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TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

A WIN FOR THE MINING INDUSTRY: THE HIGH COURT'S RECENT DECISION REGARDING THE CALCULATION OF A ROYALTY

In the recently decided matter of *United Manganese of Kalahari (Proprietary) Limited v Commissioner for the South African Revenue Service* (74158/2016) [2017] ZAGPPHC 628 (3 October 2017), United Manganese of Kalahari (Proprietary) Limited applied to the Gauteng Provincial Division, Pretoria for declaratory relief in relation to the correct interpretation and application of s6(3)(b) of the Mineral and Petroleum Resources Royalty Act, No 28 of 2008.

CUSTOMS HIGHLIGHTS

This week's selected highlights in the Customs and Excise environment since our last instalment.

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The letter of findings stated that UMK incorrectly deducted transport and distribution costs from gross sales and in so doing it estimated these costs instead of using actual costs incurred.

UMK launched an application to the High Court to seek declaratory relief to obtain certainty in relation to the correct interpretation of s6(3)(b) of the Royalty Act.

In the recently decided matter of *United Manganese of Kalahari (Proprietary) Limited v Commissioner for the South African Revenue Service* (74158/2016) [2017] ZAGPPHC 628 (3 October 2017), United Manganese of Kalahari (Proprietary) Limited (UMK) applied to the Gauteng Provincial Division, Pretoria (High Court) for declaratory relief in relation to the correct interpretation and application of s6(3)(b) of the Mineral and Petroleum Resources Royalty Act, No 28 of 2008 (Royalty Act).

Facts

UMK conducts 'mining operations' as defined in s1 of the Mineral and Petroleum Resources Development Act, No 28 of 2002 (MPRDA). It is an 'extractor' of an 'unrefined mineral resource' (it mines unrefined manganese) and is liable for payment of a 'royalty' in terms of s3 the Royalty Act.

The High Court explained that as part of the value chain, the manganese ore is loaded onto trucks or trains for delivery to UMK's customers. UMK bears the obligation to incur all costs necessary to effect delivery of the manganese from the mine to its customers, if so required in terms of the relevant contract delivery terms. These costs include transport, insurance and handling (TIH) costs. In its royalty calculation for the 2010 and 2011 years of assessment, UMK calculated its gross sales by deducting the TIH expenditure from the amounts it received in respect of its transfer of manganese.

The South African Revenue Service (SARS) conducted an audit and after numerous correspondence between the parties, SARS issued a letter of audit findings in relation to UMK's royalty payment for the 2010 and 2011 years of assessment. The letter of findings stated, among other things, that UMK incorrectly deducted transport and distribution costs from gross sales and in so doing it estimated these costs instead of using actual costs incurred. UMK maintained that it determined its gross sales in terms of s6(3)(b) of the Royalty Act with reference to expenditure actually incurred by it, and not based on any estimated figures as SARS alleged.

UMK launched an application to the High Court to seek declaratory relief to obtain certainty in relation to the correct interpretation of s6(3)(b) of the Royalty Act.

Legal framework

Section 2 of the Royalty Act imposes the obligation on a person to "pay a royalty for the benefit of the National Revenue Fund in respect of the transfer of a mineral resource extracted from within the Republic".

Section 3(2) of the Royalty Act further provides for the manner in which the royalty is calculated. In terms of s3(2), the royalty "in respect of the transfer of an unrefined mineral resource is determined by multiplying the gross sales of the extractor in respect of that mineral resource during the year of assessment:

(a) by the percentage determined in accordance with the formula in s4(2); or

(b) by the percentage determined in accordance with the formula as the Minister may announce in the national annual budget contemplated in s27(1) of the Public Finance Management Act, 1999 (Act No 1 of 1999) with effect from a date mentioned in that announcement."

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UMK contended that it was entitled, in terms of s6(3)(b) of the Royalty Act, to calculate its gross sales by deducting the TIH expenditure.

The formula presently applicable in s4(2) is as follows:

- 0.5 + [earnings before interest and taxes/(gross sales in respect of unrefined mineral resources x 9)] x 100.

In terms of s4(3)(b), the percentage determined in terms of the formula must not exceed 7%.

Section 6(2)(a) states that gross sales in respect of an unrefined mineral resource transferred - as mentioned in paragraph (a) of the definition of 'transfer' in s1, in the condition specified in Schedule 2 for that mineral resource - is the amount received or accrued during the year of assessment in respect of the transfer of that mineral resource.

Section 6(3)(b) states that for purposes of s6(2), gross sales are determined without regard to any expenditure incurred in respect of transport, insurance and handling of an unrefined mineral resource after that mineral resource was brought to the condition specified in Schedule 2 for that mineral resource or any expenditure incurred in respect of transport, insurance and handling to effect the disposal of that mineral resource.

Schedule 2 to the Royalty Act sets out the conditions that mineral resources, including manganese, must meet in order to constitute an "unrefined mineral resource".

Judgment

UMK contended that it was entitled, in terms of s6(3)(b) of the Royalty Act, to calculate its gross sales by deducting the TIH expenditure, or any expenditure incurred by it in respect of TIH, after the manganese was brought to the condition specified in Schedule 2, or to effect the disposal of the manganese, from the amounts received by or accrued to it during the 2010 and 2011 years of assessment in respect of its transfer of manganese.

SARS, on the other hand, contended that UMK may only deduct those costs that were included in UMK's prices to its customers, in calculating gross sales as contemplated in s6(3)(b). Stated differently, if UMK's gross revenue is simply a function of the market price applying from time to time and not a function of the costs incurred in delivering the manganese to its customers, such costs cannot be deducted from gross sales as contemplated in s6(3)(b).

SARS opposed the relief sought by UMK on a number of different grounds. Firstly, SARS argued that the High Court lacked jurisdiction to hear the matter. The matter ought to properly have been brought in the Tax Court after SARS had had an opportunity to render a decision in respect of the assessments at issue. The High Court rejected SARS's argument and referred to tax cases where it had been decided that a Superior Court has jurisdiction to hear and determine tax cases turning on a question of law. As the issue before the High Court did not involve a question of fact, but simply one of law, the Commissioner for SARS and the Tax Court were not the only competent authorities to decide the issue.

Secondly, SARS argued that UMK failed to exhaust its internal remedies provided for in the Tax Administration Act, No 28 of 2011 (TAA). The High Court held that it has the power to decide tax matters where the relief sought is for declaratory orders involving questions of law only or is interlocutory in nature, without first exhausting the remedies provided for in the TAA.

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The legislature intended to exclude TIH expenditure after the condition specified in Schedule 2 and TIH expenditure incurred to effect the disposal of the mineral resource.

Thirdly, SARS contended that the granting of declaratory relief is discretionary and the court ought not to exercise its discretion to grant such relief in the circumstances of the case. However, the High Court took the view that it should exercise its judicial discretion in favour of the adjudication of the relief sought as there are no judicial pronouncements on the interpretation and application of the Royalty Act.

Finally, regarding the merits of the case, SARS argued that the language of s6(3)(b) of the Royalty Act is clear and unambiguous and that the interpretation contended for by UMK ought not to be adopted by the High Court.

On the question of the interpretation of s6(3)(b), the High Court said that the section must be interpreted in accordance with the established principles of interpretation. The words used in s6(3)(b) were clear and unambiguous and made it plain that, in calculating the royalty payable, the legislature intended to exclude TIH "expenditure incurred" post the condition specified in Schedule 2 and TIH "expenditure incurred" to effect the disposal of the mineral resource. That is, whether or not the extractor, being UMK in this case, "actually received" or is "entitled to" recover the TIH costs from its customer.

Section 6(3)(b) can only be understood to provide for the exclusion of all expenditure relating to TIH costs incurred by the seller of an unrefined mineral resource and the provision is not limited to amounts received by or accrued to a seller in the recovery of distribution costs. It contains no provision in terms of which UMK (an extractor) would have to show that expenditure incurred in respect of TIH or expenditure incurred in respect of TIH to effect the disposal of the mineral resource occurred in circumstances where such expenditure was taken into account in determining UMK's gross price.

The High Court noted that the legislature deleted the words "any amount received or accrued for the TIH of an unrefined mineral post the condition specified" in Schedule 2 and the words "any amount received or accrued" to effect the disposal of that mineral resource, when s6(3)(b) was amended. These words were substituted with the words "any expenditure incurred" in respect of the TIH of an unrefined mineral resource and "any expenditure incurred" in respect of transport, insurance and handling to effect the disposal of that mineral resource. According to the High Court, this indicated that the legislature intended to exclude TIH expenditure incurred after the condition specified in Schedule 2 and TIH expenditure incurred to effect the disposal of the mineral resource, whether or not the extractor "actually received" or is "entitled to" recover the TIH costs from its customer. In other words, whether or not the TIH expenditure was included by the extractor in the calculation of its sales price(s).

The court ordered that UMK is entitled to calculate its gross sales by deducting any expenditure incurred in respect of transport, insurance and handling of the manganese after the manganese had been brought to the condition specified in Schedule 2 of the Royalty Act and any expenditure incurred in respect of transport, insurance and handling to effect the disposal of the manganese. It held that such expenditure could be deducted irrespective of whether any such expenditure was specifically and/or consciously considered in the determination of UMK's gross sales and irrespective of whether such transport, insurance and handling costs were of a capital nature.

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It remains to be seen whether s6(3)(b) will be amended in order to state that a deduction of TIH is not allowed, as SARS argued in this matter.

Comments

Interestingly, prior to the decision in this matter, SARS issued a draft binding general ruling on 10 March 2017, which suggested that "all expenditure in respect of transport, insurance and handling incurred after the mineral resource is brought to the condition specified in Schedule 1 or 2 must not be taken into consideration when calculating gross sales and EBIT". It remains to be seen whether s6(3)(b) will be amended in order to state that a deduction of TIH is not allowed, as SARS argued in this matter.

Nandipha Mzizi

CHAMBERS GLOBAL 2011 - 2017 ranks our Tax and Exchange Control practice in Band 2: Tax.

Gerhard Badenhorst ranked by CHAMBERS GLOBAL 2014 - 2017 in Band 1: Tax: Indirect Tax.

Emil Brincker ranked by CHAMBERS GLOBAL 2003 - 2017 in Band 1: Tax.

Mark Linington ranked by CHAMBERS GLOBAL 2017 in Band 1: Tax.

Ludwig Smith ranked by CHAMBERS GLOBAL 2017 in Band 3: Tax.

Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory and Who's Who Legal: Corporate Tax – Controversy for 2017.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2017.

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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 and 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.

This week's selected highlights in the Customs and Excise environment since our last instalment.

1. In terms of Draft Rule 3.11(2)(a) to the Customs Duty Act, 2014, SARS intends to exclude clearances for home use ex warehouse from the (future) deferment benefit. Although comments are due to SARS on 31 October 2017 and individual comments can be made to SARS directly, SARS called for consolidated comment. It is therefore suggested that comments be provided to SAAFF by 27 October 2017 to Mr. Johan Marais at jmarais@saaff.org.za.

2. The International Trade Administration Commission has received the following Customs tariff applications (certain sections may be quoted from the Customs Tariff Applications List 12/2017 of 20 October 2017):

   2.1 **Creation of temporary rebate provisions on ordinary customs and safeguard duties applicable to:**

   2.1.1 Flat-rolled products of other alloy steel of a width of 600mm or more, classifiable in tariff subheading 7225.99, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available on the SACU market.

   Enquiries: ITAC Ref: 13/2017, Enquiries: Diphetogo Rathete/ Njabulo Mahlalela, Tel: 012 394 3683/3684 or email: drathete@itac.org.za/nmahlalela@itac.org.za. Written representations must be submitted within two weeks of the date of the notice.

   2.2 **The creation of a temporary rebate provision on safeguard duty for the importation of certain hot rolled steel classifiable under tariff headings 72.08 and 72.25, as follows:**

   2.2.1 Flat-rolled products of iron or non-alloy steel, of a width of 600mm or more, not in coils, not further worked than hot-rolled, of a thickness of 2mm or more but not exceeding 160mm, with a yield strength of 550 MPa or more but not exceeding 960 MPa and having an impact strength of 27 Joules or more but not exceeding 69 Joules at -20°C or less but not less than -60°C, classifiable in tariff subheading 7208.5,

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in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

2.2.2 Flat-rolled products of other alloy steel, of a width of 600mm or more, not in coils, not further worked than hot-rolled, of a thickness of 2mm or more but not exceeding 160mm, with a yield strength of 550 MPa or more but not exceeding 960 MPa and having an impact strength of 27 Joules or more but not exceeding 69 Joules at -20°C or less but not less than -60°C, classifiable in tariff subheading 7225.40, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

2.2.3 Flat-rolled products of iron or non-alloy steel, of a width of 600mm or more, not in coils, not further worked than hot-rolled, of a thickness of 2mm or more but not exceeding 160mm, with a Brinell hardness of 400 HBW or more but not exceeding 700 HBW and having an impact strength of 15 Joules or more but not exceeding 95 Joules at -40°C, classifiable in tariff subheading 7208.5, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

2.2.4 Flat-rolled products of other alloy steel, of a width of 600mm or more, not in coils, not further worked than hot-rolled, of a thickness of 2mm or more but not exceeding 160mm, with a Brinell hardness of 400 HBW or more but not exceeding 700 HBW and having an impact strength of 15 Joules or more but not exceeding 95 Joules at -40°C, classifiable in tariff subheading 7225.40, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by

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specific permit, provided the products are not available in the SACU market;

2.2.5 Flat-rolled products of iron or non-alloy steel, of a width of 600mm or more, not in coils, not further worked than hot-rolled and of a thickness of 40mm or more but not exceeding 160mm, with a Brinell hardness of 350 HBW and having an impact strength of 95 Joules at -40°C, classifiable in tariff subheading 7208.5, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

2.2.6 Flat-rolled products of other alloy steel, of a width of 600mm or more, not in coils, not further worked than hot-rolled and of a thickness of 40mm or more but not exceeding 160mm, with a Brinell hardness of 350 HBW and having an impact strength of 95 Joules at -40°C, classifiable in tariff subheading 7225.40, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

2.2.7 Flat-rolled products of iron or non-alloy steel, of a width of 600mm or more, not in coils, not further worked than hot-rolled and of a thickness of 5mm or more but not exceeding 50mm, with a Brinell hardness of 350 HBW and having an impact strength of 60 Joules at -40°C, classifiable in tariff subheading 7208.5, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

2.2.8 Flat-rolled products of other alloy steel, of a width of 600mm or more, not in coils, not further worked

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than hot-rolled and of a thickness of 5mm or more but not exceeding 50mm, with a Brinell hardness of 350 HBW and having an impact strength of 60 Joules at -40°C, classifiable in tariff subheading 7225.40, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market;

2.2.9 Flat-rolled products of other alloy steel, of a width of 600mm or more, not further worked than hot-rolled, not in coils, with a thickness of 2mm or more but not exceeding 100mm, with a nickel content of 1.8 per cent by mass or more but not exceeding 3 per cent, a molybdenum content of 0.7 per cent by mass or more but not exceeding 0.8 per cent and a chrome content of 1.0 per cent by mass or more but not exceeding 2.0 per cent, with a Brinell hardness of 260 HBW or more but not exceeding 640 HBW, classifiable in tariff subheading 7225.40, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market; and

2.2.10 Flat-rolled products of other alloy steel, of a width of 600mm or more, not further worked than hot-rolled, not in coils, with a thickness of 2mm or more but not exceeding 20mm, with a copper content of 0.25 per cent by mass or more but not exceeding 0.40 per cent and a chromium content of 1.0 per cent by mass or more but not exceeding 2.0 per cent, with a yield strength of 550 MPa or more but not exceeding 960 MPa, classifiable in tariff subheading 7225.40, in such quantities, at such times and subject to such conditions as the International Trade Administration Commission may allow by specific permit, provided the products are not available in the SACU market.

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CUSTOMS AND EXCISE HIGHLIGHTS

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Enquiries: ITAC Ref: 14/2017, Mr. Tshepiso Sejamoholo and/ or Ms. Lufuno Maliaga, Tel: 012 394 1605/3835 or email: tsejamoholo@itac.org.za/ lmaliaga@itac.org.za. Written submissions should be made within two weeks of the date of the notice.

2.3 Creation of rebate provisions on ordinary customs and safeguard duties applicable on primary flat steel not manufactured locally, classifiable under chapter 72.

Enquires: ITAC Ref: 16/2017, contact Lufuno Maliaga, Daniel Thwala and Pfarelo Phaswana, Tel: 012 394 3835/5162/3628 or email lmaliaga@itac.org.za / dthwala@itac.org.za / pphaswana@itac.org.za. Written representations should be made within four weeks from the date of the notice.

Petr Erasmus

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