Tax & Exchange Control

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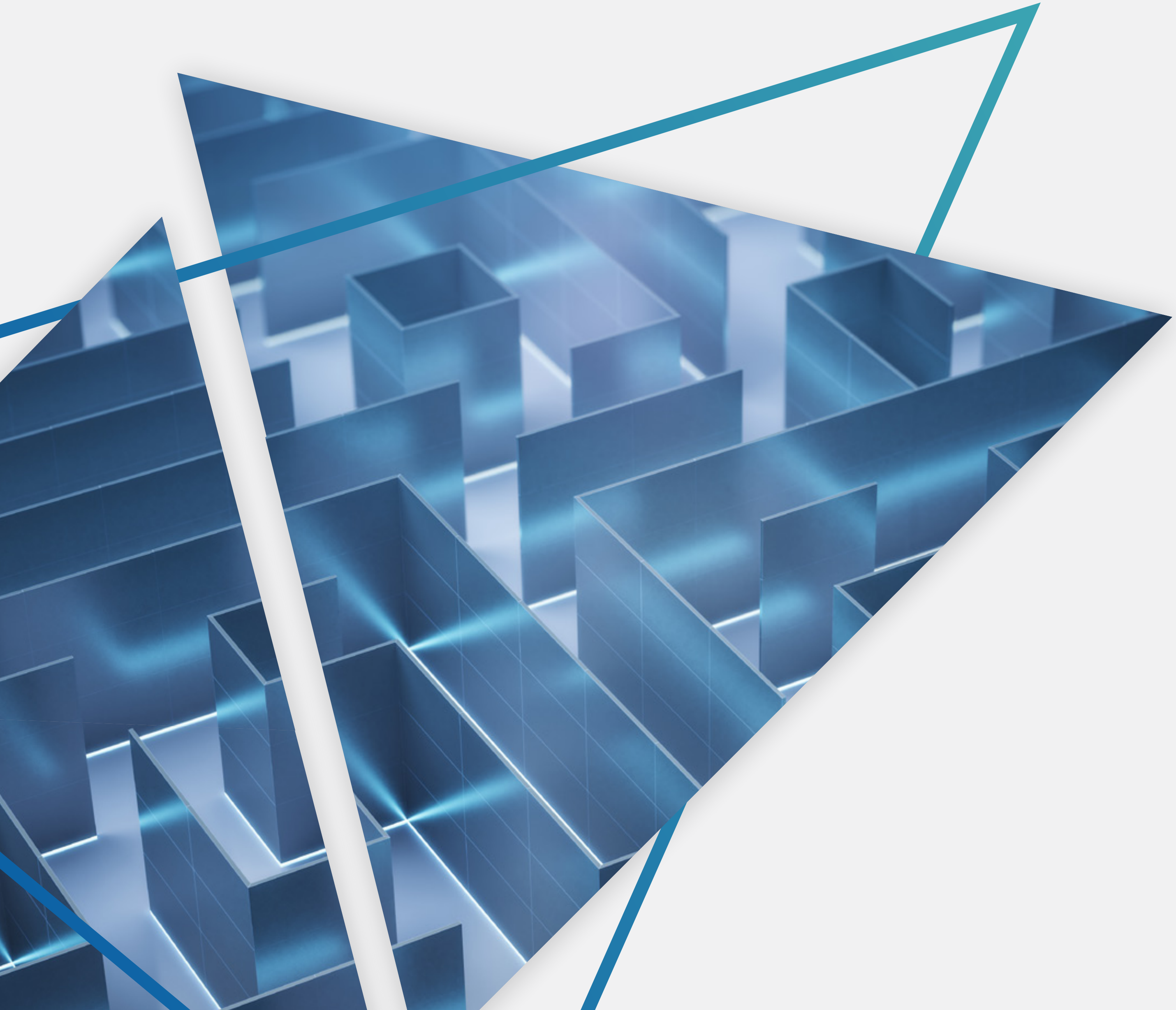

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SOUTH AFRICA

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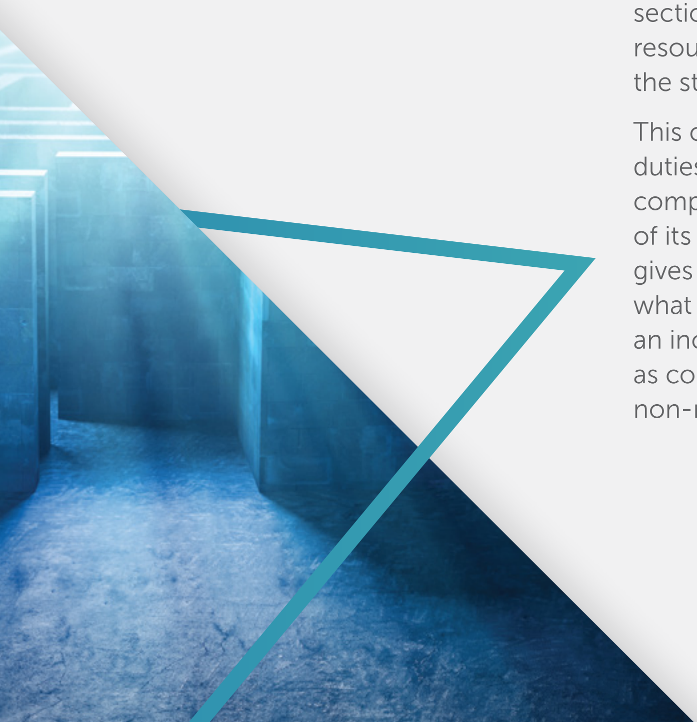
Coal for Christmas is fine, but did you pay royalties?

A practical deep dive into royalty tax compliance for coal in South Africa.



In a country where energy security, mining regulation and tax policy frequently intersect, coal royalty has become a point of legal and fiscal scrutiny. While coal might power your braai, it also fuels a complex fiscal relationship between mining companies and the state. This article unpacks how royalties are calculated under South Africa's evolving mineral regulatory regime, and why compliance matters.

The legal framework: From custodianship to compensation

The Mineral and Petroleum Resources Royalty Act 28 of 2008 (Royalty Act) is grounded in the custodianship principle set out in section 3 of the Mineral and Petroleum Resources Development Act 28 of 2002 (MPRDA). The section declares South Africa's mineral and petroleum resources to be the common heritage of all citizens, with the state appointed as custodian on their behalf.

This custodial function is not abstract; it imposes legal duties on the state, including adherence to the MPRDA, compliance with administrative law, and the fulfilment of its fiduciary obligations to the public. The Royalty Act gives legislative effect to this framework by introducing what is often described as a "*resource rent*". Although not an income tax in the traditional sense, this royalty serves as compensation to the state for the extraction of finite, non-renewable resources.

When and how royalties apply

Section 2 of the Royalty Act imposes a royalty on the "*transfer*" of mineral resources extracted from within South Africa. A transfer includes not only a sale but also disposal, consumption, theft, destruction or loss of the mineral unless it has already been transferred earlier in the value chain. The royalty is calculated on the gross sales value of the mineral at the point of transfer, and the applicable percentage is determined by whether the mineral is classified as refined or unrefined under the schedules of the act.

Coal is classified as an unrefined mineral resource, and therefore the royalty payable falls under the regime for unrefined minerals set out in Schedule 2. This classification is important, as it defines the applicable royalty formula and the basis for determining the gross sales value.

The challenge of calorific value

A key complication in calculating coal royalties lies in determining the calorific value (CV) of the coal, that is, the amount of energy the coal can produce. Schedule 2 of the Royalty Act specifies that coal subject to royalties must fall within a calorific value range of 19.0 MJ/kg to 27.0 MJ/kg. However, the act does not prescribe the method by which CV must be measured, which has resulted in inconsistent practices across the industry.

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Some producers have measured CV on an air-dried (AD) basis, which removes some moisture before testing and tends to inflate energy values. Others have relied on as-received (AR) CVs, which include moisture content and therefore provide a lower, and arguably more accurate, reflection of the coal's quality at the point of transfer. These divergent practices have led to variations in reported gross sales values and, consequently, royalty obligations.

Before 1 March 2014, Schedule 2 specified only a minimum CV of 19.0 MJ/kg. The Taxation Laws Amendment Act 31 of 2013 introduced a range between 19.0 MJ/kg and 27.0 MJ/kg to better reflect market realities, including Eskom's demand for low-grade coal around the lower end of the range, newer power plants requiring mid-range CVs, and export-grade coal often exceeding 23 MJ/kg. While this shift made the royalty regime more commercially relevant, it also intensified confusion over how CV should be measured for compliance purposes.

Section 6A and royalty adjustments

To guard against manipulation or misclassification of mineral quality, section 6A(1A) of the Royalty Act provides that if a mineral is transferred with a quality below the minimum specified range, it is nevertheless deemed to meet the minimum value for royalty calculation purposes. Similarly, if it exceeds the maximum value, it is capped accordingly.

This provision is particularly relevant to coal producers using AD measurements. Because AD CVs can push the reported value of coal above 27.0 MJ/kg, downward adjustments under section 6A may be required. In contrast, AR measurements are less likely to breach the maximum and better reflect the coal's condition at the "*first saleable point*", which is the statutory benchmark for determining gross sales.

SARS Interpretation Note 138

To address the inconsistency in CV measurement, the South African Revenue Service (SARS) issued Interpretation Note 138, which provides guidance on the correct method for determining calorific value for royalty purposes. The note confirms that CV must be assessed at the first saleable point and must reflect the as-received condition, not the artificially elevated air-dried condition.

This development marks a significant shift in enforcement. By standardising the CV methodology across the industry, SARS aims to ensure consistent royalty calculations, prevent underreporting and secure accurate revenue collection. While the note brings much-needed clarity and alignment, it also imposes more stringent compliance expectations on mining companies, especially those that have historically relied on AD measurements.

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Implications for industry and practice

Interpretation Note 138 is a reminder that royalty compliance is more than a technical accounting exercise, and is a strategic issue that affects the bottom line. Producers who previously applied for AD CVs may find themselves liable for additional royalty payments or open to audit challenges. Conversely, those adopting AR CVs in line with SARS' guidance will benefit from regulatory certainty and reduced risk of disputes.

That said, challenges remain. Differences between industry norms and SARS' interpretation may still give rise to disagreements over the application of section 6A adjustments, or the use of sampling and lab procedures that affect CV determination. Legal and technical advisors will play a critical role in navigating these grey areas as the regime continues to evolve.

Conclusion

As South Africa continues refining its mineral regulatory framework, the clarity offered by Interpretation Note 138 is both welcome and necessary. But clarity brings responsibility. Coal extractors must now align with a more disciplined approach to calorific value reporting and ensure their royalty payments reflect both legal requirements and operational realities.

In the current environment, accurate CV measurement is not just a tax obligation but is a cornerstone of regulatory compliance. For mining companies that want to avoid surprises in their Christmas stocking, now is the time to review, adjust and engage.

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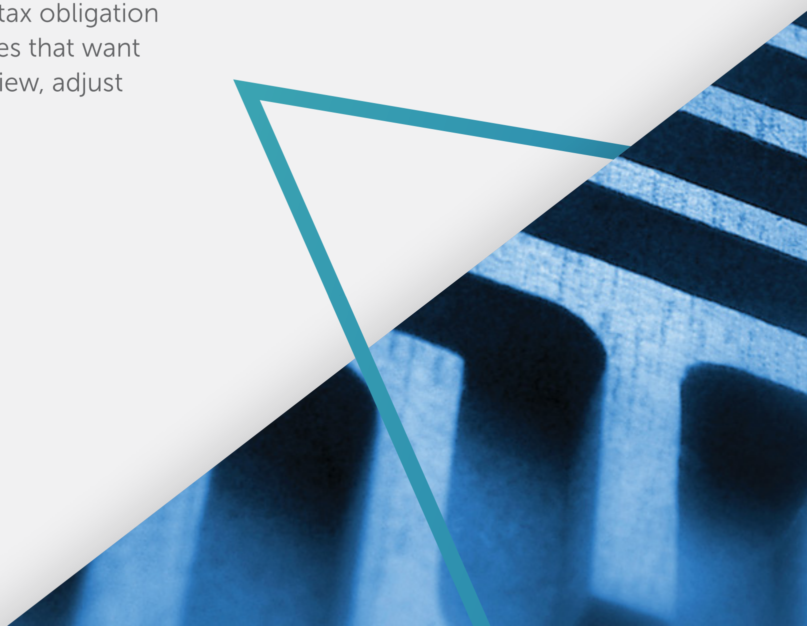
Overseen by Howmera Parak



Rule 56, default cures and fairness: SCA confirms substance over procedure in tax disputes

In *Commissioner for the South African Revenue Service v Virgin Mobile South Africa (Pty) Ltd* [2025] ZASCA 77 (4 June 2025), the Supreme Court of Appeal (SCA) delivered important guidance on the procedural interplay between Rule 56 of the Tax Court Rules (Rules) and the requirement for condonation under Rule 52. This ruling provides important clarity on how late filings should be approached, particularly where the defaulting party acts within the grace period afforded under Rule 56.

Background

Under Rule 31 of the Tax Court Rules, the South African Revenue Service (SARS) must file its statement of grounds of assessment and opposing appeal within 45 business days after receiving the taxpayer's Rule 10 notice of appeal. If SARS fails to meet this deadline, the taxpayer may invoke Rule 56(1)(a), placing SARS on terms to remedy the default within 15 business days or face default judgment in terms of section 129(2) of the Tax Administration Act 28 of 2011 (TAA).

In the *Virgin Mobile* case, SARS missed the initial 45-day deadline but filed its Rule 31 statement within the 15-day period stipulated in the taxpayer's Rule 56 notice. SARS, however, did not simultaneously apply for condonation in terms of Rule 52. The taxpayer argued that the late filing was invalid without a condonation application and sought a default judgment.

Voluntary excuse versus opposing party notice

Before we delve into the SCA's findings, let's recap the distinct roles of Rule 52 and Rule 56 of the Tax Court Rules.

Rule 52 allows a defaulting party to apply to the Tax Court for condonation where it has failed to comply with a procedural deadline, typically on its own initiative and before a Rule 56 notice is served. In contrast, Rule 56 allows the opposing party to issue a notice demanding compliance within 15 business days, failing which it may apply for default judgment under section 129(2) of the TAA.

In essence, Rule 52 is a request for leniency, while Rule 56 is a demand for compliance. The two serve distinct procedural purposes.

The SCA's findings

The SCA rejected the taxpayer's position, holding that compliance with a Rule 56 notice within the 15-day period does not require a separate application for condonation. In the court's view, Rule 56 operates as a complete mechanism for addressing procedural default. Where a party remedies its non-compliance within the grace period afforded by Rule 56, the matter should proceed on its merits.

The SCA likened Rule 56 to Rule 26 of the Uniform Rules, which allows a party to lift a bar by simply complying within the notice period. It emphasised that once SARS complied with the Rule 56 notice, "*the purpose of Rule 56 was achieved*", and no condonation under Rule 52 was necessary. Requiring both would, in the court's words, introduce "*unnecessary duplication*" and procedural inefficiency.

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Why this judgment matters

The ruling confirms that, while procedural timelines remain important, the courts will not endorse outcomes that elevate form over substance, particularly where a party acts swiftly to correct a default. SARS, having responded within the timeframe specified in the Rule 56 notice, was entitled to proceed without the need for condonation.

For taxpayers, this judgment offers the following key takeaways:

- Rule 56(1) should be used as a prompt and not a hammer. The SCA clearly set out that the purpose of Rule 56 is to drive compliance. If the defaulting party responds within 15 days, a default judgment is no longer available, even if the original non-compliance was clear.
- Plan your timelines carefully. Rule 56 creates a built-in 15-day extension period. If a party misses the original deadline but files within the Rule 56 notice period, litigation must proceed on the merits. Only where non-compliance continues after the Rule 56 notice period will the taxpayer be entitled to seek a default judgment under section 129(2) of the TAA.
- Be careful of overreach. Once SARS complied with the Rule 56 notice in *Virgin Mobile*, the taxpayer's continued pursuit of a default judgment was found to be an "*irregular step*". Attempting to extract procedural advantage where the default has been cured may result in adverse cost orders.

The "*possum*" paradox

The SCA acknowledged a perceived tension in the Rules' design and in this context, the following statement by Musi AJA is apt:

> *"The majority of the high court found it irrational that a party can ignore the Rules and wait for a Rule 56(1) notice to comply therewith and so avoid having to apply for condonation. It is how the Rules were designed. They allow a party to play possum..."*

It arguably refers to the implied fallacy in the Rules that if one engages with SARS on an amicable basis, asking it to comply and it continuously fails (especially if it does not reveal the reasons behind the delay and whether they are reasonable), by serving the Rule 56 notice, the taxpayer could be shooting themselves in the foot. It also becomes, to some extent, a game of procedural poker.

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For those taxpayers, the SCA has the following instructive lesson:

> *"In an adversarial system such as ours, where the Rules allow the parties to regulate the advancement of a matter, specifically before litis contestatio, it is important for the innocent party to timeously invoke a Rule that is aimed at ensuring compliance with the Rules. The innocent party must be vigilant. The law favours and assists those who timeously pursue their procedural and substantive rights, and not those who delay or neglect them. The taxpayer could have invoked Rule 56(1) immediately after the lapse of the 45 days stipulated in Rule 31."*

There is therefore little doubt that this judgment will have an impact on the interactions and tactical approaches between taxpayers and SARS in relation to compliance with the time periods in the Tax Court Rules. One thing is clear, Rule 56 is a powerful enforcement tool, but its strength lies in timely invocation.

Conclusion

This judgment reinforces that tax procedure must serve fairness, not formalism. The SCA's approach ensures that technical non-compliance, if swiftly remedied, does not derail substantive progress. However, it also raises important questions about what the most appropriate method to adopt is when enforcing compliance with stipulated time periods.

For both SARS and taxpayers, the message is clear: resolve procedural defaults promptly and focus on the merits.

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