732[40] rental income earned by a farmer on the lease of a portion of his farm was held not to be income *derived from* farming operations. The case involved a farm owner who let a portion of his farm for an annual rental of $300, to a tenant who carried on farming operations thereon for his own account. The farm owner sought to include the rental income derived by him as part of the gross income derived from farming operations.

In *Western Platinum Ltd v C: SARS*[41] it was held that in order to be mining income its source must be minerals taken from the earth. The phrase 'income derived from mining operations' was interpreted to mean 'income derived from the business of

[39]1918 AD 237.
[40](1951) 18 SATC 108 (C).
[41]2004 4 ALL SA 611 (SCA) 67 SATC 1.

extracting minerals from the soil'. It was further held that income which was directly connected to a mining source qualified as mining income while an intermediate investment of such income, putting it to work as capital, generally broke the direct connection.

Van Blerck (1992:10-3) says the following on the treatment of the following streams of income that might be received by a mining taxpayer during the production phase of a mine:

(i) Interest income

The classification of interest income between mining and non-mining income was thoroughly dealt with in the *Western Platinum* case. In that case, it was held that interest earned by the taxpayer company by virtue of its participation in the cash management scheme was not mining income since such interest related not to mining operations but to an investment decision taken by the company. Interest earned, such as interest on money placed on overnight call accounts, interest on fixed deposits and interest on tax refunds, were held not to be mining income in that case. The court held that interest on late payments by customers to be mining income since such interest was derived from the business of extracting minerals from the soil. The principle established in that case was that the classification of interest income between mining and non-mining activities was dependant on the source of such income.

Van Blerck (1992:10-4) concludes that where interest is an inherent part of the proceeds of the sale of minerals by a mining operation, for example, where the contract of sale provides for delay in the payment of the proceeds and the consequent payment of interest, such interest may be regarded as mining income.

(ii) Rental income

According to Van Blerck (1992:10-4), the determination of whether rental income is mining or non-mining income depends on the asset usage test as aforementioned. Where the assets are not mining assets as defined any rental income earned upon their usage would be non-mining income.

Rental income received on the lease of mining assets (i.e. as defined in section 36(11)(*d*)), such as mining houses let to mine employees constitutes mining income. Aiken and Peat (1993:24) states that rental income will usually constitute non-mining income where the expenditure on the assets let has not been treated as mining capital expenditure.

(iii) Royalties

It was established in the *Gloucester Manganese* case that royalties received by the mine owner who had granted a third party sole rights to prospect, mine and dispose of all manganese ore discovered, constituted non-mining income. According to Van Blerck (1992:10-6), this will be the case despite the fact that the royalty may be calculated by reference to the revenue or profits of the mining company.

Where, however, the arrangement between the mining rights holder and third party is in substance a partnership, the 'royalty' will represent a share of profit which will constitute mining income (Van Blerck 1992:10-6).

(iv) Disposal of mining rights

Van Blerck (1992:10-5) indicates that where mining rights are disposed for an outright consideration, the resultant proceeds would not constitute mining income even if the company selling the mining rights is a mining company. This, according to Van Blerck (1992:10-5), is due to the fact that the consideration received is not connected with the mining operations since such consideration would not have been derived from any process by which mineral was won from the soil.

It is submitted that the source of the income from the disposal of the mining rights is not from the winning of minerals from the soil.

4.5 Non-Production Phase

According to Van Blerck (1992:10-31), where a mining company receives an amount in respect of the sterilisation of a capital asset, such receipt constitutes income of a capital nature and is therefore not taxable. In *Glenboig Union Fireclay Co Ltd v*

IRC,[42] compensation received by the company was held to be capital in nature. The compensation related to payment received from a railway company which constructed a railway line over the land which had been leased by the company to mine fireclay. The House of Lords held that the amount so received was not profit earned in the course of the company's trade but was a capital receipt, being payment made for the sterilisation of a capital asset.

Similar views were held in *CIR v Illovo Sugar Estates Ltd.*[43] In that case, compensation was paid by the South African government to the company for the destruction of sugar cane as a consequence of certain of the company's canefields having been requisitioned by the military authorities during the Second World War. The court made a distinction between the amount received by the taxpayer in respect of the destruction of the cane rations and the compensation received for the destruction of the standing crops. The court held that the amount received in respect of the destruction of the cane rations constituted compensation for the loss of portion of the company's income producing machine, and such receipt was capital income not to be taxed. In contrast, compensation received in respect of the standing crops was held to be revenue income which, according to the court, had to be assessed to tax.

In another case insurance proceeds received by a gold mining company was held to be mining income. The taxpayer in ITC 1572,[44] which was classified as a post-1973 goldmine, received an amount of R940 000 as a result of a breakdown of its machinery as agreed between appellant and its insurer. The Commissioner for Inland Revenue taxed the receipt as non-mining income. In allowing the taxpayer's appeal, Zulman J held as follows

> 'I believe that one cannot give proper effect to the intention of the legislature if one interprets the words in s 15 as meaning that the sum of R940 000 odd was derived from an insurance company, or received from an insurance company, or even more broadly was derived from an insurance policy, and not mining activity. After all the business of the company was mining. Its business was not taking out insurance policies or making claims on insurance policies.'

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[42]1921 SC 400, 12 TC 427.
[43]1951 (1) SA 306 (N), 17 SATC 387.
[44](1993) 56 SATC 175.

It is submitted that it is correct that insurance proceeds should be taxed as mining income as determined by the court above. This follows from the fact that the insurance premiums paid to the insurance company would have been deducted as mining expenditure as held in the *Sub-Nigel v CIR*[45] case.

4.6 Post-Production Phase

According to Van Blerck (1992:10-32), income may still be earned after a mine has terminated its mining operations. Such income must be separated between mining and non-mining income. There is no requirement in the Act that mining activity should have taken place in the year in which the income is earned. It has been established that for income to constitute mining income such income must be 'derived from the business of extracting minerals'. This test should still be applied to determine the classification of income between mining and non-mining activities even when mining operations have ceased. Van Blerck (1992:10-32) states that the words 'derived from' require a close and causal connection between the mining operation and the income. It is submitted that income received from the disposal of minerals in the post-production stage constitutes mining income.

4.7 Conclusion

It was established in this chapter that a mine could receive income in any of the five stages of its life. It is imperative that such income is accounted for correctly for income tax purposes. Aiken and Peat (1993:21) emphasise that the existence of ring-fencing provisions makes it important to account for income under the correct heading. It has been established that to constitute mining income its source must be from the business of extracting minerals from the soil. It is submitted that only income that has a direct link to the winning of minerals from the soil constitutes mining income for income tax purposes. This is in accordance with the decision taken by the SCA in the *Western Platinum* case.

[45] 1948 4 SA 580 (A), 15 SATC 381.

Prospecting Stage

It is submitted that a mining taxpayer is not regarded as conducting mining operations during the prospecting stage of a mine development. This is largely due to the fact that the activities conducted at this stage of a mine development do not result in minerals being won from the soil. This is in line with the judgment of the court in the *Murchison Exploration* case where it was held that exploration activities did not constitute mining operations.

It is therefore concluded that income received by a mining taxpayer during the prospecting and exploration stage of a mine development does not constitute mining income for income tax purposes. It is further submitted that capital gains received by a mining taxpayer upon the disposal of such prospecting rights would not constitute mining income for income tax purposes.

Pre-Production Stage

Income received during the pre-production stage of a mine development would constitute mining income only where such income relates to the disposal of any mineral extracted from the soil before the mine commences full production. It is submitted that the fact that full production has not commenced is irrelevant in classifying the income received in the pre-production stage of a mine development for income tax purposes. The question to ask would be whether or not the source of the income received is from the disposal of minerals won from the soil. If the answer to this question is in the positive then the income received would constitute mining income.

It is submitted that a taxpayer would be regarded as conducting mining operations to the point where such activities entails the winning of minerals from the soil during the pre-production stage of a mine development. It is therefore concluded that the majority of the income received during the pre-production stage of a mine development would constitute non-mining income with the exception of income received from the disposal of minerals that had been won from the soil.

Production Stage

The majority of the income of a mining taxpayer is received and earned during this stage of a mine development. It is thus important to ensure that the different streams of income received in this stage of a mine development are treated correctly for income tax purposes. These would include, amongst others, the following types of income:

- Interest;
- Royalties;
- Rental;
- Capital profit on disposal of capital assets, and
- Capital profit on disposal of mining rights.

The decision of the court in the *Western Platinum* case is of great importance in categorising income between mining and non-mining where full mining production has commenced. It is submitted that for income to qualify as 'mining income', its source must be from the business of winning minerals from the soil. It is further submitted that the income received by a mining taxpayer that is not linked with the taxpayer's mining activities would not constitute 'mining income' for income tax purposes.

It is further submitted that rental income received from the direct utilisation of mining assets constitutes mining income, while on the other hand, income received from the indirect utilisation of mining assets or other assets constitutes non-mining income.

In summation, it is submitted that income received should be classified by reference to its source to determine the distinction between mining and non-mining income for income tax purposes.

Non-Production Stage

In light of the decision taken in ITC 1572, it is submitted that income received during the non-production stage would be classified as mining income where a direct link exists between such income and the taxpayer's mining operations.

It is further submitted that a distinction would be made between capital and revenue depending on which hole the income is intended to fill. Where the income received is intended to fill the capital hole then such income would constitute mining capital income which would be subject to capital gains tax in terms of the Eighth Schedule. Where, however, the income received fills the revenue hole then such income would constitute mining revenue income. This is in line with the decision in the *Illovo Sugar Estates* case.

Post-Production Stage

Income received by a taxpayer long after the mining operations have ceased would still constitute 'mining income' where such income relates to the taxpayer's direct ceased mining operations. This would be the case where, for instance, the taxpayer disposes of stockpiled minerals long after ceasing active mining operations.

It is submitted that the decision in the *Western Platinum* case is still relevant to determine the correct classification of income received between mining and non-mining categories even in instances where mining operations have ceased.

CHAPTER 5

5 Mining Expenditure and Losses

5.1 Introduction

A mining company is likely to have a combination of mining and non-mining expenditure. It is of utmost importance that such expenditure be classified correctly for income tax purposes. Van Blerck (1992:11-2) confirms that the categorisation of expenditure incurred by a mining company between mining and non-mining can become a difficult exercise.

As with any other business activity, mining expenditure incurred by a mining company can be either revenue or capital in nature. Mining expenditure will be incurred in various stages of a mine, with differing treatment depending on the stage where the expenditure is incurred.

Van Blerck (1992:11-3) asserts that expenditure incurred on mining and mining rights by a mining company (as opposed to a company which deals in such rights) is generally regarded to be of a capital nature as such rights confer an enduring benefit on the company. Van Blerck (1992:12-13) cites ITC 990[46] where it was held that expenditure incurred by a diamond-digger on mining rights was not mining equipment for income tax purposes. The effects of that judgement means that expenditure incurred on mining rights which confers an enduring benefit on the mining right holder, though considered capital in nature, does not qualify as a mining asset for the purposes of section 36(11) of the Act. It suffices to conclude that such capital expenditure is not tax deductible.

Aiken and Peat (1993:26-27) add that where mining and mineral rights have a short life expectancy which do not confer enduring benefit, a mining company might in such a case deduct the acquisition cost as revenue expenditure.

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[46](1962) 25 SATC 125.

5.2 Prospecting Expenditure

Aiken and Peat (1993:8) state that the nature of the prospecting expenditure incurred is dependent on the intention of the prospector. According to De Koker (1996), the deduction of the cost of prospecting operations by a taxpayer conducting mining operations must be distinguished from the deduction of the cost of prospecting whose income is not derived from mining operations but from the sale of mining claims or rights. It was established in Van Blerck (1992:9-4) that it is possible to divide tax deductible prospecting expenditure into these two categories:

(i) Prospecting Expenditure Incurred by a Speculator

According to Van Blerck (1992:9-5), the prospecting operations by a speculator constitute a trade, and, as such prospecting expenditure incurred would be in the production of income. Such expenditure is to be classified as a deduction in terms of the general deduction formula in section 11(*a*) of the Act, because the selling of the mineral rights would constitute revenue income in the hands of the speculator.

Where the speculator intends entering into an agreement whereby a third party is granted the right to exploit the mineral deposits in return for a royalty, that royalty will be taxable as non-mining income. In this case, however, both the initial and prospecting expenditure will be of a capital nature but will not rank for a deduction under either section 15(*b*) or section 36, due to the fact that the speculator is not carrying on mining operations.

(ii) Prospecting Expenditure Incurred by a Miner

According to Aiken and Peat (1993:8), where the prospector is a mining company which intends itself to mine any mineral deposits discovered; the prospecting expenditure will normally be of a capital nature. Similarly, the prospecting expenditure will be of a capital nature if the prospector intends to enter into a royalty agreement in terms of which a third party will be permitted to exploit the deposit in return for a royalty. Such capital prospecting expenditure will be deductible from mining income in terms of section 15(*b*) of the Act. Aiken and Peat (1993:8) further state that, should the prospector dispose of the mineral deposit in an outright sale, then

the prospecting expenditure will be of a revenue nature. The revenue prospecting expenditure will be deductible for income tax purposes in terms of section 11(*a*) of the Act.

5.3 Pre-Production Expenditure

Where interest and other charges are incurred in respect of loans utilised for mining purposes prior to the commencement of production, or during any period of non-production, such interest is classified as capital expenditure for mining tax purposes (Van Blerck 1992:11-13).

Aiken and Peat (1993:27) state that costs in this stage of a mine development include development costs, general administration, management and interest and finance charges on loans utilised for mining purposes. Such expenses, according to Aiken and Peat (1993:27), are considered to be capital in nature and are deductible in terms of section 36 of the Act.

According to Van Blerck (1992:11-5), expenditure incurred in the pre-production stage of a mine is specifically provided for in section 36 of the Act since the Revenue authorities hold the view that pre-production expenditure is not incurred in the production of income and/or that it is capital and is thus not deductible.

The issue of pre-production expenditure was dealt with by the court in *Palabora Mining Co v SIR,*[47] where it was held that expenditure incurred by the company before the commencement of mining and earning of income from such operations was not capital in nature as was argued by the Revenue authorities. Ogilvie Thompson held that:

> '[The] appellant was already carrying on "trade" within the meaning of section 1 of the Act before it incurred the expenditure in issue. It is immaterial that no anode copper was actually produced until after most of the expenditure in question was incurred. Having regard to the circumstances, the expenditure in issue was, in my judgment, so closely linked with appellant's income-earning operations during the tax year ending December 1966 as to constitute revenue expenditure in respect of that tax year.'

[47] 1973 (3) SA 819 (A), 35 SATC 159.

A mine incurs substantial investment in the form of capital expenditure during the pre-production phase of a mine. The capital expenditure involves, *inter alia*:

- shaft-sinking;
- investment in mine equipment;
- construction of roads, and
- construction of buildings such as schools, recreation facilities and health facilities.

Van Blerck (1992:12-2) questions whether the fact that the preamble to section 15(*a*) requires capital allowances to be deducted from mining mean that production must commence first, and mining income be earned before the allowances may be claimed. The answer to this crucial question, according to Van Blerck (1992:12-2), lies in the fact that the Act provides for the calculation of a capital allowance on unredeemed mining capital expenditure in a manner which clearly envisages that a new mine would have capital expenditure which cannot be deducted if there is no mining income.

This implies that during the pre-production phase, a mine will accumulate mining capital expenditure ('unredeemed mining capital expenditure') which can only be deducted against future mining income. It was earlier established that for income to constitute 'mining income' its source must be the business of extracting minerals from the earth. It suffices to say that since no mineral is won at this phase of a mine, the capital expenditure incurred cannot be deducted since no mining income will be generated. It is important to note that mining capital expenditure incurred cannot be utilised against non-mining income.

Van Blerck (1992:11-11) states that housing costs have long been accepted as an integral part of mining capital expenditure, provided that the houses or other accommodation are to be let by the mine to its employees. Houses erected by the mine for the purpose of resale will fall outside the definition of 'capital expenditure'. The same applies to houses not let to mine employees.

According to Van Blerck (1992:11-12), strong support for the contention that expenditure on mine schools constitutes mining capital expenditure comes from ITC 1439.[48] The issue hinged on the question whether or not expenditure on a school could be regarded as expenditure in relation to mining operations. The court held that expenditure on a school constituted expenditure in relation to mining operations, and further held that such expenditure constituted capital expenditure for mining tax purposes. Expenditure on a mine school is specifically included in the definition of 'capital expenditure' in terms section 36(11)(*d*)(iii) of the Act.

De Koker and Williams (2011) state that expenditure incurred in the development stage of a mine is generally included in capital expenditure as defined, but such amount is not available as a deduction until the mine concerned commences production.

Van Blerck (1992:12-3) concludes that expenditure incurred during the pre-production period which is not development expenditure could be deductible under the general deduction formula. As established in Aiken and Peat (1993:27), the judge in the *Palabora Mining* case pointed out that the mining redemption allowance granted by section 15(*a*) read with section 36 was granted *in lieu* of sections 11(*e*), 11(*f*), 11(*g*A) and 11(*o*) and made no reference to section 11(*a*).

5.4 Production Expenditure

Van Blerck (1992:11-13) states that interest and finance charges incurred in respect of loans utilised for mining purposes during the production phase of a mine do not constitute mining capital expenditure. Such interest is deductible either in terms of sections 11(*a*), 11(*b*A) or 24J of the Act. It is important to note that such interest would have been deductible under section 11(*a*) before section 24J became a charging section in respect of instruments issued on or after 1 January 2005. Van Blerck (1992:11-13) determines that the interest which relates to machinery, plant or buildings before such assets have been brought into use is deductible in the year of assessment in which the assets are first brought into use in the production of income.[49]

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[48](1987) 50 SATC 178 (Z).
[49]Section 11(*b*A).

Interest incurred on a loan that does not satisfy the requirements of section 24J (i.e. the loan is for a period of less than 24 months), and the interest relates to assets used in the production of income, a deduction of such interest will be allowed in terms of the general deduction formula. Where, however, the loan constitutes an 'instrument'[50] as defined, and the interest incurred relates to assets used for trade purposes, then such interest is deductible in terms of section 24J of the Act.

Van Blerck (1992:11-14) asserts that royalty payments incurred by a mining company in respect of mining rights constitutes deductible revenue expenditure. He argues, by citing the words of Watermeyer CJ in the *New State Areas v CIR*[51] case, that such expenditure is part of the cost of 'performing the income-earning operations' of the mine rather than part of 'establishing or improving or adding to the income-earning plant or machinery'. The new Mineral and Petroleum Resources Royalty (Administration) Act[52] 29 of 2008 ('the Royalty Act') introduces royalty tax payable by mining companies on the transfer of mineral resources extracted from within the Republic. It is submitted that the royalty tax payable to the National Revenue Fund ('NRF') constitutes mining expenditure which is deductible in terms of section 11(*a*) of the Act.

It was established in the *Sub-Nigel* case that a gold mining company which had entered into insurance policies against loss of profits and the cost of standing charges in consequence of fire was entitled to the deduct its premiums in terms of the general deduction formula. It was held in that case that the expenditure was incurred in the production of income and was not of a capital nature (Van Blerck 1992:11-15).

Capital expenditure incurred is redeemed during the production phase of a mine as aforementioned. The redemption of capital expenditure is discussed in detail below.

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[50] The term 'instrument' is defined in terms of section 24J of the Act.
[51] 1946 AD 610,14 SATC 155.
[52] The Royalty Act levies a tax on mining revenue (i.e. Gross Sales) rather than mining profit, payable to the NRF. This discussion has been included for completeness purposes only and as such the provisions of the Royalty Act will not be considered in detail for the purposes of this research report.

5.4.1 Redemption of Mining Capital Expenditure Incurred

The balance of unredeemed mining capital expenditure will be redeemed (i.e. deducted) against mining income in the production phase of a mine. The redemption of such mining capital allowances is provided for in terms of section 15(*a*) of the Act which reads that:

> 'there shall be allowed to be deducted from the income derived by the taxpayer from mining operations-
> (a) an amount to be ascertained under the provisions of section 36, in lieu of the allowances in section 11*(e), (f), (gA), (gC), (o)*, 12D, 12DA, 12F and 13*quin*
> (b) ...'

Van Blerck (1992:12-4) states that the fact that the deduction is *in lieu* of various other sections can cause some confusion. He asks whether it is possible that a mining company could fail in its claim for a deduction where such deduction is *in lieu* of the various deductions provided for in terms of section 15(*a*). Van Blerck (1992:12-5) submits that this cannot be, because deduction 'A' can only be regarded as being *in lieu* of deduction 'B' to the extent that its provisions embrace a transaction which would have been dealt with under 'B'.

Aiken and Peat (1993:29) asserts that capital expenditure incurred by a mine that fails to meet the definition of 'mining capital expenditure', may nevertheless be deductible under another allowance, including any one of the allowances *in lieu* of which the capital redemption allowance is granted.

A deduction of expenditure as described in section 36 therefore replaces the allowances referred to in section 15(*a*) above. This means that a taxpayer cannot claim a deduction in terms of section 36 as well as in terms of any of the sections referred to in section 15(*a*).Van Blerck (1992:12-2) states that the capital redemption deduction may be divided into two categories, namely, full redemption and Partial Annual Redemption ('PAR'). These will be discussed below in detail.

5.4.1.1 Full Redemption Deduction

According to Van Blerck (1992:12-3), the capital allowance in respect of assets qualifying for the full redemption deduction would be the capital expenditure incurred. Mining capital expenditure incurred is redeemable in full in respect of the following assets:

Shaft Sinking

The term 'shaft sinking' is not defined in the Act. In the case of *Union Government v Nourse Mines Ltd*[53] the court, in interpreting the term 'shaft sinking' held that:

> 'The cost of shaft sinking is the cost of making an excavation and furnishing it with the usual requirements for a shaft, and all incidental costs in draining that shaft until perfected are costs of shaft sinking.'

Section 36(11) of the Act defines 'expenditure on shaft sinking' to include 'expenditure on sumps, pump-chambers, stations and ore bins accessory to a shaft'.

It is submitted that shaft sinking expenditure incurred is redeemed in full in the first year of commencement of mineral production, subject to ring-fencing provisions to be discussed below.

Mine Equipment

'Mine equipment' is not defined in the Act. The term was, however, interpreted in the *Nourse Mines* case, where Wessel J held that

> 'the hole in the ground called a shaft is not part of the equipment of a mine any more than are levels, drives, winges or raises. The timbering, however, in the shaft, the pumps that carry the water, the rails and trolleys for carrying ore, and generally all the apparatus that is necessary for carrying on mine operations may be called the equipment of a mine'.

[53](1912) TPD 924.

Van Blerck (1992:12-12) concludes that due to this wide interpretation, the tax authorities accepted the interpretation of the term 'mine equipment' to include all underground equipment as well as surface railway lines, administrative buildings, schools and storage facilities, amongst others.

Notwithstanding this wide interpretation, it is important to note that the full redemption deduction is only available to mine equipment used directly in the mining process. Mine equipment that would qualify for 100% accelerated capital allowances includes continuous miners, haulers and drills.

Mine equipment such as schools and administrative buildings will not qualify for the full redemption deduction as a result. Capital expenditure on such assets is deductible in terms of the PAR discussed below.

It was established in ITC 1110[54] that the mine equipment must be owned by the mine for the capital redemption deduction to apply.

5.4.1.2 PAR

Capital redemption on certain mining equipment identified in terms of section 36(11)(*d*) is made available over a period of time as opposed to full capital redemption discussed above. The mining assets include the following:

- residential housing for occupation by the taxpayer's employees, together with furniture for such housing;
- infrastructure in respect of residential areas developed for sale to the taxpayer's employees;
- hospitals, schools or shops owned and operated by the taxpayer mainly for the use of its employees;
- recreational buildings and facilities owned and operated by the taxpayer mainly for the use of its employees;
- any railway line or system having a similar function for the transport of minerals from the mine to the nearest public transport system;

[54](1967) 29 SATC 169.

- motor vehicles intended for the private or partly private use of the taxpayer's employees.

Instead of ranking for immediate redemption, expenditure on such assets is deemed to be payable in ten equal instalments (five in the case of motor vehicles), the first on the date when payment became due and subsequent instalments of the anniversary dates (Aiken and Peat, 1993:36). The reason for applying PAR on these assets, according to Van Blerck (1992:12-19), is that these are not used directly in the mining process and should as such be written off over a longer period. These were the recommendations of the 1988 *Marais Committee*, which the Government accepted in 1989 (Van Blerck 1992:12-19).

5.4.2 Ring-Fencing of Mining Capital Expenditure Incurred

Sections 36(7C), (7E) and (7F) of the Act place a cap on the deduction of capital expenditure incurred by a producing mine. Capital expenditure in respect of each mine must be determined separately and will not qualify as a deduction until the mine in question is in production (De Koker and Williams 2011). According to Aiken and Peat (1993:41), the term 'ring-fencing' refers to artificial barriers created by legislation with the intention of ensuring that capital expenditure incurred in respect of a particular trade or business operation is only deductible up to the amount of actual income from that trade or business operation, the balance being carried forward to rank for deduction in the following year. It is clear that such provisions were aimed at preventing the creation of significant assessed losses likely to be caused by the redemption of the accumulated capital expenditure incurred prior to commencement of mining operations. It has been previously mentioned that investment in a mine involves substantial capital expenditure, especially prior to production. Aiken and Peat (1993:41) state that if it were not for the ring-fencing provision, the full capital expenditure would otherwise be deductible, creating a tax loss for the trade or business operation concerned where such losses would be set-off against taxable income from another trade or business operation.

Aiken and Peat (1993:41) assert that two types of ring-fencing are applicable to the redemption of capital expenditure within the mining industry, being the 'outer' or

'general' and the 'inner' or 'per mine' ring-fencing. These are discussed in detail below.

5.4.2.1 Outer or General Ring-Fencing

This ring-fencing provision[55] limits the deduction of capital expenditure incurred to the taxable income derived from mining operations. Any excess capital expenditure is carried forward and deemed to be an amount of capital expenditure incurred during the next year of assessment. De Koker and Williams (2011) state that such amounts are normally referred to as unredeemed capital expenditure incurred.

According to Aiken and Peat (1993:41), a mine could set-off assessed losses created by the redemption of mining capital expenditure against income from any other trade. The outer ring-fencing provision was introduced in 1984 to ensure that unredeemed capital expenditure is not set-off against non-mining income. The effect of the outer ring-fencing provision is that non-mining taxable income cannot be reduced by the amount of capital expenditure available for redemption in a year of assessment.

It is interesting to note that, as a consequence of this ring-fencing provision, a mining taxpayer could be taxed on non-mining income, such as rental received on the utilisation of non-mining assets, despite having substantial unredeemed capital expenditure.

5.4.2.2 Inner or Per Mine Ring-Fencing

Van Blerck (1992:12-29) asserts that before 1985 a company operating more than one mine could set-off any unredeemed capital expenditure from one mine against mining income of another. The inner ring-fencing provision[56] was introduced in 1985 and is effective for years of assessment commencing on or after 5 December 1985.

According to Aiken and Peat (1993:42), the inner ring-fencing provision provides that the capital expenditure allowance in respect of any particular mine in any year of assessment may not exceed the taxable income from mining (determined before the

[55]Section 36(7E).
[56]Section 36(7F).

capital expenditure redemption allowance but after the set-off of any balance of assessed loss in respect of that mine brought forward from the preceding year) derived by the mining company from mining on that mine. For the purposes of this section, two or more mines carried on by a company are deemed to constitute a single mine.

The effect of the inner ring-fencing provision is that each mine is treated separately for the purposes of determining the capital expenditure allowance redeemable in a year of assessment. Any unredeemed capital expenditure is carried forward and is deemed to be capital expenditure incurred during such year of assessment.

In terms of section 36(7F), the Minister of Finance may, after consultation with the Minister of Mineral and Energy Affairs (now referred to as Minister of Mineral Resources), determine that the inner ring-fencing provisions not be applicable. Aiken and Peat (1993) stress that such exemption is seldom granted in practice.

Section 36(7G) was introduced as a consequence of strong opposition from the mining industry to the restrictions placed by the inner ring-fencing and its intention was to relax such restrictions. Of utmost concern to the mining industry was the inescapable reality that unredeemed capital expenditure accumulated by a failed mining investment would never be deductible. The provisions of section 36(7G) override the restrictions placed on a mine in terms of the provisions of section 36(7F) and are only applicable where a new mine commences mining operations after 14 March 1990. Where capital expenditure on a new mine would be disallowed in terms of the inner ring-fencing provision, such capital expenditure may nevertheless still be allowed providing that it does not exceed 25% of the taxable income of the taxpayer derived from mining. Van Blerck (1992:15-7) indicates that the pool of mining income is not restricted to particular categories of mines. He provides as an example, a company which operated coal mines, gold mines and base minerals that would have a single pool of income against which this 25% could be calculated. He further states that separate mines could combine in a partnership to create a larger pool of eligible income in order to launch a larger new venture.

The partial relaxing provisions provided by section 36(7G) will, however, not apply where the capital expenditure incurred is in respect of any new mine which has been

disposed of by the taxpayer in the current year of assessment. This proviso is presumably aimed to prevent new mines being housed temporarily in companies with substantial mining tax losses prior to disposal. The provisions will also not be applicable in the case of the taxpayer being a company and its acquisition of the right to mine or the mineral rights in respect of such new mine is financed wholly or partly by the issue of any share in respect of which any dividend is to be calculated by reference to that portion of the company's profits which is attributable to the operations of such mine. The purpose of this proviso is to prevent companies with substantial mining profits from hosting a new mine which was financed by way of issue of shares and transferring some profits by way of a dividend to the former owners of the mine (Van Blerck 1993:12-31)

The purpose of introducing the partial relaxing provisions was to stimulate companies into developing new mines, as stated in the Income Tax Bill.[57] The current wording of the section refers to 'mining operations or any related operations were or are commenced by the taxpayer after 14 March 1990'. Based on such wording, where a company buys an existing mine, can such a mine constitute a new mine for the purposes of this section, and will the provisions of section 36(7G) be applicable? The answer appears to be affirmative, based on the current wording of the section. It is unlikely that the legislature had this intention in mind when this statutory provision was promulgated.

According to De Koker and Williams (2011), the deduction regime established by section 36(7C) appears disarmingly simple, but grammatically inelegant. The provisions of sections 36(7C), (7E), (7F) and (7G) can be summarised using an illustrative example.[58]

A taxpayer has three different mines which are not contiguous (i.e. considered not to be a single mine) and these mines were developed as follows:

Mine 1- developed before 5 December 1984;

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[57]Explanatory Memorandum on the Income Tax Bill, 1990.

[58] Illustrative example adopted from the Mining Tax Course notes conducted by the University of the Witwatersrand in 2011 titled *Mining Tax Law Certificate* which was presented by the Mandela Institute.

Mine 2- developed after 5 December 1984 but before 14 March 1990;
Mine 3- developed after 14 March 1990.

The net income before losses and capital expenditure for the year is as follows:
Income from non-mining operations is R50 000

	Mine 1	**Mine 2**	**Mine 3**
Assessed loss brought forward	-	-	100 000
Mining income	100 000	200 000	50 000
Unredeemed capital expenditure	100 000	-	50 000
Capital expenditure for the year	20 000	30 000	40 000

The taxable income for the year will be determined as follows:

	Non-mining	Mining			Total
		Mine 1	Mine 2	Mine 3	
Net income	50 000	100 000	200 000	50 000	400 000
Assessed loss b/f	-	-	-	(100 000)	(100 000)
Income after assessed loss	50 000	100 000	200 000	(50 000)	300 000
Assessed loss utilised-s36(7E)	-	(25 000)	(25 000)	50 000	-
Income after loss	50 000	75 000	175 000	-	300,000
Redemption allowance - s36(7F)	-	(75,000)	(30 000)	-	(105 000)
Income after redemption allowance	50 000	-	145 000	-	195 000

Redemption allowance-s36(7G)	-	-	(36 250)[59]	-	(36 250)
Taxable income for the year	50 000	-	108 750	-	158 750

The capital expenditure for the year is determined as follows:

	Mine 1	**Mine 2**	**Mine 3**
Unredeemed capital expenditure b/f	100 000	-	50 000
Capital expenditure for the year	20 000	30 000	40 000
Total capital expenditure before capital expenditure utilised, s36(7F)	120 000	30 000	90 000
Capital expenditure utilised against mining income	(75 000)	(30 000)	-
Unredeemed capital expenditure before application of s36(7G)	45 000	-	90 000
Utilisation of capital expenditure-s36(7G)	-	-	(36 250)
Unredeemed capital expenditure carried forward to 2009 year of assessment	30 000	-	53 750

The R50 000 relating to non-mining income is not available to redeem or reduce the mining capital expenditure. In terms of section 36(7F), Mine 1 can redeem its capital expenditure of R120 000 by R75 000 which is available after reducing its income by the accumulated assessed loss of R25 000 relating to Mine 3. The unredeemed capital expenditure of R30 000 is carried forward to the succeeding year of assessment to be deducted against mining income.

Mine 2 can redeem its mining capital expenditure incurred against its available mining income of R175 000, which is sufficient to absorb the full mining capital

[59] Determined at 25% of R145 000, being the taxable mining income available to utilise unredeemed capital expenditure in terms of section 36(7G) of the Act.

expenditure incurred. As a result, Mine 2 will not have any balance of capital expenditure to be carried forward to the succeeding year of assessment.

Save for the provisions of section 36(7G), Mine 3 would have carried forward the full R90 000 capital expenditure to the succeeding year of assessment since it has no mining income to redeem such capital expenditure against. With the introduction of section 36(7G), the taxpayer can reduce its taxable income as well the capital expenditure of Mine 3 by R36 250, being 25% of the taxpayer's taxable income from mining operations. The unredeemed capital expenditure of R53 750 is carried forward to the succeeding year of assessment.

5.4.3 Recoupment of Capital Allowances

Where a mine has not been allowed a deduction in respect of expenditure (for example, on land), the recovery or recoupment of this expenditure has no tax consequence (Van Blerck 1992:14-2). Aiken and Peat (1993:39) state that where allowances have been granted (whether the redemption allowance or any other) the taxpayer will have to recoup all or some of the allowances previously granted. Recoupment of mining capital allowances is treated in terms of paragraph (*j*) of the definition of 'gross income' in section 1 of the Act. Aiken and Peat (1993:39) add that recoupment of capital expenditure which had qualified for the capital redemption allowance in terms of section 36 is not to be treated in terms of general recoupment provisions in section 8(4)(*a*) of the Act.

Van Blerck (1992:14-5) enquires whether a recoupment of such previously allowed capital expenditure should be credited to expenditure or be treated as income in its own right. The recoupment, according to Van Blerck (1992:14-5), is income since the provisions of paragraph 1 of the definition of 'gross income' specifically require the inclusion of recoupment in income. The amount taxable in terms of paragraph (j) is the excess recoupment remaining after reducing the proceeds received by the amount of current mining capital expenditure.

The recoupment of non-mining capital expenditure incurred by a mining company and deducted under a provision other than the capital redemption allowance is subject to tax in terms section 8(4)(*a*) of the Act (Aiken and Peat, 1993:40).

5.5 Expenditure Incurred During Periods of Non-Production

Van Blerck (1992:12-19) mentions that the provisions of section 36(11) of the Act are equally applicable to development expenditure, general administration and management expenditure as well as any interest and other charges on loans utilised for mining purposes during any period of non-production.

Van Blerck (1992:11-3) states that for a benefit to be enduring it must either be permanent or have a reasonably long-term life. This is a very important principle that could assist to distinguish capital from revenue expenditure. Van Blerck (1992:11-3) says that where the benefit conferred has only a short duration there is a good argument for such expenditure to be revenue in nature. He cites the *Palabora Mining* case to support this view. In that case expenditure by a mining company on a barrage was held not to confer any enduring benefit on the basis that the benefit only had a life of some eight months. The expenditure was consequently held to be of revenue nature.

Aiken and Peat (1993:27) express the view that arguments formulated to deduct pre-production expenditure should be used to argue for the deduction of similar expenditure incurred during periods of non-production. The arguments referred to here are those established in the *Palabora Mining* case, that is, that the preamble of section 15(*a*) refers to allowances *in lieu* of specific sections and not section 11(*a*).

It was held in the *Broken Hill* case that expenditure incurred during the period in which a mine is placed on a 'care and maintenance' project constitutes mining expenditure. Expenditure incurred by a mining company during the temporary suspension of mining operations is regarded as mining expenditure. Expenditure in this case will include non-capital expenditure which is defined to be capital expenditure for the purposes of section 36(11) of the Act (Van Blerck 1992:12-19).

In *COT v Nchanga Consolidated Copper Mines,*[60] the court held that compensation paid by the taxpayer to another group of mining companies in order to compensate the second company for restricting its output for twelve months did not give rise to an enduring benefit due to the shortness of this period (Van Blerck 1992:11-21). The expenditure was held not to be of a capital nature. The court held as follows:

> 'payment made by the respondent company was wholly related to an incident of its output of the year and as such was a cost incidental to the production and sale of the output of the mine, ranking as an operating cost in the determination of the company's profits for the year'.

The court was satisfied that the expenditure constituted mining expenditure. It is submitted that revenue expenditure incurred during the period of non-production constitutes mining expenditure if one considers the judgment of the *Nchanga Consolidated* case above.

5.6 Post-Termination Expenditure

Van Blerck (1992:11-29) establishes that there are two possible problems to consider with regard to expenditure incurred after mining operations have ceased. The first issue, according to Van Blerck (1992:11-29), is whether such expenditure can be said to be incurred 'in the production of income'. Van Blerck (1992:11-29) cites the *Sub-Nigel* case, where it was held that for expenditure to be said to having been incurred in the production of income does not mean that such expenditure must produce income in the year it was incurred. Van Blerck (1992:11-30) concludes by having regard to the *Port Elizabeth Tramway Company Limited v CIR*[61] case that expenditure incurred in the post-production stage of a mine would be a concomitant of conducting mining operations and the fact that such expenditure is incurred after mining operations have ceased is irrelevant.

The second issue raised by Van Blerck (1992:11-29) is whether the deductibility of such expenditure will provide any benefit for the mining company since little income, if any will be earned in the post-termination stage of a mine.

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[60] [1964] 1 ALL ER 208 (PC), 26 SATC 37.
[61] 1936 CPD 241, 8 SATC 13.

It would appear that post-termination expenditure is deductible in terms of the general deduction formula in that such expenditure can be regarded as being incurred in the production of income in this stage of a mine development. The mine will, however, be in a predicament since there will likely be no income against which such expenditure can be deducted. This will result in an assessed loss that the mining company will not be in a position to utilise against mining income since mining production will have ceased. Such assessed loss can be set-off against non-mining taxable income.

5.7 Assessed Losses

Assessed losses are treated in terms of section 20 of the Act. Aiken and Peat (1993:53) determine that where a taxpayer derives mining and non-mining income, the assessed loss incurred from mining operations is set-off against mining income while that which relates to non-mining activities is set off against non-mining income. Any loss from one or other activity which remains after such set-off is then set-off against the income of the other activity. It is important to distinguish between unredeemed capital expenditure and assessed loss. The former cannot be set-off against non-mining income while the latter can.

Van Blerck (1992:11-20) concurs with the views of Aiken and Peat above. He cites ITC 770[62] where the court confirmed that an assessed loss of one activity can be set-off against income of another activity, even if one of such trades is mining operations. The taxpayer in the instant case carried out three distinct trades, one coal mining, one of investment and one of share-jobbing. The taxpayer sustained a loss in the share-jobbing trade and earned profits from the other two trades. The tax authorities sought to set-off this loss exclusively against the profit from the investment activities, and to tax the coal-mining profit in full. The Commissioner's representative conceded in that case that it was the practice of the authorities, where a person showed an assessed loss on one or more separate trades, to apportion the set-off of such loss *pro rata* to the remaining trades. The court held this to be the correct treatment of the assessed loss. It follows that the same treatment is adopted in respect of assessed losses brought forward from prior years.

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[62](1953) 19 SATC 216.

5.8 Conclusion

The classification of expenditure is dependent on the stage in which it is incurred as well as its nature.

Prospecting Stage

Prospecting and exploration expenditure incurred by a prospective miner is specifically deductible in terms of section 15(*b*) of the Act. Prospecting and exploration expenditure incurred by a speculator does not constitute mining expenditure and is deductible under section 11(*a*) of the Act.

Prospecting and exploration expenditure therefore constitutes mining expenditure for income tax purposes despite the fact that no minerals are won during this stage of a mine development.

Pre-Production Stage

This chapter established that development and general administration expenditure incurred during the pre-production stage of a mine development constitutes 'capital expenditure' as defined which is deductible in terms of section 36 of the Act, despite the fact that full production has not commenced. It is submitted that the following expenditure, amongst others, incurred during the pre-production stage constitutes mining capital expenditure for income tax purposes:

- Shaft-sinking;
- Development costs;
- General administration and management costs;
- Interest and finance charges on loans utilised for mining purposes;
- Investment in mine equipment;
- Construction of roads, and
- Construction of buildings such as schools, recreation facilities and health facilities.

The capital expenditure incurred would be redeemed once full production has commenced.

It is further submitted that expenditure not regarded as 'capital expenditure' by a mining taxpayer during this stage of a mine development would rank for a deduction under section 11(*a*) of the Act. Interest incurred on non-mining assets during this stage of a mine development would be deductible in terms of section 11(*b*A) of the Act once the assets in question are brought into productive use.

Production Stage

It is submitted that non-capital mining expenditure incurred in the production stage is deductible against mining income in terms of section 11(*a*) of the Act. The accumulated capital expenditure incurred before this stage of a mine development is redeemed against mining income. This would include the development and shaft-sinking expenditure incurred in the pre-production phase discussed above. In light of the decision in the *Palabora Mining* case, expenditure which confers an enduring benefit on the taxpayer constitutes capital expenditure for income tax purposes.

It is further submitted that capital allowances on direct mine assets is deductible in full against mining income while indirect mine assets such as mine schools, are written off over the useful life of such assets in terms of section 36(11)(*d*) of the Act.

In conclusion, it is submitted that the correct tax treatment of mining expenditure incurred in this stage of a mine development is dependent on whether expenditure is capital or revenue in nature; and whether capital expenditure relates to direct or indirect mine assets.

Non-Production Stage

It is submitted that revenue expenditure incurred during any period of non-production would constitute mining expenditure where a causal link exists between such expenditure and the mining activities of the taxpayer, despite the fact that no active mining operation is conducted during such period of non-production. This is in accordance with the decisions delivered in the *Broken Hill* and *Nchanga Consolidated*

cases. The revenue mining expenditure would rank as a deduction under section 11(*a*) of the Act.

Mining expenditure that confers an enduring benefit to the taxpayer is regarded to be capital in nature and is treated in terms of section 36(11)(*d*) of the Act for income tax purposes. It was established in the *Palabora Mining* case that for it to be enduring, such benefit must be permanent or long term in nature.

Post-Production Stage

Expenditure incurred by a mining taxpayer would still constitute mining expenditure even when is it incurred after the mine has ceased its operations if a direct link exists between such expenditure and the taxpayer's ceased mining operations. The test to be used to determine the classification of expenditure incurred in the post-production phase of a mine is whether or not such expenditure is a concomitant of the taxpayer's ceased mining operations. This is in accordance with the decision in the *Port Elizabeth Tramway* case. It is submitted that if the answer to this question is affirmative, then the expenditure would constitute mining expenditure for income tax purposes.

CHAPTER 6

6 Environmental Rehabilitation

Mining rights holders are required by law to rehabilitate the environment upon the closure of a mine operation. The MPRDA requires mining taxpayers to make financial provision for the rehabilitation of mined land. Aiken and Peat (1993:47) assert that it is not surprising that mining law places strict obligations on the miner to rehabilitate the mined area in light of the current environmental consciousness.

Section 37A of the Act allows a person carrying on any trade, in determining taxable income during any year of assessment commencing on or after 2 November 2006, to deduct any cash paid to a company or trust ('rehabilitation fund') whose sole object is the environmental rehabilitation of mined land. The receipts or accruals of rehabilitation funds are exempt from tax in terms of section 10(1)(*c*P) of the Act.

Prior to 2 November 2006, only taxpayers engaged in mining, prospecting, quarrying or similar operations were allowed to deduct from income, in terms of section 11(*h*A), cash paid to a company, society, association of persons or trust referred to in section 10(1)(*c*H) of the Act. The amount deductible in terms of section 11(*h*A) was determined in accordance with a formula, and approved by the then Department of Minerals and Energy ('DME').[63]

The contribution ranking for deduction under the current regime (i.e. section 37A) is not limited and requires no approval from DMR. The amount deductible from income is the cash contribution paid to the rehabilitation fund during the year of assessment. In terms of section 37A, only trusts and companies may be used as a rehabilitation fund, unlike in the old regime of section 11(*h*A) which allowed unregistered entities such as societies, amongst others, to b^ used as rehabilitation entities.

The following restrictions are put on a section 37A rehabilitation fund (De Koker and Williams 2011):

[63] On 10 May 2009 an announcement to replace the DME with two new ministries was made. The two ministries were named Ministry of Energy, and the Ministry of Mineral Resources respectively.

- the rehabilitation fund must have as its sole object, the management of environmental rehabilitation of mined land in terms of rights governed by the MPRDA;
- the rehabilitation fund can only hold permitted assets;
- the rehabilitation fund cannot withdraw benefits for reasons other than the rehabilitation of the environment or as directed by the Minister of Mineral Resources.

De Koker and Williams (2011) add that excess reserves available on completion of rehabilitation will not revert to the taxpayers. Such reserves must be transferred to another rehabilitation fund established by the taxpayer for mining rehabilitation purposes, or to a general trust account prescribed by the Minister of Mineral Resources.

The Commissioner is empowered to impose penalties where any of the rules governing the rehabilitation fund are contravened. Section 37A (7) of the Act deems certain amounts to be taxable income accruing to the trust or company where any provision of section 37A was contravened. It is submitted that such taxable income does not constitute mining income even where the company is conducting mining operations. It is presumed that the source of the income could not be the extraction of minerals from the soil.

It is submitted that cash contributions made by a mining taxpayer to any rehabilitation company or trust will rank as a deduction in terms of section 37A of the Act. It is further submitted that the cash contribution does not necessarily constitute mining expenditure even where the person making the contribution is conducting mining operations. This follows from the fact that the preamble of section 37A indicates that the deduction is available to a person carrying on *any* trade. It is apparent that the contribution could be deducted against non-mining income during any stage of a mine.

CHAPTER 7

7 Conclusion on the Research Problem

As aforementioned, South Africa is one of the leading countries in the World which is rich in mineral deposits. These include platinum, gold, diamonds and manganese amongst others. A question for income tax purposes is whether the extraction of such mineral deposits constitutes mining and mining operations.

It was indicated in the *Western Railway* case that a person is conducting mining operations where the process involved therein is the extraction of materials possessing value in use from the soil. It is submitted that the interpretation by courts of what constitutes a mineral as well as what constitutes mining operations is not always consistent.

Common clay was held not to be mineral in the *Brick & Potteries* case on the one hand, while, on the other hand, the court found common clay to constitute a mineral in the *Finbro Furnishers* case. It is submitted that the confusion of whether or not a material constitutes a mineral is further complicated by a lack of a definition of the term in the Act. It is important to refer to the words of Rumpff JA in the *Falcon Investments* case:

> '...the test of what is a mineral is what, at the date of the instrument in question, the word in the vernacular of the mining world, the commercial world, and among landowners, and in the case of conflict this meaning must prevail over the purely scientific meaning'.

It is submitted that the question of whether or not a material constitutes a 'mineral', in the absence of a definition of the term in the Act, will depend on the merits of the case. It is further submitted that there are grounds to argue that *any* material that could be got naturally from within the soil or constituent thereof must constitute a mineral, provided that such material possesses value in use. Such conclusion is drawn from the judgments passed in the *Great Western Railway* and the *Finbro Furnishers* cases discussed above. It is submitted that this view would render what is commonly known

as quarrying operations to be mining operations for income tax purposes where the material quarried carries value in use.

It is submitted that the physical act of extracting minerals from the soil does not necessarily constitute 'mining operations' and 'mining' as previously defined. Contract miners such as Shaft Sinkers (Pty) Ltd and MCC Contract (Pty) Ltd are some of the established companies whose operations involve extracting minerals from the soil on behalf of others. The *Gloucester Manganese* case established that the activities of mining contractors do not always constitute mining operations. The contractor receives rental income (i.e. non-mining income) where the agreement between the parties does not involve share of profits. It follows then that the contractor would not be entitled to 100% accelerated capital allowances granted to mining operators in relation to machine and equipment utilised to extract minerals. It is further submitted that none of the capital allowance deduction provisions in terms of section 36 would be available to the mining contractor. The contractor would rely on other sections of the Act, such as sections 11(*e*), 12C, 13*ter*, 13*quin*, to deduct capital allowances in relation to machinery and equipment used for the purposes of trade.

When does the process of winning a mineral cease, and when does the manufacturing process start? It is imperative that a distinction be made between the two processes. It is submitted that the process of mining should cease at the first sealable point of the material being extracted from the earth. Any beneficiation of the mineral should constitute the beginning of a manufacturing process. Did the court err in its findings in the *Foskor* case? It is submitted the process of Foskor is more akin to the continuation of a process of winning minerals from the soil or constituent of the soil. It is further submitted that it should be considered irrelevant that the physical extraction of the foskorite bearing ore was performed by PMC. Due attention should be paid to the words of Wessel J where he said the following in the *Nourse Mines* case:

> 'To win gold includes all operations necessary, not only to reach and extract the ore, but also to convert it into metal.'

It is common cause that the first sellable point of the foskorite bearing ore was after the further processing of such material by Foskor. The process applied by Foskor is no different to that applied by the taxpayer in the *Henderson* case where the court held the process conducted by the latter as mining operations. In is submitted that the decision of the court regarding the overlap between mining activities and a process of manufacture taken in the *Foskor* case could be challenged. It is inopportune that the judgment was taken by the SCA and it is submitted that there is a reservation whether the taxpayer could be granted leave to appeal this judgment in the Constitutional Court.[64]

Income received and expenditure incurred by a mining company must be distinguished between mining and non-mining sources. This separation ensures that the taxable income and the eventual tax liability are correctly and accurately computed. It is submitted that income constitutes mining income where its source involves the business of extracting minerals from the soil. Any other income constitutes non-mining income for which the provisions of section 15 do not find application. Expenditure incurred by a mining company constitutes mining expenditure where the expenditure is closely linked to the process of winning minerals from the soil. It is therefore submitted that any other expenditure would constitute non-mining expenditure, the deduction of which should be sought from the general deduction formula, amongst other sections. It is further submitted that the provisions of section 15, read with section 36 of the Act does not find application in respect to expenditure relating to non-mining activities.

It has been established that contributions made by a mining taxpayer towards a rehabilitation fund whose responsibility is the rehabilitation of mined land constitutes non-mining expenditure.

In conclusion, it is submitted that the tax authorities must apply their best judgements when dealing with the taxation of companies in the mining industry, and in deciding whether a taxpayer is in fact conducting mining operations in relation to natural

[64] The taxpayer could appeal the judgment in the Constitutional Court should they successfully prove that their constitutional rights as contained in the Bill of Rights were violated. In the absence of such appeal the judgment of the SCA stands and is likely to create a precedent.

materials found in the soil. Any incorrect assessment could have dire consequences for taxpayers as well as the tax authorities as was highlighted in the *Foskor* case where the taxpayer's reassessed tax liability was in excess of R200 million.

CHAPTER 8

8 Recommendations

The following is hereby recommended as a result of the findings of the research conducted:

8.1 Introducing a Definition of 'Mineral' in the Act

It was established in this report that the interpretation of the term 'mineral' for income tax purposes has been left to the courts. It was also established that the courts have not always been consistent in their interpretation of this important term in relation to mining operations. Other statutes, such as the MPRDA, define what constitutes a 'mineral'. It is recommended that the legislature introduces a definition of the term 'mineral' for income tax purposes. It is further recommended that the Act adopts the definition of the term 'mineral' as it appears in the MPRDA. This would prevent absurd situations where a material held to be a mineral in terms of the MPRDA is not considered as such by the court for income tax purposes, as has occurred before. In adopting the definition contained in the MPRDA, it is important to highlight the words of Van Winsen J in the *Bellville-Inry (Edms) Bpk v Continental China (Pty) Ltd*[65] case where the following was said:

> '...I find it difficult to conceive why a statute should be so interpreted as to attach a meaning to a word like "minerals" narrower than that assigned to it in a number of statutes especially concerned with minerals and the rights associated therewith.'

It is therefore submitted that should a definition of 'mineral' be introduced into the Act, such should not differ from definition of the same term in another statute, such as the MPRDA. Taxpayers will not have to rely on the courts to determine whether a certain material constitutes a mineral or not.

In addition to introducing a definition of 'mineral', the legislature should consider adopting the concept of 'first saleable point' in the Act as used in the MPRDA, to distinguish between mining operations and manufacturing activities. The first saleable

[65] 1976 3 SA 583 (C).

point of a mineral won from the soil could be used as a point at which mining operations ceases. It is submitted that any further processing of the mineral beyond this point would denote the start of a manufacturing process. These interventions would assist to simplify the determination of taxable income and tax liability from mining operations.

8.2 Full Relaxation of Ring-Fencing Provisions

This report established that operating a mine usually involves substantial capital investment. Such capital injection is usually required during the prospecting and pre-production phase of a mine. It was established that capital expenditure redeemable during a year of assessment is restricted in terms of the 'inner' and 'outer' ring-fencing provisions. As it was established, unredeemed capital expenditure is limited to mining taxable income. It is submitted that such restrictions place a serious financial burden on mining taxpayers. The partial relaxation of these restrictions was introduced by section 36(7G), but this is only beneficial to taxpayers venturing into new mine operations.

It has been established that not all mining explorations eventually result in minerals being extracted from the earth. A mining project can fail at the pre-production phase, after a mine has made a substantial investment in mine equipment and shaft-sinking expenditure. Under the current tax regime, such capital expenditure can only be set-off against mining income, that being income associated with the business of extracting minerals from the earth.

The ring-fencing provisions have the undesirable effects of denying mining taxpayers an opportunity to set-off unredeemable capital expenditure against taxable income generated from non-mining operations. It is further added that failed mining projects might sit with massive unredeemed capital expenditure that would eventually be forfeited. It is against this backdrop that the legislature should consider introducing provisions which allow for full relaxation of the ring-fencing provisions.

It is further submitted that the relaxation of the ring-fencing provisions would encourage taxpayers to venture into risky mining projects, thereby increasing the tax base.

8.3 Future Research

The Royalty Act was recently introduced to levy royalty tax payable to the NRF. The royalty tax is calculated by multiplying a formula determined in terms of section 4 of the Royalty Act by the Gross Sales on the transfer of minerals extracted in the Republic.

It is recommended that detailed research be conducted on the application of the Royalty Act, and its impact on the mining industry. The research should entail the following:

- Persons required to register and the registration process;
- Meaning of 'transfer of minerals';
- Calculation of EBIT;
- Analysis of refined and unrefined minerals;
- Analysis of the formula used to calculate the royalty tax.

APPENDIX A

Abbreviations Used in the Report

(A)	Appellate Division of the Supreme Court of South Africa.
AD	Reports of the Appellate Division of the Supreme Court of South Africa.
AITR	Australian & New Zealand Income Tax Reports.
ALL SA	All South African Law Reports.
(C)	Cape Provincial Division of the High Court of South Africa.
CIR	Commissioner for Inland Revenue.
COT	Commissioner of Taxes.
CPD	Reports of the Cape Provincial Division of the Supreme Court of South Africa.
C:SARS	Commissioner for the South African Revenue Service.
(D)	Durban and Coastal Local Division of the High Court of South Africa.
ITC	Income Tax Court (Special Court or Tax Court).
R	High Court of Rhodesia.
SA	South African Law Reports.
SATC	South African Tax Cases.
(SCA)	Supreme Court of Appeal.
SIR	Secretary for Inland Revenue.

(T)	Transvaal Provincial Division of the High Court of South Africa.
TPD	The Reports of Transvaal Provincial Division of the Supreme Court in South Africa.
W	Witwatersrand Local Division of the High Court of South Africa.
WLR	Reports of the Witwatersrand Local Division of the Supreme Court of South Africa.
WLR	Weekly Law Reports.
Z	High Court of Zimbabwe.

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