South African Institute of Tax Professionals

31 August 2020

**To: The National Treasury**
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**The South African Revenue Service**
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**Via email**: National Treasury (2020AnnexCProp@treasury.gov.za)
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**RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2020: MINING INDUSTRY**

We attached the comments from the SAIT Mining Tax Industry Work Group (the WG) on the relevant proposals contained in the draft Taxation Laws Amendment Bill, 2020. We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate.

Please do not hesitate to contact us should you need further information.

Yours sincerely,

**SAIT Mining Tax Industry Work Group**

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**All references are to legislation are to the Income Tax Act, No. 58 of 1962, and proposals contained in the draft Taxation Laws Amendment Bill, 2020 (draft TLAB).**

## 1. ADDRESSING THE TAX TREATMENT OF ALLOWABLE MINING CAPITAL EXPENDITURE

[Applicable provisions: Sections 15 and 36]

### 1.1 Government proposal

1.1.1 It is apparent from the draft Explanatory Memorandum on the draft TLAB, 2020 (the draft EM), that the rationale for the proposed to section 15 read with section 36 is to prohibit so-called contract miners from qualifying for the accelerated capital expenditure deduction ordinarily available to persons carrying on mining operations and thus, counter the judgement handed down in *Benhaus Mining v Commissioner, South African Revenue Service* [2019] ZASCA 17.

1.1.2 Per the Explanatory Memorandum, contract mining comprise the services of independent contractors with the required plant and machinery (contract miners) to excavate minerals from the soil on behalf of the mineral rights holder for a fee.

1.1.3 Broadly, the proposal is to only allow a taxpayer that holds a mining right (as defined in section 1(1)) to claim the accelerated capital expenditure in terms of section 15 and 36, in respect of the mine where those mining operations are carried on. This amendment is intended to ensure that "contract miners" do not qualify for this allowance.

1.1.4 In other words, the National Treasury's proposal to limit the deduction provided for in terms of section 15 read with section 36 to the holder of the mineral right in order to exclude persons carrying on contract mining, that is "*services of independent contractors with the required plant and machinery to excavate minerals from the soil on behalf of the mineral rights holder for a fee*" has far wider implications than what is apparently intended.

1.1.5 These unintended consequences are demonstrated in the scenarios discussed hereunder.

### 1.2 Unincorporated Joint Ventures (UJV's)

1.2.1 Mining companies have historically established UJVs due to various commercial imperatives, one of which has been to ensure compliance with the South African Broad Based Black Economic Empowerment (BEE) legislation, including the Mining Charter.

1.2.2 These UJVs may be structured such that the mineral right is in the name of only one of the participants to the UJV. In the event that section 15 is amended to restrict the availability of the accelerated capital expenditure deduction to the mineral right holder, this will exclude the other UJV non- mineral right holder from its share of the deduction despite it having contributed to the capital expenditure.

1.2.3 A similar scenario arises in circumstances in which more than one mineral right is held by different UJV participants, but for the purposes of joint mining operations.

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1.2.4 In these circumstances, the proposed amendment will have the consequence that only expenditure relating to the mineral right and the deduction by the mineral right holder will qualify, again despite all participants having contributed to the capital expenditure.

1.2.5 The matter is further complicated where the capital expenditure overlaps more than one separately owned mineral right. Furthermore, in view of the fact that generally these UJVs are not structured as partnerships nor qualify as partnerships, section 24H will not assist (nor would it be likely to assist in any event) the non-mineral right holder participants.

1.2.6 This matter if further analysed under paragraph 1.3.

**1.3 Risks associated with mining operations in South Africa**

1.3.1 Companies engaged in prospecting and mining operations; whose business models are based on revenue from minerals won from the soil are exposed to significant risks e.g.

- the ore body is not what they expected it to be (lower quality/ quantity)
- the effects on the environment and future rehabilitation costs
- funding costs
- safety risks to employees/ effects on the surrounding communities
- movement in commodity prices/ fluctuations in demand etc.
- the significant time delays between incurring capital expenditure and earning revenue.

1.3.2 In addition to the risks above, mining companies are in many instances “price takers’ as there is uncertainty in the revenue base due to the commodity prices fluctuating and the fluctuation in the exchange rate while costs are mainly Rand based.

1.3.3 However, mining operations can bring significant financial benefits to the country, and therefore, from a policy perspective, it is important that this industry be appropriately stimulated. The original policy intention of section 15 and 36, acknowledged this risk/ reward dynamic.

1.3.4 Therefore, in principle we agree that since those companies engaged in mining activities for a fee (i.e. “contract mining”), are not exposed to these types of risks, the accelerated capital allowance should not be made available to them. Their revenue base is certain and so they should not be given the same benefit afforded to entities with an uncertain revenue base.

1.3.5 However, mining is a complex undertaking. Mining entities enter into certain types of arrangements to leverage off skills, expertise, supply availability etc. Capital allocations also factor into these decisions. These arrangements are completely different from contract mining since the overall risks and uncertainty in relation to revenue still remain. But these arrangements would still be caught by these proposals.

1.3.6 By way of example:

1.3.6.1 Mining company A (Co A) and Mining company B (Co B) enter into an unincorporated Joint Venture (UJV).

1.3.6.2 Both decide to share in the risks and rewards equally (i.e. 50/50 UJV).

1.3.6.3 Co A owns the mining right. Both company contributions funding and assets according to a predetermined arrangement, and agree that profits (or losses) are shared equally.

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1.3.6.4 Both companies contribute R1m each which is used spent on qualifying capital expenditure in terms of section 15 and 36 of the Act.

1.3.6.5 Co B would not own the mining right but would clearly be exposed to the same risks and rewards as Co A, who does own the rights.

1.3.6.6 However, per the proposed changes only Co A can claim capital allowances (assuming all other requirements are met).

1.3.6.7 Therefore, only R1m of capital expenditure incurred on this mine can be claimed.

1.3.6.8 The remaining R1m incurred by Co B cannot be claimed.

1.3.6.9 To add to Co B's frustration, it would also not be allowed to claim a section 12C allowance, as excluded from this definition are taxpayers carrying on a trade of mining (and the definition of mining is not changed).

1.3.6.10 Co B then potentially cannot claim a hundred percent allowance for the expenditure it incurred and would potentially have to claim a section 11 (e) deduction.

1.3.6.11 Even if section 12C and section 11(e) were amended to cater for mining companies it defeats the purpose of catering for the unique circumstances that mining companies operate under.

1.3.6.12 Had this JV been incorporated into a company (JV Co), and Co A transferred its mining right to it, the full R2m would be claimed in JV Co.

1.3.6.13 Further, JV Co claiming the allowance would be within the policy intention (being no different from any other mining company) and therefore it follows that it is illogical that Co B cannot claim its share of capital expenditure in a UJV as per the above scenario.

1.3.6.14 If the proposal goes ahead in its current format, it is acknowledged that companies can then incorporate JV to ensure that the capital expenditure is claimable in terms of section (15) and section (36).

1.3.6.15 However, to effect this, the DMR must approve the mining right transfer and both companies would incur additional administrative burdens.

1.3.6.16 This would further discourage both local and foreign investment into the mining sector.

1.3.7 Mining companies have in the prior years obtained SARS Rulings confirming that both JV partners are carrying on mining activities and were allowed to claim the capital expenditure in their undivided interest in the UJV. One would thus assume that SARS's view was that JV partners should qualify and thus this proposal would go against this and the Rulings previously issued.

1.3.8 In other instances, UJVs are entered into by a junior miner who owns the mining right with larger miners who provide capital. If the larger miner cannot claim the deduction, it would dissuade them from entering into these arrangements, negatively impacting on the development of junior miners.

### 1.4 Mergers and acquisitions

1.4.1 The disposal and acquisition of mining operations have generally required the transaction to be structured to provide for a so-called interim arrangement in terms of which the purchaser conducts contract mining in respect of the mining operations acquired from the seller. The latter is necessitated by the delay in obtaining approval for the transfer of the mineral right as required in terms of section 11 of the Minerals and Petroleum Resources Development Act, 2008 (the MPRDA).

1.4.2 In this situation, the buyer would normally enter into an arrangement with the seller to enable it to mine the asset from the date of signature until the transfer of a mining right is approved. In effect the buyer assumes all risks and rewards of the asset.

1.4.3 Accordingly, in the event that section 15 is amended to limit the deduction to the mineral right holder, this will provide an insurmountable obstacle to any mergers and acquisition activity in the future thus stifling the growth and development of the South African economy.

1.4.4 It does not seem fair that the buyer of a mine, who assumes all risks and who is not engaged in contract mining as defined, should be penalised as a result of a delay in the transfer of the mining right by the DMR. SARS has again, in the past, issued Rulings confirming that the buyer is carrying on mining operations and therefore allowed to claim capital expenditure until the mining right has transferred.

### 1.5 Additional considerations

1.5.1 The following transaction, which are clearly not contract mining arrangements are also caught by this proposal include:

- Miners who conduct mining operations, and who are subject to the same risks and rewards, but do not own a mining right due to technicalities of the MPRDA e.g. tailings reclamations.

- Miners who conduct prospecting operations and only hold a prospecting right

1.5.2 Further the following concerns arise from this proposal:

- How will miners deal with unredeemed capital expenditure carried forward? Will it be lost?

1.5.3 Given the nature of capital expenditure allowances miners were not required to have maintained tax asset registers. Without a transitional arrangement, they will not have time to build a system to track allowances in terms of other sections of the Act.

1.5.4 The impact on Royalty calculations has also not been factored in.

1.5.5 The proposed amendment, in circumstances detailed above, put South Africa at a disadvantage to its peers in competing for foreign capital being less attractive comparing to the incentives offered by countries such as Australia and Canada.

1.5.6 As demonstrated above, the proposed amendment will have dire consequences for the South African economy and it is therefore urged that the wording of the proposed amendment be reconsidered to ensure that it achieves the goal intended:

1.5.6.1 Potentially, the term contract miner could be defined and a specific exclusion be inserted into section 15 to exclude contract miners from benefiting in terms of deduction. However, any definition in this regard should take into account the fact that in certain UJV's, one of the participants (not being the mineral right holder) may be tasked with managing the mining operations in exchange for which it may receive a fee.

1.5.6.2 Therefore, the definition would need to be more on point than as described in the draft EM, that is an independent contractor "*with the required plant and machinery to excavate minerals from the soil on behalf of the mineral rights holder for a fee*". A potential solution may be to exclude contract miners, unless such person participates in the profits of the mining operations in respect of which such services are rendered".

1.5.6.3 In many ways, the distinction here is similar to that between equity shares and preference shares, in that should the taxpayer not carry a right to participate in the profits beyond a specific amount (i.e. limited to the contact fee), then it should not be allowed to claim the allowance. We propose that a similar distinct be introduced into section 15 of the Act. That way contract miners are excluded but other arrangements where the risks remain are still included.

1.5.6.4 The proposed amendment is a quick fix to the contract mining scenario; however, it creates significant unintended consequences. We are happy to engage with SARS and National Treasury on this matter to assist in the drafting of the proposal.

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## 2. CHANGING THE MINISTER OF FINANCE DISCRETION IN LIFTING RING-FENCING OF CAPITAL EXPENDITURE PER MINE

[Applicable provision: Section 36(7F)]

### 2.1 Government proposal

2.1.1 Currently section 36 of the Act empowers the Minister of Finance after consultation with the Minister of Resources to uplift the ring fencing of capex per mine.

2.1.2 The draft amendments propose that this discretion be removed and additional proviso to apply to the Commissioner to deem such mines to be one. This proposal essentially moves this discretion from the Minister of Finance to SARS.

### 2.2 Comments

2.2.1 Applications to the Minister of Finance in consultation with the Minister of Resources, is the preferable route, as policy should be set by Treasury and Department of Minerals, Resources and Energy (DMRE), whilst SARS' mandate lies with administration of the Tax Acts.

2.2.2 There may be cases where investors will be approaching the Finance and DMRE Departments, to invest in SA, which may involve contiguous mines, which will require the lifting of the per mine ringfence. Without the Ministerial discretion, such investments may be lost.

2.2.3 It is recommended that that the mandate (and the expertise) to set economic policy resides with the Department of Finance and not SARS.

2.2.4 However, to the extent that the request is not accepted: We propose that the criteria be more objective so that it could be measured against, in keeping with SARS' commitment to fairness, openness and transparency.

2.2.5 The situations in which a relaxation will be contemplated should be defined, and the criteria should be more specific.

2.2.6 For e.g. one of the criteria is to provide financial statements and management accounts. This is not very specific: For what purpose will it be used? If the intention is to see the extent to which the separate mines are reporting using the same financial statements and management accounts, then this should be stated. If the intention is to evaluate this information for example to see the liquidity position then that should be stated.

2.2.7 Right now, it seems that SARS can use this information as they choose. In theory, two taxpayers could have identical information but SARS could approve one and not the other. The other taxpayer would not have any recourse against this decision, as there is no basis on which to object. Had the criteria been that the taxpayer should be experiencing financial hardship (which is evidenced by the financial statements and management accounts), then the criteria becomes more objective. Further there should be an objection process as well for administrative fairness.

End.

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