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24 June 2022

To: The South African Revenue Service
Lehae La SARS
299 Bronkhorst Street
PRETORIA
0181

Via email: SARS policycomments@sars.gov.za

RE: SAIT RESPONSE TO CALL FOR COMMENT ON THE DRAFT INTERPRETATION NOTE – SECTION 37A

Dear Colleagues,

The SAIT Mining Industry Tax Work Group appreciate the invitation to comment on this draft interpretation note (**draft IN**), that provides guidance on the interpretation and application of section 37A of the Income Tax Act, No. 58 of 1962 (**the ITA**).

1. Structure and approach of the draft IN

Upon a reading of the draft IN, we understand that the purpose of the draft IN is to provide guidance on the interpretation and application of section 37A, which deals with payments made by persons to a mining rehabilitation company or trust where that company or trust has been established for the purposes of conducting rehabilitation upon the closure of a mine or the cessation of mining activities.

The rehabilitation is to also cover any latent and residual environmental impacts of the mining activities.

The draft IN also discusses the tax regime intended to facilitate the rehabilitation activities, as well as specific anti-avoidance rules designed to prevent misuse or abuse of those provisions.

2. Background

To cast back to the underlying intention in the introduction of section 37A of the ITA in 2006, one may take guidance from the accompanying Explanatory Memorandum (EM) to the Revenue Laws Amendment Act, No. 20 of 2006[1].

The following was stated under the "**Reasons for Change**":

> *"While Government is comfortable with the objectives of the rehabilitation fund mechanism, this mechanism has given rise to practical administrative problems, including:*
>
> *(i) A lack co-ordination between the Department of Minerals and Energy (DME) and South African Revenue Services (SARS) in terms of approvals and regulatory provisions;*
>
> *(ii) Unnecessary complexities in terms of the deduction contribution formula;*
>
> *(iii) Concerns about compliance in terms of fund document amendments; and*
>
> *(iv) Various uncertainties and complexities involving contraventions by rehabilitation funds.".*[2]

According to the EM's proposal, the amendments were meant to:

A. Unify the deduction contribution rules of section 11(hA) and the exemption rules of section 10(1)(cH);
B. Address the above-mentioned concerns; and
C. Ensure that all contributions, distributions and withdrawals cater solely for mining rehabilitation upon closure.

[1] Act No. 20 of 2006, signed on 7 February 2007 and published in GG 29603.
[2] The Department of Mineral Resources, is now the Department of Mineral Resources and Energy, and the document shall from hereon out refer to the DMRE.

In terms of the Mineral and Petroleum Resources Development Act, No. 28 of 2002 (MPRDA), mining companies must make financial provision for the environmental rehabilitation of mining areas upon closure. Methods used for financial provision include reserves set asides within a rehabilitation company, society, association or trust (i.e. a rehabilitation fund). The provisions of the MPRDA must be read with the provisions of the National Environmental Management Act, No. 107 of 1998 (NEMA) governing environmental rehabilitation, which forms the basis of sustainable development.

Ordinarily, provisions and reserves do not generate tax deductions, and any growth is taxed upon receipt or accrual.

At the outset, it is clearly stated that the policy reasons for the tax system catering for (a) contributions to these funds to be tax deductible; and (b) the growth in these funds to be tax-free, remain. However, unlike ordinary incentives that motivate a certain desired behaviour through fiscal incentives, the current regime matches and facilitates an obligation that has been imposed by a separate piece of legislation. It follows that the policy imperatives, unlike in the case of pure fiscal incentives, are not solely under the auspices of the Minister of Finance, but rather under the purview of the Minister of the DMRE and the Minister of the Department of Forestry, Fisheries and Environment's (DFFE).

The underlying obligation towards rehabilitation, and what indeed constitutes rehabilitation remains with the DMRE and as influenced by the DFFE. In contrast, the Minister of Finance determines the conditions upon which a mining rehabilitation fund will be eligible to facilitate a tax deduction upon contribution, and enjoy tax exempt growth.

In the last instance, should there be a failure to rehabilitate as required, the National Environmental Management Act, No. 107 of 1998 (NEMA) determines the circumstances under which the Minister of the DMRE may use all or part of the financial provision (funds and assets) of a mining rehabilitation company or trust to rehabilitate the affected areas.

Despite the fact that the conditions surrounding the tax regime falls under the purview of the Minister of Finance, the conditions should still align with the MPRDA and the practical implementation as influenced by the DFFE to ensure that the outcome of facilitating the rehabilitation spend through a beneficial fiscal regime remains effective. In analysing the draft Interpretation Note (Draft IN) issued by the SARS, we hark back to the EM.

3. Rehabilitation and timing

It is acknowledged that the word “rehabilitation” is not defined in NEMA, the MPRDA or the ITA. The draft IN proposes to use “its ordinary meaning as applied to the subject matter in relation to which it is used.” However, on the basis that the entire tax regime is based on the obligation to rehabilitate, the ordinary meaning does not seem sufficient, and consideration should be given to the context and purpose of the tax legislation and in particular the context and purpose of the legislation imposing the rehabilitation obligations. Such legislation not only provides the obligation to be met, but also sets the most basic gatekeeper parameters of ensuring that the contributions made to the fund is appropriate, as well as whether the payments out of the fund is appropriate.

This is the subject of the most fundamental of the points that this submission wishes to make: Without the certainty as to what constitutes rehabilitation, the remainder of the framework of the tax regime must be interpreted in a void.

We therefore turn back to obligation to rehabilitate:

Section 28(1) of NEMA deals with the duty of care and remediation of environmental damage and provides as follows: *"Every person who causes, has caused or may cause significant pollution or degradation of the environment must take reasonable measures to prevent such pollution or degradation from occurring, continuing or recurring, or, in so far as such harm to the environment is authorised by law or cannot be reasonably avoided or stopped, to minimise and rectify such pollution or degradation of the environment."*

Further, as is stated in the draft IN, under section 37(1) of the MPRDA, the principles set out in section 2 of NEMA apply to all prospecting and mining operations and any matter or activity relating to such operations and serves as guidelines for the interpretation, administration, and implementation of the environmental requirements of the MPRDA. NEMA requires an Annual Rehabilitation Plan and a progress report to be submitted to the DMRE, which suggests an expectation of concurrent or annual rehabilitation that will ultimately contribute to rehabilitation at closure and financial provisioning should be made for rehabilitation both annually and at closure.

It therefore appears that any rehabilitation activity that falls within the direction given above should qualify to be funded, in terms of the contribution and in terms of the extraction of the reserve from the rehabilitation fund. It should be irrelevant whether the rehabilitation is so-called ongoing, concurrent or at closure, as the objective is the same i.e. to ensure that the disturbances are rehabilitated on mine closure.

Any rehabilitation falling within the parameters above should qualify (i.e. in response to the obligations on the entity responsible for any environmental liability, pollution or ecological degradation, the pumping and treatment of polluted or extraneous water, the management and sustainable closure thereof), notwithstanding the issuing of a closure certificate by the DMRE under section 43(1) of the MPRDA.

It would be appreciated if confirmation of this interpretation can be stated directly in the draft IN.

Furthermore, we disagree with distinction drawn in the interpretation of the following words: *"the sole object of that company or trust is to apply its property solely for rehabilitation upon premature closure, decommissioning and final closure, and post closure coverage of any latent and residual environmental impacts on the area covered in terms of any permit, right, reservation or permission contemplated in paragraph (d)(i)(aa) to restore one or more areas to their natural or predetermined state, or to a land use which conforms to the generally accepted principle of sustainable development;"* against so-called ongoing or concurrent rehabilitation.

There does not appear to be any reason to infer a timing requirement that determines when the rehabilitation must occur or must be planned to occur in order to qualify as generating the requisite deduction for a contribution, or qualify as proper extraction of funds. To do so, would contradict the spirit and intention of NEMA and the MPRDA and may result in an unbusiness-like outcome.

We refer here again to section 43(1) of the MPRDA, which allows that once the above provisions have been complied with, the Minister will issue a closure certificate to the holder or the owner concerned.

It is recommended that should there be a total impasse in interpreting section 37A in line with the provisions of the MPRDA and the provisions of the NEMA, National Treasury should consider amendments to section 37A to make the section practically enforceable.

The necessity of ensuring that the facilitation of the rehabilitation expenditure through the tax regime is effective, is critically important in a period where any non-qualifying expenditure have to come out of day-to-day cashflow and operating expenses, in cases where mines are undertaking their very real rehabilitation obligations due to shaft and pit closures, etc. It does not appear to be in anyone's interest to have a punitive interpretation that hinges on a timing requirement that does not follow from the legislation creating the initial obligations.

4. Value-Added Tax

We note that the draft IN does not deal with the related VAT considerations and suggest that SARS include it as part of the current draft IN.

5. Disclosure

In terms of section 37A(7) of the ITA, SARS may impose a penalty if the rehabilitation fund makes impermissible withdrawals (e.g. used for other profit making activities not related to rehabilitation or closure). In these instances, the withdrawals will be taxed on their market value. Furthermore, SARS may deem50% of the market value of all property so distributed to be normal tax payable by the holder of the mining or prospecting right.

During discussions, it was suggested that it may be beneficial to SARS and the taxpayers if additional disclosure can prevent the imposition of penalties, especially at a later stage.

Section 37A(10) of the ITA requires that a company or trust must within three months after the end of any year of assessment submit a report to the Director-General of the National Treasury in respect of that year of assessment providing the Director-General of the National Treasury with information comprising—

- the total amount of contributions to the company or the trust;
- the total amount of withdrawals from the company or the trust; and
- the purposes for which any amount of those withdrawals were applied.

It is proposed that the section 37A(10) report be submitted together with the rehabilitation fund return in order to assist with disclosure and allow SARS to ask the appropriate questions within a shorter timeframe.

It is further recommended that the rehabilitation fund return obligations be aligned with the entity with the rehabilitation contribution. Such an alignment will allow easier reconciliation for the taxpayer and for SARS. However, in order to facilitate such an alignment, various changes to entities' financial year-ends would have to be facilitated.

At present, National Treasury does not have a dedicated email address that can facilitate acceptance of the section 37A(10) reports. It is anticipated that an Annexure C request will follow to assist taxpayers in their disclosure to National Treasury.

6. Insurance premiums

In terms of section 37A(6) of the ITA, only certain permissible investments may be made by the rehabilitation fund, failing which the fund will be taxed on the market value of those impermissible assets as if that market value was fully received as income.

Currently, one of the permissible assets is an insurance policy. However, in order to qualify the insurance premium must be an expense in terms of IFRS. However, all the relevant insurance policies currently in the market, upon application of IFRS, results in the insurance policy being shown on balance sheet.
The result is that no insurance policies currently qualify as a permissible asset. It is unclear if this is the intention of the legislature or an unintended outcome of other amendments. Depending on further discussion in the industry, an Annexure C amendment request may follow.

Conclusion

SAIT appreciates the opportunity to comment on this draft IN and we would welcome further engagement.

Yours faithfully,

SAIT Mining Industry Tax Work Group