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TAX & EXCHANGE CONTROL **ALERT**

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A groundbreaking victory for contract miners, won from the soil

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Customs & Excise Highlights

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

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A groundbreaking victory for contract miners, won from the soil

A taxpayer engaged in mining operations on a producing mine will be entitled to fully deduct related capital expenditure in the year of assessment it was incurred.

The Income Tax Act No 52 of 1968 (ITA) provides a special regime for taxpayers engaged in mining operations. The reasoning behind this special treatment is that the establishment of a mine is an expensive and lengthy process, with long lead times until any profit is seen by the mining company. The fiscus recognises this and with a view to incentivise mining companies to continue to establish and operate mines, applies specific rules for the deduction of prospecting expenses and capital expenditure incurred in order to engage in mining operations.

The provisions of s15(a) of the ITA, read with s36(7C), in light of the definition of 'mining operations or mining' in s1, provide the mechanism and requirements for the deduction of capital expenditure incurred for a mining operation (Redemption Allowance). Mining operations are defined in s1 of the ITA to "include every method or process by which any mineral is won from the soil or from any substance or constituent thereof". Section 15 of the ITA provides that a deduction shall be allowed as per s36, in lieu of an ordinary deduction under s11. Section 36 in turn provides for a deduction of any capital expenditure to be allowed from income derived from working any producing mine.

The effect of these provisions is that a taxpayer engaged in mining operations on a producing mine will be entitled to fully deduct related capital expenditure in the year of assessment it was incurred. This is a departure from the standard deductions relating to capital expenditure, which required amortisation of the expenditure over the useful life of the asset.

Given the vital role played by miners in the South African economy, it is important to have clarity on the nature of operations that would qualify for deductions under the Redemption Allowance. Following two earlier judgments of the Tax Court regarding the applicability of the Redemption Allowance to contract miners, the recent decision of the Supreme Court of Appeal in *Benhaus Mining (Pty) Ltd v Commissioner for the South African Revenue Service* (165/2018) [2019] ZASCA 17 has provided greater clarity regarding the position of contract miners involved in a particular part of the mining value chain.

Facts

Benhaus Mining (Pty) Ltd (Benhaus Co) was a company engaged in open-cast, contract mining for chrome. This entailed Benhaus Co entering into contracts with parties which held mining rights to provide certain services in relation to the extraction of the mineral ore.

Specifically, these services included establishing sites for open cast mining; constructing workshops; constructing and maintaining access roads, and primary and secondary haul roads; removing topsoil and stockpiling it in designated areas; excavating and stockpiling material extracted from the ground; blasting mineral-bearing ore; delivering the ore to the client's premises for processing; and rehabilitating the mining area after extraction.

The Commissioner for the South African Revenue Service (SARS) initially allowed Benhaus Co's deductions under the Redemption Allowance.

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SARS argued that the disallowance of the deduction was correct, because Benhaus Co was in fact providing services to a miner, rather than conducting mining operations in its own right.

However, in the 2013 tax year SARS re-assessed Benhaus Co's 2005 - 2009 returns, disallowing the deductions that were claimed under the Redemption Allowance. SARS argued that the disallowance of the deduction was correct, because Benhaus Co was in fact providing services to a miner, rather than conducting mining operations in its own right.

Key Issues

Although it was common cause that Benhaus Co in fact dug the minerals out of the ground with a commercial motive, SARS disputed its status as a miner. Therefore, the decision in the *Benhaus* case turned on a determination of whether the activities undertaken by Benhaus Co under contractual relationships, as described above, constitute mining operations for the purposes of the Redemption Allowance.

ITC 1907

Prior to the decision in the *Benhaus* case the Tax Court dealt with a similar problem regarding contract mining and the Redemption Allowance. In *ITC 1907* 80 SATC 271 SARS countered the taxpayer's, who was a contract miner, assertion that it was plainly engaged in mining operations by pointing to jurisprudence on the Redemption Allowance, specifically *Western Platinum Ltd v Commissioner* for SARS [2004] 4 All SA 611 (SCA). *Western Platinum*, and cases cited therein, recognised the potential for segmentation of mining operations, but to qualify for the Redemption Allowance the taxpayer had to be in the *"business of mining"*.

The nub of SARS's reason that the taxpayer was not engaged in mining operations was that the taxpayer had insulated itself from, among other things, commodity price fluctuations and the risk attendant on mines, by negotiating a set contract fee. Thus, the source of its income was not the mining and sale of minerals, but services rendered to the holder of mining rights.

The decision of the Tax Court, per Sutherland J, through an analysis of jurisprudence on the Redemption Allowance, including *Western Platinum*, held that being in the business of mining means that the taxpayer's trade must be mining. To be in the trade of mining the taxpayer must not only extract the minerals from the earth, but the trade in minerals or mining operations must be the source of the taxpayer's income.

Sutherland J therefore held that to be a 'digger' of minerals is not sufficient to qualify as a 'miner' and that the source of the taxpayer's income was in fact the services rendered, rather than a trade in minerals won from the soil. Had the contract miner been exposed to the risk of fluctuations in the price of the commodity, by earning a share of the profit rather than a set fee, it would have fit the policy rationale for the Redemption Allowance.

ITC 1913

A taxpayer, also a contract miner, on appeal argued that Sutherland J had erred in his analysis of the jurisprudence on the Redemption Allowance in *ITC 1907*. It argued that contract mining was captured by the phrase income from mining operations.

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In the SCA Benhaus Co put forward an interpretation of the Redemption Allowance, based on judgments including Western Platinum, which indicates that income derived from the business of mineral extraction is income derived from mining operations.

Further, that this was the correct reading of *Western Platinum*, because although that decision had required a commercial element to be present to qualify for the deduction, this did not equate to a requirement that the taxpayer must sell the minerals on the open market. Rather, the focus of the analysis should be the work done to earn the income, rather than the mechanism for determining the extent of the income.

SARS on the other hand adopted the reasoning of Sutherland J in *ITC 1907* and argued that the raison d'être for the taxpayer's income was in fact services rendered to a mining right holder and not the operation of a mining enterprise, as defined.

The Tax Court in this appeal held that the operations of the taxpayer were not in fact mining operations. It came to this conclusion with reference to the underpinnings of the Redemption Allowance as outlined in the Davis Tax Committee and Margo Tax Committee reports. Essentially, these reports delineate the history of the Redemption Allowance and argue that it exists because of the high risk involved in mining operations and the long lead times before significant revenue generation.

A second point which the Tax Court emphasised was that the Redemption Allowance deduction is ring fenced to the income from the mine where the capital expenditure was actually expended. This disaggregation was not done by the taxpayer and therefore even if it had succeeded in proving it was engaged in mining operations it would not have been able to deduct the Redemption Allowance.

The *Benhaus* case

In the Supreme Court of Appeal (SCA) Benhaus Co put forward an interpretation of the Redemption Allowance, based on judgments including *Western Platinum*, which indicates that income derived from the business of mineral extraction is income derived from mining operations. Further, it disputed two key criteria used by Sutherland J to distinguish contract mining from mining operations as defined and also relied upon by the court in *ITC 1913*: the risk requirement and the insufficiency of being a 'digger'.

Regarding the risk requirement which was decisive in *ITC 1907,* the SCA per Lewis ADP noted that Benhaus and contract miners indeed take commercial risks, albeit not of the market price related nature required in the judgment of Sutherland J. Secondly, regarding the insufficiency of being a 'digger' Lewis ADP noted that in cases including *Richards Bay Iron and Titanium (Pty) Ltd v CIR* 1996 (1) SA 311 (A) and *CSARS v Foskor* [2010] 3 All SA 594 (SCA), the SCA had held that "the entity that extracted the ore was the miner and that the entity that processed it into an entirely different state was not".

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The decision in the Benhaus case has resolved the degree of uncertainty which had lingered in the application of the Redemption Allowance to contract miners.

Lewis ADP, ultimately agreed with Benhaus Co that its income earning activities indeed afforded it the benefit of the Redemption Allowance. The reason being that despite contract miners not precisely fitting into the policy rationale for the Redemption Allowance, it in fact bore the capital expenses related to the extraction of the minerals, the mining operations were the core of the income earning activity carried on by Benhaus Co and earning a set fee did not undermine the fact that it was engaged in mining operations.

Conclusion

The decision in the Benhaus case has resolved the degree of uncertainty which had lingered in the application of the Redemption Allowance to contract miners. The somewhat inapposite application of the Redemption Allowance to this class of taxpayers has been noted by the Davis Tax Committee's reports. It is now for the Legislature to determine whether it does not wish to continue extending the incentivisation provided by the Redemption Allowance to contract miners.

Tsangadzaome Mukumba and Heinrich Louw

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Customs & Excise Highlights

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 & Excise environment since our last instalment.

Amendments to Rules to the Customs & Excise Act No 91 of 1964 (Act) (certain sections quoted from the SARS website):

Rule 541.03, .04, .06 and .09 to enhance the administration and compliance in respect of Health Promotion Levy on Sugary Beverages. Rule 202.00 in relation to the following forms was amended:

- DA 185.4A16 – Client type 4A16 – Non-commercial manufacturer of sugary beverages;
- DA 185 – Registration and Licensing of Customs and Excise Clients; and
- DA 185.4B2 – Licensing client type 4B2 – Manufacturing warehouse;

Rules 38.14A and 59A in relation to the implementation of the UCR.

Amendments to Schedules to the Act (certain sections quoted from the SARS website):

Schedule 1 Part 1:

- The insertion of new-8-digit tariff subheadings under headings 84.71 and 95.04 to provide for computers with a screen size exceeding 45cm as well as gaming consoles with images produced on any external screen (with effect from 1 April 2019);
- Provision for separate tariff subheadings for sanitary pads, bread flour and cake flour to facilitate the zero rating/VAT exemption as tabled by the Minister of Finance on 20 February 2019 (with effect from 1 April 2019); and
- Provision for separate tariff subheadings for pantyliners to facilitate the zero-rating/VAT exemption as tabled by the Minister of Finance on 20 February 2019 (with effect from 1 April 2019);

Schedule 1 Part 2B:

- (With effect from 1 April 2019) to give effect to the Budget proposals announced by the Minister of Finance on 20 February 2019 to apply *ad valorem* excise duty on:
  - computers with a screen size exceeding 45 cm; and
  - gaming consoles with images produced on any external screen or surface;

Schedule 1 Part 5A:

- An increase of 15c/li in the rate of the general fuel levy from 337c/li to 352c/li and 322c/li to 337c/li on petrol and diesel (respectively) to give effect to the Budget proposals announced by the Minister of Finance on 20 February 2019 (with effect from 3 April 2019);

Schedule 1 Part 5B:

- An increase of 5c/li in the RAF levy from 193c/li to 198c/li on both petrol and diesel to give effect to the Budget proposals announced by the Minister of Finance on 20 February 2019 (with effect from 3 April 2019);

Schedule 1 Part 7A:

- An increase of 10c/g in the rate of the health promotion levy from 2.1c/g per 100ml to 2.21c/g per 100ml to give effect to the Budget proposals announced by the Minister of Finance on 20 February 2019 (with effect from 1 April 2019); and

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Customs & Excise Highlights...*continued*

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- To amend Note 5 to include the reference to grams per 100 millimetres and insert Note 6 to indicate how sugar content will be calculated;

Schedule 5:

- Draft amendment relating to circumstances where a refund or drawback of duty as contemplated in s75(1)(c), s54D or s54J of the Act may be granted if the customs procedure code applicable to the export as specified in the list published on the SARS website referred to in rule 00.06 and the relevant refund or drawback item are not reflected on the export bill of entry or other export clearance declaration;

  Due date for comments: 10 May 2019;

  Comments to: lkeyser@sars.gov.za; and

Schedule 6:

- As a consequence of the increase in the fuel and RAF levy as announced by the Minister of Finance in his budget speech of 20 February 2019, the diesel refund provisions are adjusted accordingly (with effect from 3 April 2019).

SARS has issued (certain sections quoted from the notices and/or SARS website):

- A notice on 29 March 2019 relating to the postponement of implementation date of the new internal administrative appeal rules, published on 21 December 2018. The implementation date has been postponed to 1 September 2019; and
- Effective 29 March 2019, its Customs External Policy, Offences and Penalties guideline.

The International Trade Administration Commission has (certain sections quoted from the notices):

- Per notice dated 29 March 2019 issued its "Guidelines and Conditions Pertaining to a Bilateral Safeguard Application in the Economic Partnership Agreement (EPA) between the European Union (EU) Member States and the Southern African Development Community (SADC) Member States"; and
- Per notice dated 29 March 2019 issued its "Guidelines, Rules and Conditions Pertaining to Caustic Soda Imported in Terms Of Rebate Items 306.15/2815.12/01.06 and 306.15/2815.12/02.06 for the Extraction of Copper and Nickel Classifiable Under Tariff Subheadings 2603.00 and 2604.00, respectively".

On 29 March 2019 the Department of Trade and Industry has published its "Declaration of Nuclear-Related Dual-Use Equipment, Materials, Software and Related Technology as Controlled Goods, and Control Measures Applicable to Such Goods".

Petr Erasmus

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 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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