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TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

ABOUT MINES AND HOUSES: A RULING ON EXPENDITURE INCURRED TO IMPLEMENT A HOUSING SCHEME

In our Alert of 29 April 2016, we discussed the Ruling dealing with the tax consequences of a housing scheme carried out by a mining company, specifically whether such a housing scheme would give rise to a fringe benefit in the hands of the beneficiaries of the scheme (Every house has a story: Does employer-provided accommodation always constitute a fringe benefit?). In this article, we discuss another Ruling dealing with certain tax consequences from the perspective of the mines which implement the housing scheme.

CUSTOMS AND EXCISE HIGHLIGHTS

We will be providing a brief overview of the Customs and Excise environment in our weekly Tax Alert. This is the fourth instalment of the series.

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ABOUT MINES AND HOUSES: A RULING ON EXPENDITURE INCURRED TO IMPLEMENT A HOUSING SCHEME

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In our Alert of 29 April 2016, we discussed a ruling dealing with the tax consequences of a housing scheme carried out by a mining company, specifically whether the implementation of such a housing scheme would give rise to a fringe benefit in the hands of the beneficiaries of the scheme (Every house has a story: Does employer-provided accommodation always constitute a fringe benefit?). In this article, we discuss a ruling dealing with certain tax consequences from the perspective of the mines which implement the housing scheme.

For the exclusive purposes of the housing scheme, the Applicant and Co-Applicant have also established Propco, a South African resident company which is also a wholly-owned subsidiary of the Applicant.

On 10 June 2016, the South African Revenue Service (SARS) issued Binding Private Ruling 239 (Ruling) which deals with the income tax consequences resulting from cash contributions to be made by the Applicant (as a party to a mining joint venture) to a special purpose vehicle established to provide housing for the employees of the joint venture and the Applicant's group of companies.

Facts

The Mineral and Petroleum Resources Development Act, No 28 of 2002 (MPRDA) requires, in terms of s25(2)(f), that the holder of a mining right comply with the requirements of the prescribed social labour plan (SLP) to apply for and be granted a renewal of its mining right. In terms of s100 of the MPRDA, read with the Broad-Based Socio-Economic Empowerment Charter (Charter), a mining right holder is obliged to establish measures for improving the standard of housing for mine employees.

To comply with these requirements, the Applicant and the Co-Applicant, which are both South African resident mining companies, have set up a joint venture (JV). The JV has, in terms of its SLP, agreed to the implementation of a housing scheme for the benefit of its employees and the group's employees. For the exclusive purposes of the housing scheme, the Applicant and Co-Applicant have also established Propco, a South African resident company which is also a wholly-owned subsidiary of the Applicant.

Propco has concluded a funding agreement with a financial institution, in terms of which a loan will be extended to it and which requires that the housing scheme be conducted in a legal entity separate to the JV participants and that the entity is to be capitalised with a certain amount. Furthermore, the JV proposes to fund Propco by way of a cash contribution that is neither a loan nor equity share capital.

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CONTINUED

The funding agreement further provides for a restriction on the distributions that may be made to the shareholder of Propco.

The funding agreement further provides for a restriction on the distributions that may be made to the shareholder of Propco. An important fact within the context of the Ruling is that the board of directors of the Applicant's holding company resolved that any surplus cash and profits remaining in Propco after completion of the housing scheme and repayment of the loan should be utilised for social spending to further improve the lives of employees and the communities where the group conducts mining operations. To give effect to this, the memorandum of incorporation (MOI) of Propco specifically provides that:

- Upon completion of the housing projects undertaken by Propco, as set out in the group's housing policy or prior to any voluntary liquidation proceedings which may be undertaken by Propco, all surplus cash and profits shall be applied to one or more programmes that have as its/their object the improvement of the social conditions of the communities in or around the area in which the Applicant carries on its business.
- Propco shall not be entitled to undertake voluntary liquidation proceedings without having first applied all surplus cash and profits of Propco as set out above.

Legal Framework

Section 15(a) of the Income Tax Act, No 58 of 1962 (Act) states, *inter alia*, that where a taxpayer derives income from mining operations, it may not deduct the allowances provided in ss11(e), (f), (gA), (gC), (o), 12D, 12DA, 12F and 13*quin*, but instead can deduct an amount determined in terms of s36 of the Act. Section 36(7C) of the Act states that subject to the provisions of ss36(7E), (7F) and (7G), the amounts to be deducted under s15(a) from income derived from the working of any producing mine shall be the amount of 'capital expenditure' incurred. Section 36(11) contains a broad definition of 'capital expenditure', but for purposes of this article only s36(11)(e) of the Act is relevant. It states that 'capital expenditure' means, where a trade constitutes mining, any expenditure incurred in terms of a mining right pursuant to the MPRDA other than in respect of infrastructure or environmental rehabilitation.

SARS's Ruling

SARS ruled as follows:

- The Ruling is subject to the condition and assumption that the clauses in the MOI of Propco relating to the use of surplus cash and profit are strictly adhered to.
- The cash contribution to be made by the JV to Propco for purposes of the housing scheme will qualify as 'capital expenditure' in terms of s36(11)(e), for each member of the JV, to the extent that the cash contribution relates to housing for persons employed by the JV. Any part of the cash contribution that relates to housing for persons not employed by the JV will not be deductible and an apportionment of the expenditure must be made.

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ABOUT MINES AND HOUSES: A RULING ON EXPENDITURE INCURRED TO IMPLEMENT A HOUSING SCHEME

CONTINUED

If the Applicant and the Co-Applicant used the cash contribution to implement the housing scheme in their personal capacities and to comply with the MPRDA and the Mining Charter, instead of implementing it through the JV and Propco, each of them would have most likely been allowed to claim a deduction in terms of s15(a), read with s36 of the Act.

- The cash contribution will not result in the disposal of an asset by any member of the JV. Consequently, the cash contribution will not give rise to a capital gain in terms of paragraph 3 of the Eighth Schedule of the Act, nor will Propco's receipt of the cash contribution give rise to a capital gain in terms of paragraph 3 of the Eighth Schedule.
- The cash contribution to be received by Propco will constitute a receipt of a capital nature and will not constitute 'gross income', as defined in s1(1).

Comment

If the Applicant and the Co-Applicant used the cash contribution to implement the housing scheme in their personal capacities and to comply with the MPRDA and the Mining Charter, instead of implementing it through the JV and Propco, each of them would have most likely been allowed to claim a deduction in terms of s15(a), read with s36 of the Act. This Ruling suggests that SARS might give mining companies some leeway to structure their affairs in a different manner, while still complying with their obligations under the MPRDA and the Mining Charter. However, it should be noted that this Ruling is only binding upon the parties to it.

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CUSTOMS AND EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs & Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

We will be providing a brief overview of the Customs and Excise environment in our weekly Tax Alert. This is the fourth instalment of the series.

Below are this week's selected highlights:

1. Amendment of heading 08.11 relating to "Fruit and nuts, uncooked or cooked by steaming or boiling in water, frozen, whether or not containing added sugar or other sweetening matter".
2. New Zimbabwean law (Statutory Instrument 64) has placed restrictions on the importation of certain goods, including potato chips, bottled water, baked beans and yogurt. This, amongst other reasons, has caused protests at the Beitbridge border.

In an interesting judgment of the Commissioner for the *South African Revenue Service v Prudence Forwarding (Pty) Ltd and another* [2016] JOL 35747 (GJ), the Full bench of the North Gauteng High Court, Pretoria held as follows:

> "The most compelling and essentially dispositive ground of appeal is that the respondents failed to comply with the peremptory provisions of ss89(2) and 96(1) of the Act and hence the court lacked jurisdiction to set aside the seizure of the goods. Section 89(2), it will be recalled, requires any litigant to give notice to the Commissioner before serving any process for instituting any proceedings as contemplated in s96(1)(a) within 90 days after the date of the seizure or the conclusion of an internal administrative appeal.
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> ...
>
> The respondents gave written notice of their intention to seek interim relief in the form of an order to release the container against payment of a provisional payment. They gave no similar notice in respect of the new cause of action introduced by the amendment in which they sought to review and set aside the seizure of the goods.
>
> ...
>
> It was therefore incumbent upon them to serve the relevant notice and to obtain the agreement of the Commissioner or the sanction of the court to reduce the one month period in respect of the new cause of action involving a review of the seizure decision. This was not done. The respondents could not rely on the notice they served to obtain the release of the goods from detention. Section 96(1)(a)(i) of the Act makes it plain that the notice must relate to a specific cause of action, which is required to be set forth "clearly and explicitly" in the written notice. And s96(1)(a)(iii) provides that no notice shall be valid unless it complies with the requirements prescribed in the section. Thus, since no notice was delivered in respect of the review, and neither the Commissioner or the court agreed to a reduced period, the jurisdictional conditions precedent was not fulfilled, and the court accordingly

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CUSTOMS AND EXCISE HIGHLIGHTS

CONTINUED

The onus to prove compliance with the Act is not on SARS, but on the person/entity alleging compliance.

> lacked jurisdiction to grant the final relief it granted, in the form of an order setting aside the seizure of the goods. For that reason alone, the appeal must succeed".

The above demonstrates the importance (or rather necessity) of delivering a notice in terms of s96 of the Customs and Excise Act, No 91 of 1964 (Act) prior to instituting litigation (note that notice periods may differ depending on the cause of action). Further, that such notice must relate to a specific cause of action.

The Court continued as follows:

> "...the value of each blanket would have been US$34,78 and thus there was still a significant underdeclaration. Moreover, the respondents did not furnish adequate proof in rebuttal of the Bank of Taiwan documentation and the invoice sent by the supplier to the bank. The invoice is compelling *prima facie* proof that the value of the goods had been underdeclared. The respondents have not adequately answered why the bank was in possession of documentation indicating a purchase in the amount of US$119 630, as opposed to the declared value of US$9 460. They have produced other documentation setting out imports in an aggregate amount of US$847 446,85; but have singularly neglected to explain how the consignments were made up or which entries related to the container in question. Section 102(4) and (5) of the Act places an onus upon the respondents to prove compliance with the Act. They failed to discharge that onus by furnishing credible evidence of payment that controverted the supplier's invoice. That obliged the court a *quo* to regard the *prima facie* proof as conclusive. As a result there was no basis to set aside the seizure or to order the Commissioner to release the goods".

This demonstrates that in general, the onus to prove compliance with the Act is not on SARS, but on the person/entity alleging compliance.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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