A CRITICAL ANALYSIS OF THE DISTINCTION BETWEEN MINING AND MANUFACTURING FOR SOUTH AFRICAN INCOME TAX PURPOSES

by

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Declaration

This treatise is an original piece of work which is made available for photocopying, and for inter-library loan.

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Summary

‘Mining operations’ and ‘mining’ are defined in s 1 of the Income Tax Act (ITA). A concept that is of great significance to this definition is the matter of when a mineral is won and the related question of when does the mining process end and the process of manufacture commences.

Case law has not established a definitive point that can be used by the mining taxpayer to determine where the mining process ends for income tax purposes.

The Supreme Court of Appeal was presented with the perfect opportunity in the Foskor\(^1\) case to clearly define the boundaries between these processes. Unfortunately, the court did not seize this opportunity to provide legal certainty.

The significance of the distinction lies in the fact that a mining taxpayer is allowed to claim accelerated capital allowances. The objective of these allowances is to provide tax relief to the mining taxpayer taking the immense risk of investing billions of rands in capital expenditure. The capital expenditure incurred will also result in direct foreign investment. This in turn will result in economic growth and job creation.

Currently, there is no legal certainty as to which processes will qualify as mining operations for income tax purposes. This may result in mining

\(^1\) C:SARS v Foskor (Pty ) Ltd 72 SATC 174 at 185.
taxpayers being hesitant to incur capital expenditure as the risk relating to a project would have increased. The accelerated capital allowances may therefore not serve their intended purpose.

The gross domestic product (GDP) contribution from gold mining has been decreasing in the last number of years, but this decrease has to a large extent been offset by an increase in the downstream or beneficiated minerals industry. This industry has also been identified by Government as a growth sector.

The downstream or beneficiated mineral industry may not be catered for in the current definition of ‘mining operations’ and ‘mining’ and may therefore not qualify for beneficial tax allowances.

It is therefore proposed that the term ‘won’ as used in the definition of ‘mining operations’ and ‘mining’ should be defined in s 1 of the ITA as follows:

A mineral is ‘won’ when all the requisite and necessary processes, including, amongst other things, refinement, beneficiation, smelting, separation, have been undertaken to the mineral to render it saleable in an open and general market.

This extension will provide legal certainty to a mining taxpayer and will ensure that South Africa obtains direct foreign investment and maximum value for its minerals. This will contribute to economic growth for South Africa’s developing economy and result in job creation.
**Key words:** Mining operations, mining, mining tax, won, activity test, risk test, process of manufacture, Foskor, trading stock, legislative amendment to mining operations.
CHAPTER 1 INTRODUCTION AND BACKGROUND

1.1 Background to the research

Section 1 of the Income Tax Act\(^2\) (ITA) defines ‘mining operations’ and ‘mining’ as

‘every method or process by which a mineral is won from the soil or from any substance or constituent thereof’.

Since some of the terms used in the definition are not defined, it is necessary to look at the rules of interpretation of statutes to give meanings to them.

A concept that is of great significance to the definition of ‘mining operations’ is the matter of when a mineral is ‘won’ and the related question of when does the mining process end and the process of manufacture commences.

When interpreting this concept, the courts have had to decide whether to give a broad or narrow interpretation to the word ‘won’. Case law precedent dictates a broader interpretation, which in itself brings its own complexities as the answer is likely to differ depending on the commodity that is being mined.

A restrictive interpretation was adopted in the \textit{English Clays} case.\(^3\) The court held as follows:

\(^2\) Act 58 of 1962.

\(^3\) \textit{English Clays Lovering Pochin & Co v Plymouth Corporation} (1973), 2 All ER 730.
‘[O]ur view is that to “win” a mineral is to make it available or accessible to be removed from the land and to “work” a mineral is to remove it from its position in the land.’

In *Union Government v Nourse Mines, Ltd* Wessels J interpreted the words ‘to win gold’ as

‘to obtain or get the gold in the form of metal. To win gold includes all the operations necessary, not only to reach and extract the ore, but also to convert it into metal.’

Following the Supreme Court of Appeal judgment in *C:SARS v Foskor* there is a renewed focus and emphasis on the distinction between the mining and manufacturing processes.

In this case the court held that certain stock piles should be included in trading stock as defined in s 1 of the ITA and the value of them should be determined as prescribed in s 22.

The court based its decision on the fact that the processes to which the ore was subjected constituted a manufacturing process and described the distinction between mining and manufacturing as ‘unhelpful’. 

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4 (1912) TPD 924 at 930.
5 72 SATC 174 at 185.
6 At SATC 185.
The court had an opportunity in the *Foskor* case to define the boundaries between these processes. Unfortunately, it did not use this opportunity to provide legal certainty.

The ITA provides for beneficial tax rates and accelerated capital allowances when an entity is carrying on mining operations. The driver of these is the definition of ‘mining operations’ or ‘mining’.

Sections 76B to 76S empower the Commissioner to make advance tax rulings regarding the interpretation or application of the ITA. Binding private rulings are catered for in s 76Q and non-binding private opinions are contained in s 76I.

Binding private rulings may be issued for a proposed transaction when the taxpayer wants to clarify the application or interpretation of a provision of the ITA. It is submitted that a mining taxpayer would be unable to obtain a binding private ruling for its mining process as it does not fall within the defined meaning of a ‘transaction’ in terms of s 76B.

A non-binding private opinion may be issued by the Commissioner regarding the tax treatment of a particular set of facts and circumstances or a particular transaction. In terms of s 76I(2), the non-binding private opinion is not binding upon the Commissioner. The mining taxpayer may therefore obtain a non-binding private opinion with regard to its mining process, but it will not safeguard the taxpayer’s process classification for tax purposes.
If a taxpayer classifies a process as a mining process and the Commissioner views this process as a manufacturing process, severe financial losses may be suffered due to the incurrence of additional taxes, penalties and interest on the underpayment of taxes. It may also have a significant impact on the timing of cash flows for the taxpayer.

1.2 Research objectives

The objective of the treatise is to give a detailed analysis of the word ‘won’ as contained in the definition of ‘mining operations’ and ‘mining’ and the related question of when does mining operations end and a process of manufacture commence with reference to the principles contained in the interpretation of statutes, local and foreign precedent, and the various other South African statutes that have a definition of ‘mining’.

In addition, the treatise prepares possible amendments to the ITA that addresses some of the problems created by the definition of ‘mining operations’ and ‘mining’ for the mining industry.

1.3 Research method

The definition of ‘mining operations’ and ‘mining’ is analysed with reference to local and foreign precedent, other statutes, various books, tax articles and periodicals to obtain relevant information relating to the definition of ‘mining operations’ and ‘mining’ to determine when a mineral is ‘won’ and the related question of when the mining process ends and the process of manufacture commences.
Furthermore, the analysis could be used to amend the definitions of ‘mining operations’ and ‘mining’.

1.4 Approach

To meet the research objectives, the approach of this treatise is as follows:

- Chapter 2 – To give a brief overview of the general tax principles applicable to a mining taxpayer.
- Chapter 3 – To give a detailed analysis of mining tax principles.
- Chapter 4 – To explain the tax principles applicable to a taxpayer involved in manufacturing.
- Chapter 5 – To provide an analysis of the distinction between mining and manufacturing based on case law.
- Chapter 6 – To provide an analysis of the *Foskor* case and the court’s application of the distinction between mining and manufacturing.
- Chapter 7 – To give an overview as to how the application of the mining tax principles would have impacted the *Foskor* case and to propose a legislative amendment to the definition of ‘mining operations’ and ‘mining’ as defined in s 1 of the ITA to ensure legal certainty with regard to the distinction between mining and manufacturing.
CHAPTER 2    GENERAL TAX PRINCIPLES

2.1    Income and deductions

The ITA imposes a normal tax liability on a taxpayer. Normal tax is payable by both natural and juristic persons. Section 1 of the ITA defines a number of key concepts to calculate a taxpayer’s taxable income. The South African tax is levied on the residence (world-wide) basis.

A natural person may be classified as a resident of the Republic if he is ordinarily resident in South Africa or if the requirements of the so-called physical presence test are met. A juristic person is a resident of the Republic if it is incorporated, established or formed in South Africa or if its place of effective management is in South Africa.

Taxable income is calculated as gross income less exempt income, deductions and certain allowances and by adding taxable capital gains.

‘Gross income’ is defined in s 1 of the ITA to mean

‘(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or

(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic, during any year or period of assessment, excluding receipts or accruals of a capital nature . . . ’.
A resident is taxed on his world-wide receipts and accruals, whereas a non-resident is taxed only on receipts and accruals from a South African source or deemed source.

In terms of s 9(1)(cA) of the ITA, an amount will be deemed to have accrued to a person from a South African source if it has been received or accrued to him under

‘any contract made by such person for the disposal of any mineral (including natural oil) won by him or her in the course of mining operations carried on by him or her under any –

(i) mining authorisation granted under the Minerals Act, 1991 (Act 50 of 1991); or
(ii) prospecting right, mining right, exploration right or production right or mining permit issued in terms of the Mineral and Petroleum Resources Development Act, 2002 (Act 28 of 2002)’.

Irrespective of the residency of the mining entity, a person carrying on mining activities (in terms of these Acts) will always be subject to tax in South Africa, since it is deemed to be from a South African source in terms of s 9(1)(cA).

Section 10 of the ITA specifies those receipts and accruals that are exempt from tax.
Section 11(a) read with s 23(g), known as the general deduction formula, provides the basis for amounts to be deducted from income. The items that may be deducted are contained in s 11(a) (the so-called positive test) whereas s 23(g) (the so-called negative test) stipulates which items may not be deducted.

A taxpayer may deduct expenditure and losses actually incurred in the production of the income, provided they are not of a capital nature. An additional requirement is that the taxpayer must be carrying on a trade.

### 2.2 Capital allowances

Since capital expenditure is not deductible, the ITA grants certain capital allowances. Allowances on moveable assets are mainly provided for in s 11(e) and s 12C. Allowances on immovable property are mainly provided for in s 13, s 13ter, s 13sex, s 13quin, and s 12D.

Section 15(a) provides for accelerated capital allowances for a mining taxpayer. The accelerated capital allowances are granted in lieu of the capital allowances contained in s 11(e), s 11(f), s 11(gA), s 11(gC), s 11(o), s 12D, s 12DA, s 12F and s 13quin. The quantum of the allowance is determined with reference to the provisions of s 36. The allowance is limited to mining income and the various ring-fencing provisions contained in s 36(7C), s (7E), s (7F) and s (7G).
Apart from the provisions that s 15(a) is granted in lieu of, certain provisions exclude from their application of a mining taxpayer, for example, s 12C.

First, for a taxpayer to qualify for the accelerated capital allowances, he must be carrying on ‘mining operations’ and ‘mining’ as defined in s 1 of the ITA. This is generally referred to as the activity test.

‘Mining operations’ and ‘mining’ are defined to include any method or process by which any mineral is won from the soil or from any substance or constituent thereof.

Secondly, the potential mining taxpayer needs to earn mining income – the so-called risk test. This criterion is contained in the wording of s 15 which allows the accelerated capital allowance to be claimed against only mining income.

2.3 The importance of the mining tax regime

Once the taxpayer has met the requirements of both the activity and risk tests, he will be taxed in terms of a complex set of provisions that are aimed at providing the mining taxpayer tax relief. The mining industry is capital intensive and requires large amounts to be invested. The tax relief is aimed at stimulating mining investment in South Africa.

To ensure that these objectives are met, the mining tax law of South Africa needs to be clear as to when a taxpayer will qualify.
CHAPTER 3  PRINCIPLES APPLICABLE TO MINING

The definition of ‘mining operations’ and ‘mining’ requires a mineral to be won from the soil or from a substance or constituent of it.

The specific terms used within the definition of ‘mining operations’ and ‘mining’, namely, ‘mineral’, ‘won’ and ‘soil’, are not defined in the ITA. It is therefore necessary to look at the rules of interpretation of statutes to determine the meaning of these words.

The rules of interpretation of statutes require the interpreter to determine the meaning of the words with reference to

- the Constitution (which forms the basis of the law),
- case law,
- definitions of the words as they are used in other Acts, and
- the ordinary meaning of the words.

In this regard the following statement is important:7

‘In a taxing Act one has only to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in. Nothing is to be implied. One can only look fairly at the language used.’

7 Cape Brandy Syndicate v Inland Revenue Commissioners [1921] 1 K.B. 64 at 71.
3.1 Mining operations and mining

In the first instance, an analysis is performed on the definition as a whole. Secondly, an analysis is then performed on the individual words used in the definition.

3.1.1 Analysis of the definition as a whole

3.1.1.1 Ordinary meaning of the term

In ITC 909 J.C.R. Fieldsend said the following: 8

‘In common parlance I do not think that anyone would say that the appellant in quarrying [blue] stone was mining or carrying out mining operations.’

(Emphasis added.)

It has to be determined whether the ITA uses the term ‘mining operations’ in any other sense than that which it has in ordinary speech.

According to the Collins Concise Dictionary ‘mining’ means

‘to dig into the earth for minerals’.

3.1.1.2 Other Acts

In the determination of the meaning of ‘mining operations’ and ‘mining’ for ITA purposes it is necessary to refer to the meaning of similar terms in other statutes. The Minerals and Petroleum Resources Development Act 9 (MPRDA) defines ‘mine’, when used as a verb, as meaning

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8 (1960) 24 SATC 97 at 98.
‘any operation or activity for the purpose of winning any mineral on, in or under the earth, water or any residue deposit, whether by underground or open working or otherwise and includes any operation or activity incidental thereto’.

3.1.1.3  Case law

When interpreting the definition of ‘mining operations’ and ‘mining’ with reference to the ITA the courts adopted a broad interpretation in some instances and a narrow interpretation in other instances.

3.1.1.3.1  Broad interpretation

In the Nyasaland Quarries case\textsuperscript{10}, the judge said that in his opinion there can be no doubt whatever that in defining the expressions ‘mining operations’ and ‘mining’ as it has done, the legislature intended to give these expressions, when used elsewhere in the Act, a meaning wider than the ordinary everyday meaning of those terms. It is wide due to the use of the words every method or process by which any mineral is won. Also, s 2 of the ITA states that the various expressions must have the meaning assigned to them ‘unless inconsistent with the context’. In his opinion the intention of the legislature in enacting the definition of ‘mining operations’ and ‘mining’ in s 2 was to give those expressions an extended meaning in relation to the equipment and depletion of capital assets allowances.

\textsuperscript{10} COT v Nyasaland Quarries & Mining Co, 24 SATC 579.
It was held in *Australian Slate Quarries Ltd v FCOT*\(^{11}\) that ‘mining operations’ embraced all operations, whether by hand or by machinery, and whether confined to excavating the surface as in alluvial claims or extended to excavations below the surface, by which a valuable deposit, other than ordinary soil, is extracted from the earth.

### 3.1.1.3.2 Narrow interpretation

A narrow interpretation of the term ‘mining operations’ and ‘mining’ was adopted in the *New South Wales Associated Blue Metal Quarries* case.\(^{12}\) In the court *a quo* Judge Kitto held as follows:

> “While “mining” is nowadays given an extended meaning in relation to the winning of substances which have come to be thought of as generally obtained by underground working, so as to include the extraction of such substances even by means of surface excavations, yet such an extended meaning is not ordinarily given to the word in relation to other substances. For them, the word “quarrying” is usually employed, though this again is by way of extension since the primary significance of the noun “quarry” is a pit for the cutting of blocks of stone such as those in question in *Stronach’s Case*. It would, I think, be unusual to apply the word “mine” to open diggings for the obtaining of stone of a kind which does not call up, by association, the idea of mining in the sense of sinking a shaft and tunnelling in pursuit of a desired substance.’

\(^{11}\) (1956) 6 AITR 239.

\(^{12}\) (1955) 6 AITR 239.
The Full Court agreed with his view.\(^\text{13}\)

### 3.1.3.3 Prospecting and exploration

Prospecting and exploration activities alone do not fall within the ambit of the definition of ‘mining operations’ or ‘mining’. Mining is the process by which minerals are won from the soil for the purpose of profit.\(^\text{14}\)

### 3.1.2 Analysis of individual words used in the definition

#### 3.1.2.1 Method or process

A method or process must be part of the taxpayer’s activities to be carrying on mining operations.

A process is defined as\(^\text{15}\)

> ‘a series of actions which produce a change or development’.

With respect to mining operations, the question is therefore if this process will include more than the mere extraction of the ore from the soil? It also gives rise to the question as to when do mining operations cease and when does manufacturing commence?

Mining versus manufacturing is discussed in detail in Chapter 5 below.

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\(^{13}\) At AITR 242.

\(^{14}\) *Murchison Exploration & Mining Co Ltd v CIR* 10 SATC 143 at 149.

3.1.2.2 Mineral

The next word in the definition of ‘mining operations’ and ‘mining’ is ‘mineral’.

It is defined in the *Oxford Dictionary* as

‘a solid, naturally occurring inorganic substance – a substance obtained by mining’.

The MPRDA defines a mineral as

‘any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process and includes sand, stone, rock, clay, soil, and any mineral occurring in residue stockpiles or in residue deposits but excludes:

(a) water, other than water taken from land or sea for the extraction of any mineral from such water;

(b) petroleum; and

(c) peat’.

There are cases dealing with the definition of a ‘mineral’ for income tax purposes. In ITC 909 reference was made to Halsbury’s *Laws of England* and it was noted that\(^\text{16}\)

‘the word is susceptible of expansion or limitation in meaning according to the intention with which it is used’.

In the *Nyasaland Quarries* case it was held that whether a particular substance was a mineral, was a mixed question of fact and law. The judge

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\(^{16}\) (1960) 24 SATC 97 at 99.
referred to the definition of a ‘mineral’ as stated in the Great Western Railway\(^{17}\) case,

‘it is any substance that can be got from within the surface of the earth which possesses a value in use, apart from its mere possession of the bulk and weight, which makes it occupy so much of the earth’s crust’.

The judge in ITC 1249\(^{18}\) was of the opinion that it must be a substance that can be found naturally within the earth’s surface. Once it is converted into something that cannot be found within the earth, it does not qualify as a mineral.

In New Blue Sky Gold Mining Co Ltd v Marshall\(^{19}\) it was said that a mineral is an inorganic substance having a definite chemical composition and crystallisation of its own, and a certain degree of hardness and specific gravity.

Due to the significance of the word ‘mineral’ in the definition of ‘mining operations’ and ‘mining’, it is submitted that a wide interpretation must be adopted in interpreting the term to give effect to the intention of the legislature.

**3.1.2.3 Win or won**

The Collins Concise Dictionary defines ‘win’ as

\(^{17}\) Great Western Railway v Carpalla United China Clay (1909) 1 Ch 231.

\(^{18}\) (1988) 51 SATC 111.

\(^{19}\) 1905 TS 363.
‘to extract (ore, coal, etc.) from a mine or (metal or other minerals) from ore’.

The word ‘win’ is also used in other revenue statutes. Prior to its amendment by the 2010 Taxation Laws Amendment Act\textsuperscript{20}, s 2 of the Mineral and Petroleum Resources Royalty Act (MPRRA)\textsuperscript{21} stated that

‘[a] person that wins or recovers a mineral resource from within the Republic must pay a royalty for the benefit of the National Revenue Fund in respect of the transfer of that mineral resource’.

(Emphasis added.)

It is also used in the definition of ‘mine’, when used as a verb, in s 1 of the MPRDA.

A restrictive interpretation was adopted in the \textit{English Clays} case. The court held as follows:\textsuperscript{22}

'[O]ur view is that to “win” a mineral is to make it available or accessible to be removed from the land and to “work” a mineral is to remove it from its position in the land.'

In contrast to the restrictive interpretation adopted in the \textit{English Clays} case, a broad interpretation was adopted in the \textit{Nourse Mines} case where it was held that\textsuperscript{23}

\begin{flushleft}
\textsuperscript{20} Act 7 of 2010. \\
\textsuperscript{21} Act 28 of 2008. \\
\textsuperscript{22} 1974 All ER 249 at 243. \\
\textsuperscript{23} (1912) TPD 924 at 930.
\end{flushleft}
‘[t]he ordinary meaning of the words “to win gold” is to obtain or get the gold in the form of metal. To win gold includes all the operations necessary, not only to reach and extract the ore, but also to convert it into metal.’

3.1.2.3.1 Mining and manufacturing

3.1.2.3.1.1 The Boksburg Brick and Fire Clay case

In 1941 the court had to decide if a company was carrying on ‘mining operations’ within the scope of the Companies Tax Ordinance 12 of 1933. Section 10(1) read as follows:

‘There shall be exempt from taxation – (1) in terms of sub-sec (1) of sec three of Act 5 of 1921 any portion of a taxable income or any portion of a dividend distributed which is derived from mining operations carried on within the Province, or from rights in or to mines or minerals within the Province.’

The only question that had to be answered in Boksburg Brick & Fire Clay Co Ltd v CIR24 was whether the company was carrying on mining operations. ‘Mining operations’ was not defined in Ordinance 12 of 1933.

‘Mining operations’ was, however, defined in the Union Income Tax Statutes. Section 100 of the Union Income Tax Act25 defined mining operations as follows:

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24 12 SATC 225 at 227.
25 Act 41 of 1917.
"Mining operations" and "mining" include every method or process by which any mineral is won from the soil or from any substance or constituent thereof.'

This definition is also in-line with the definition of 'mining operations' and 'mining' contained in the ITA. The court had no difficulty in deciding that fire clay is a mineral.

The process carried on by the taxpayer was described as follows: 26

'The [taxpayer] causes the soil lying on top of the fire clay to be removed by excavation. . . . The [taxpayer] extracts the fire clay by drilling into it, blasting it loose by explosives and hauling it to the surface by cocopans on an endless wire rope haulage. This is the usual and customary method of extracting fire clay except where it has been softened by partial natural disintegration, and can therefore be removed by pick and shovel. . . . On the surface the fire clay is passed through grinding mills. Some of it is placed in bags, some of it is mixed with water and mechanically pugged, so that it is made into a plastic mass. . . . The pugged fire clay is moulded to make fire bricks, slabs, crucibles, furnace linings and retorts, and these are placed in kilns and burnt. . . . The ground fire clay in bags, and the aforesaid moulded articles after burning, are sold by the [taxpayer]. . . . The [taxpayer's] trade sales for the year material to this action amounted to £61,338 16s. 5d., whereof the sum of £4,815 1s. 6d. was derived from sales of ground fire clay in bags and the sum of £56,523 11s. 11d. from sales of articles

26 At SATC 227.
moulded and manufactured, as above described, by the [taxpayer] out of its fire clay.’

What is interesting to note from the judgment is the following statement:27

‘In my opinion, therefore, the contention of the [taxpayer] is correct, and a portion at least of its commercial activities is devoted to mining operations.’

(Emphasis added.)

From the above statement it follows that Maritz J considered some of the activities carried on by the Boksburg Brick & Fire Clay Co not to be mining operations. Unfortunately, he did not go on to consider which portion of the company’s operations fell within the ambit of mining operations and which part in the manufacturing sphere.

This case confirms that a single process carried on by a mining company may be divided into a mining process and a manufacturing process for income tax purposes.

3.1.2.3.1.2  Rex v Blom & another

In *Rex v Blom & another*28 the court was called upon to determine if the company should pay a cost-of-living allowance in terms of the War Measure.29 The company was involved in the winning and quarrying of lime.

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27 At SATC 229.
28 [1951] 1 All SA 1 (T).
29 39 of 1943.
It had to remove the raw material from the ground, process it and turn it into building lime.

The Mines Department and the Department for Inland Revenue treated the lime quarries as mines. The basis upon which the Department of Labour contended that they were not mining is contained in the definition of an ‘employee’ in terms of the War Measure. It defined an ‘employee’ as follows:

'[I]n these regulations unless inconsistent with the context of “mine” includes all excavations for the purpose of searching for and winning metals, minerals or precious stones but not including stone, sand, clay or similar material for roadmaking, building, brick-and tile-making or like purposes.'

The court a quo held that the operations fell within the last part of the definition of an ‘employee’, namely,

'[b]ut not including stone, sand, clay or similar material for roadmaking, building, brick-and tile-making or like purposes'.

It was argued that because the finished product is used for building, the operations fell within the requirements of the definition – lime is a similar material to sand, stone or clay.

Blackwell J concluded that it was incorrect to say that processed lime was the same as stone, sand or clay. Stone, sand or clay can be used in its original condition, it requires no further processing to be used in the building industry. Does the above statement infer that further processing is necessary to qualify as a mining operation?
The court held that the company was carrying on mining and therefore not liable to pay the cost-of-living allowance. Roper J concurred with the judgment of Blackwell J, but noted that no distinction had been made between the excavation activities and the process of converting the limestone into lime. This distinction may be drawn in other cases when the court has to interpret the meaning of ‘mining’ or ‘mine’.

3.2 The risk factor

Once the taxpayer has satisfied all the requirements of the definition of ‘mining operations’ and ‘mining’ as contained in s 1 of the ITA, it is then necessary to determine if he carries the risks associated with a mining process, that is, does he

- receive the reward of gains made in the process, and
- bear the brunt of losses suffered.

Section 15(a) of the ITA established the principle that a taxpayer must be earning mining income to qualify for the accelerated capital allowances. The quantum of the allowance is determined in terms of s 36 and is limited to mining income in the year of assessment.

Mining income is income that has been derived from mining operations.

What is then required from a taxpayer to derive income from mining operations? Does the term ‘derived from’ require a causal connection between the mining operation and the income?
In ITC 732\(^{30}\) and ITC 1505\(^{31}\) ‘derived from’ had to be interpreted in the context of farming operations. For income to be derived from farming operations it was held that the income must be directly so derived.

These principles were confirmed in *CIR v D&N Promotions (Pty) Ltd*. It was held that\(^{32}\)

‘the income and the source from which the income arises, namely farming operations, which of course embraces numerous agricultural activities, must be *directly connected*. An indirect connection or a remote one will not suffice.’

(Emphasis added.)

In *Western Platinum Ltd v C:SARS*, \(^{33}\) it was considered whether various interest income streams could be mining income. In this regard it is stated that\(^{34}\)

‘[t]he *fiscus* favours miners and farmers. Miners are permitted to deduct certain categories of capital expenditure from income derived from mining operations. . . .These are class privileges. In determining their extent, one adopts a strict construction of the empowering legislation. That is the golden rule laid down in *Ernst v Commissioner for Inland Revenue* 1954 (1) SA 318 (A) at 323C-E and approved in *Commissioner for Inland Revenue v D & N Promotions (Pty) Ltd* 1995 (2) SA 296 (A) at 305A-B.’

\(^{30}\) (1951) 18 SATC 108.

\(^{31}\) 53 SATC 406.

\(^{32}\) 1995 (2) SA 296 (A), 57 SATC 178 at 183.

\(^{33}\) [2004] 4 All SA 611 (SCA) 67 SATC 1.

\(^{34}\) In para [1] at SATC 6.
Conradie JA expresses the view that mining operations by themselves cannot produce income. ‘Mining operations’ and ‘mining’ is capable of accommodating commercial transactions. With regard to minerals the commercial transaction would normally be a sale. He stated the following:\textsuperscript{35}

‘One would therefore, at least, have to interpose a sale (and the associated delivery and payment) between the extraction of the minerals and the income, thus postulating a business.’

For mining income its source is the minerals being taken from the earth. Its income is therefore directly connected to its source.\textsuperscript{36}

A venture requires an element of risk. If a taxpayer is not at risk when carrying on the mining operations that produce the income, he is not earning mining income for purposes of the ITA.

3.3 Conclusion

The corner stone of mining tax is the definition of ‘mining operations’ and ‘mining’. The wording used in this definition is wide and general and its interpretation is problematic. It is difficult to establish when in the process mining operations end and manufacturing commences. Several factors may potentially impact the point when the change occurs, including

- the imposition of different legal entities,

\textsuperscript{35} In para [6] at SATC 7.
\textsuperscript{36} In para [6] at SATC 7.
• whether a part of the process may be classified as a separate and distinct operation,
• the nature and chemical composition of the mineral being mined, and
• its ultimate economic use.

Once it has been established that a particular process is a ‘mining operation’, it must then be determined if the taxpayer is deriving income from this mining operation. For a taxpayer to derive income from mining operations there has to be a causal connection between the income earned and the winning of the minerals from the soil. The income will result from the sale of the minerals mined.
CHAPTER 4 PRINCIPLES APPLICABLE TO MANUFACTURING

Section 15 provides the mining taxpayer with accelerated capital allowances. These are then quantified in s 36. If a taxpayer’s process or part of it does not constitute a mining process, can this process or part of it possibly qualify as a manufacturing process. And then what capital allowances are available?

When a taxpayer incurs expenditure of a capital nature the amount incurred cannot be deducted for normal tax purposes. The ITA makes special provision for capital allowances on qualifying assets. Capital allowances help reduce the taxpayer’s normal tax liability for the relevant year of assessment.

Section 12C and s 12E(1) provides for capital allowances for plant or machinery used directly in a process of manufacture or a process that is similar to a process of manufacture. Section 13(1) allows the taxpayer an allowance for buildings used in a process of manufacture or a process similar to a process of manufacture.

4.1 Process of manufacture

It is important to determine if the taxpayer’s process constitutes a process of manufacture or a process similar to a process of manufacture. These concepts have not been defined in the ITA. It is therefore necessary to look at its interpretation with reference to case law.
It should be noted that both s 12C and s 12E(1) excludes from their application an asset used for farming or mining operations. This is important, since a court would not have had to consider if miners or farmers carry on a ‘process of manufacture’.

In ITC 1006 it was held that ‘manufacture’ means\(^\text{37}\) ‘the production of something essentially different from the material used’.

The court also required that the process should be a complete process. This means that should the taxpayer merely perform one step in the entire process, he would not be ‘manufacturing’ an item.

In contrast with the requirement in ITC 1006 that it should be a complete process, the court in COT v Processing Enterprises (Pvt) Ltd held that a\(^\text{38}\) ‘manufacturing process need not necessarily produce the end product provided it is an essential stage in the final production of that end product, or an important stage in the final production of that end product’.

A prominent case on the interpretation of the ‘process of manufacture’ is SIR v Safranmark (Pty) Ltd.\(^\text{39}\) The court in this case referred with approval to the following dictum of Miller J in ITC 1247:\(^\text{40}\)

\[(1)\text{ The term “process of manufacture”, in the context, denotes an action or series of actions directed to the production of an object or thing which is} \]

\(^{37}\) (1962) 25 SATC 248 at 520.

\(^{38}\) 1975 (2) SA 213 (RAD), 37 SATC 109 at 113.

\(^{39}\) 1982 (1) SA 113 (A), 43 SATC 235.

\(^{40}\) (1975) 38 SATC 27 at 31.
essentially different from the materials or components which went into its making.

‘(2) The requirement of “essential difference” necessarily imports and element of degree; and there are no fixed criteria – nor is there any precise universal test – whereby it can be determined whether or not a change in the materials or components wrought by the process, be it as to the nature, form, shape or utility of the materials or components, has brought about an essential difference. This must be decided on the individual facts of each case.

‘(3) When deciding whether a particular activity does or does not fall within the ambit of a “process of manufacture” the ordinary, natural meaning of that phrase in the English language must not be lost sight of.”

(Emphasis added.)

Another instance when the courts were called upon to determine whether a particular activity is part of a manufacturing process, is the case of *SIR v Cape Lime Company Ltd.*

Cape Lime’s business was to produce hydrated lime for agricultural and other purposes. It owned two properties – the one constituted the quarry where the limestone was found in the form of dolomite and the other the plant where the lime was produced.

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41 *SIR v Safranmark (Pty) Ltd* (1982) 3 All SA 212 (AD).
42 1967(4) SA 226(A), 29 SATC 131.
The steps in the process were summarised by Jennett AJA as follows: 43

'(a) [T]he extraction of the limestone from natural deposits;
(b) the breaking up of this raw material into pieces of manageable size;
(c) the subjection of the pieces of limestone to the calcination, hydrating and milling and separating processes to produce the powdered lime;
(d) the packing into containers.'

Two new and unused trucks were acquired by the taxpayer and were used in transporting the reduced fragments of rock from the quarry to the plant – they were used for this purpose 70% of the time. For the remainder of their time they were used in transporting rock from the stockpile direct to the crushing plant.

The question that had to be determined by the Appellate Division of the Supreme Court (now the Supreme Court of Appeal) was when the process of manufacture commenced. Did the process

- commence at the quarry where the rock was broken up into smaller pieces, or
- did it commence when the smaller pieces of rock were submitted to the kilns?

This question did not involve the question of whether the process was a process of manufacture – it was limited to when the process of manufacture

43 At SATC 146.
commenced. The following statement by Steyn CJ is relevant in this regard:\textsuperscript{44}

[D]it word nie betwis nie dat ons hier met ‘n vervaardigingsproses, soos in die betrokke bepaling bedoel, te doen het. Die geskilpunt is beperk tot die vraag waar die proses begin.’

In arriving at his conclusion, he referred to the following \textit{dictum} from Wessels JA.\textsuperscript{45}

'In order to produce lime, which is something \textit{essentially different} from the raw material in its original form and state (i.e. in the form of natural deposits of limestone on the land) the respondent carried out a succession of operations which are all directed to the end result. In the process the \textit{nature, the form and the chemical composition of the raw material are changed}.'

(Emphasis added.)

The court therefore came to the conclusion that the breaking of the rock into smaller pieces on the quarry floor was the commencement of the process of manufacture and that the trucks were therefore used in that process. It was the first step in a series of processes to produce lime.

Thus, for a process to qualify as a process of manufacture for income tax purposes, the object that is produced should be essentially different from the original raw materials. A change in the nature, form or chemical composition

\textsuperscript{44} At SATC 136.

\textsuperscript{45} At SATC 140.
of the raw materials may be an indicator of a process of manufacture, but there is no universal test to apply to determine whether a process will qualify. It will be determined based on the facts of each situation.

4.2 Capital allowances

Once it has been established that the taxpayer’s process is a process of manufacture, the following capital allowances are available in terms of s 12C:

- For new or unused machinery or plant brought into use for the first time by the taxpayer for purposes of trade (excluding mining, farming, banking, financial services, insurance or rental business) – 40% in year 1 and 20% in each of the following three years of assessment.

- In all other instances, but again excluding mining and farming trades, an allowance of 20% in each year of assessment for five years.

This allowance is not proportionally reduced if the asset was used only for a portion of the year. Once the asset is brought into use in a process of manufacture, the full allowance is claimable in that year.

The s 12E(1) allowance is available to a small business corporation when plant or machinery is brought into use for the first time by it for purposes of trade and is used directly in a process of manufacture. An allowance equal to the cost of the asset is granted in the year when it is brought into use.
It seems unlikely that a taxpayer carrying on a mining trade would satisfy the conditions required to be a small business corporation.

Section 13(1) provides for an annual allowance of 5% in relation to manufacturing buildings when the erection or improvements commenced after 1 October 1999. It is understood that for capital allowance purposes mining buildings are treated as mine equipment.\textsuperscript{46} It follows that a taxpayer carrying on a mining trade will not qualify for the s 13(1) capital allowance.

\textbf{4.3 Conclusion}

If a process does not qualify as a mining process, but qualifies as a manufacturing process, this will result in the capital allowances being spread over a longer period of time, that is over four or five years in terms of s 12C, as opposed to a full capital allowance being claimable in year 1, provided that the entity has sufficient mining income.

The difference in the timing of the cash flows will result in a different rate of return on the investment for the mining taxpayer. This could affect the project’s viability.

\textsuperscript{46} Section (36)(11)(a).
CHAPTER 5 DISTINCTION BETWEEN MINING AND MANUFACTURING

The distinction between the mining and manufacturing processes is of significance. The nature of these processes makes the distinction problematic – in some instances the mining and manufacturing processes are part of one continuous process. At what stage in this process has the miner won his mineral and when did he start to produce something in a process of manufacture?

There is one term and one word in the definition of ‘mining operations’ and ‘mining’ that give rise to the question when does mining operations end, and when does manufacturing commence. These are ‘every method or process’ and ‘win’.

In Chapter 3 issues around these two concepts were discussed. In this chapter, local and foreign precedent are examined to establish various factors that may influence the change-over between mining and manufacturing.

5.1 Domestic precedent

5.1.1 Separate and distinct operations

Rand Refinery’s main objective was the refining of gold. The court was called upon to decide whether it was liable for payment of an additional rate
that was imposed under s 8(3) of Ordinance 1 of 1916 on improvements used for purposes not incidental to mining.\textsuperscript{47}

The relevant provision read as follows:\textsuperscript{48}

‘Provided that in the case of land held under a licence or any other mining title to dig or prospect for precious metals and precious stones or base metals such additional rate shall, unless otherwise determined by the local authority, be levied upon the value of any improvements upon such land used for residential purposes, or for purposes not incidental to mining operations, or otherwise as well as upon the site value of the land.’

In arriving at its decision the court considered whether the work of refining gold is ‘incidental to mining operations’. It looked at the concept in terms of what is generally understood by the term and how it is used in the specific ordinance. For purposes of this treatise it is necessary only to consider the general meaning of the term.

Two opposing views were presented to the court with reference to the general understanding of the term:

- It was argued that the object of mining for gold and silver is to win the metals in its purest form. Refining removes from the bars of bullion those elements that are not gold and delivers a product consisting of pure gold or silver.

\textsuperscript{47} Rand Refinery Ltd \textit{v} Town Council of Germiston 1929 WLD 63.

\textsuperscript{48} At WLD 64.
• Alternatively, refining is a process separate from ordinary mining operations. ‘Mining’ includes the extraction of the ore from the ground and the necessary processes to get it into a commodity that is easily disposed of. The mining process therefore ends when the gold bullion is produced.

The manager of the refinery gave evidence that before the establishment of Rand Refinery no refining activities were carried on in South Africa. The gold was either sent for refining in England or the gold bullion was sold to the banks.

Refining operations are normally carried on as a distinct and separate operation – it is normally done by an entity other than the mining taxpayer and on different premises to the mining operations. The refining of gold may therefore qualify as ‘incidental’ to mining operations, but is not included in ‘mining operations’.

5.1.2 Process separated between different legal entities

Zaaiplaats Tin Mining Co Ltd was required to pay the Government a royalty calculated on the annual net produce obtained from the exercise of the right leased. There was a dispute between the parties with regard to the value on which the royalty was payable. The court had to decide whether the royalty
was payable on the value of the tin concentrates produced from the leased property or on the value of the metallic tin.\(^49\)

The process entailed the severing from the soil the crude tin bearing ore andsubjecting it to a process that reduces it to tin ore concentrates, or cassiterite. The tin ore concentrates could then be disposed of to customers. Generally, the smelting process was performed by foreign smelters which reduced the tin ore concentrates into metallic tin cast into ingots.

Zaaiplaats performed some smelting operations during 1918. It calculated the royalty based on the metallic tin produced and paid the amount to the Government.

Three arguments were laid before the court by the taxpayer. Two of the three arguments are relevant to the term ‘winning’.

The first argument centred on the acquisition of ownership. It was contended that when the operations have reached a point where a portion of what has been severed from the ground are disregarded, it can be said that the taxpayer has worked and won a portion of the mineral content of the claim. This will then be when the tin concentrate is produced. Murray J was not convinced that this argument was logically sound and said that impurities will also be removed from the tin concentrate to produce the metallic tin.

\(^{49}\) Zaaiplaats Tin Mining Co Ltd v Union Government 1944 TPD 42.
Secondly, it was argued that tin ore concentrates are a marketable product. Therefore, once a marketable product is produced the taxpayer has the product of the right leased.

This argument also did not find favour. In this regard the following was stated:\(^5^0\)

‘Though smelting may be carried on as a separate business it is obviously different from the business of turning metallic tin into manufactured tin articles. When smelting forms part of the full process adopted by the lessee of reducing to marketable form the mineral content of the claims, it seems to me that it would be an answer by the lessee to the defendant, when royalty is claimed at the tin ore concentrate stage, that the process of production selected by his is incomplete and that royalty is not then claimable. The fact that an additional process has been decided upon and operates upon what would in itself be capable of description as a product, does not render the final form into which the ore is converted any the less a product of the right leased. The metallic tin is what the lessee has won from the earth in consequence of the right leased; it is just as much a product of a tin mine as coke (obtained by the application to coal of an additional process) is a product of a coal mine Bowes v Ravenworth (24 L.J.C.P.; 73).’

(Emphasis added.)

Despite the fact that the ‘marketable product’ argument did not find favour with the court, the MPRRA is based on the concept of the ‘first saleable condition’, being the first point when there is a market for the product.

\(^{5^0}\) At TPD 48.
This raises the question whether the *Zaaiplaats Tin* case is authority for the argument that if the process is at any time interrupted and resumed by a second entity, the mining operations will end with the entity handing over the operations to the second entity. It may be argued that the causal connection to the mining process was broken and that the activities carried on by the second entity are too remote to qualify as mining operations.

It is submitted by in Franklin and Kaplan\textsuperscript{51} that the discontinuance of processing at any stage by a mining company would complete the company’s mining of the mineral and that any further processing, whether in the form of reduction or smelting, would not, if undertaken by a third party, amount to mining operations.

**5.1.3 ITC 1455**

ITC 1455\textsuperscript{52} has been referred to in cases when the distinction between mining and manufacturing had to be made, for example, the *Foskor*\textsuperscript{53} and *Richards Bay Iron & Titanium*\textsuperscript{54} cases. Its judgment is considered to be useful with reference to the issue of the ending of the mining process and the commencing of the manufacturing process.

\textsuperscript{51} *Mining and Mineral Laws* at 705. This view is supported in *SA Mineral and Petroleum Law* in footnote 265 at 94.

\textsuperscript{52} (1988) 51 SATC.

\textsuperscript{53} 72 SATC 174 in para [26] at 181.

\textsuperscript{54} *Richards Bay Iron & Titanium (Pty) Ltd & another v CIR* 1996 (1) SA 311 (A), 58 SATC 55.
The main business objective of the company was the manufacture of steel and vanadium products. Its registration certificate also stated that it was conducting mining and quarrying. It was conducting opencast mining for magnetite ore. The magnetite ore was mined at site B. It was also crushed, washed, screened and stockpiled at site B. The magnetite ore was processed at plant A to produce liquid pig iron and vanadium-bearing slag.

The court described the process at plant A as follows: \(^{55}\)

‘In order to produce the liquid pig iron and the vanadium-bearing slag, the magnetite ore is mixed with coal and fluxes, heated in a pre-reduction rotary kiln (where about 60 per cent of the oxygen of the iron-oxide is removed), smelted in an electric smelting furnace and then treated in a shaking ladle. The vanadium-bearing slag has a higher melting point than iron and therefore solidifies sooner. The molten pig iron is then poured from the shaking ladle and taken to a furnace where steel is made from the iron.’

The taxpayer admitted to conducting both a manufacturing and a mining enterprise. The court was therefore required to decide when the mining operations ended and when the manufacturing process commenced.

The taxpayer argued that its mining operations ended at site B.

The Commissioner contended that the purpose of mining is the production of minerals and that the iron and vanadium pentoxide are won only once they are produced by the shaking ladle.

\(^{55}\) At SATC 115.
5.1.3.1 Ordinary meaning

The court compared the operations of the taxpayer to a gold-mining operation and describes this process as follows: 56

‘The gold exists in discrete particles in the rock. The mined rock is crushed and the gold is leached out. The gold ore is then heated and bullion is poured. In ordinary parlance the latter operation will not be referred to as the manufacturing of gold but to the mining of gold.’

It concluded that 57

‘the gold and diamond is already in the earth. One merely isolates it. In the case of iron production the iron is not in the ore. Iron oxide is. The iron is produced by an industrial process.’

The court also referred to the judgment in FCOT v Broken Hill Proprietary Co Ltd 58.

In terms of the ordinary meaning of ‘mining operations’ the court was satisfied that the operations of the appellant ended at site B.

5.1.3.2 Statutory meaning

‘Mining operations’ was defined in the Sales Tax Act (STA) as

‘those operations the essential object of which is the recovery of mineral or oil deposits from the earth, including operations concerned with prospecting for such deposits, the extraction of the deposit-bearing materials from the

56 At SATC 119.
57 At SATC 120.
58 (1969) 1 ATR 40.
Earth and the treatment of those materials for the purpose of recovering such deposits therefrom.

The court then interpreted the definition in terms of the facts as 59

‘the expression “mining operations” means those operations the essential object of which is the recovery of mineral (ie iron or vanadium) deposits from the earth, including operations concerned with prospecting for such deposits, the extraction of the deposit-bearing (ie magnetite) materials from the earth and the treatment of those materials for the purpose of recovering such deposits (ie iron or vanadium) therefrom’.

As a result, the court held that all the operations up to, and including, the shaking lade fall within the ambit of ‘mining operations’ in terms of the statutory definition.

It is submitted that the definition of ‘mining operations’ and ‘mining’ in the ITA is similar to the definition in the STA.

5.1.3.3 Conclusion

The point at which a mineral is won for purposes of the ITA depends on the commodity being extracted and the level of purity and refinement.

Based on the fact that the definition of ‘mining operations’ and ‘mining’ starts with the word ‘includes’, implies that it is wider than the ordinary meaning of the term. Furthermore, the general terms used in the definition dictate a broader interpretation.

59 At SATC 116.
It is therefore submitted that the statutory interpretation of ‘mining operations’ and ‘mining’ as discussed above is more aligned with the ITA definition. It follows that the process for income tax purposes should also include all operations up to and including the shaking ladle.

5.1.4 Factors to consider

Based on local precedent, the following factors may have an impact on when the mining process ends and when the manufacturing process commences:

- Is a part of the taxpayer’s process a distinct and separate operation?\(^{60}\)
- Is the entire process carried on by the same taxpayer?\(^{61}\)
- Does the end product of the process occur naturally in the earth or does it exist in another form?\(^{62}\)
- Is the end product a result of an industrial process?\(^{63}\)

5.2 Foreign precedent

Foreign precedent on this issue is found in a number of Australian cases. Australian mining tax also refers to the concept of mining operations and has also caused many interpretation problems. The South African courts have referred to some Australian cases in their judgments, for example, ITC 1455. A detailed analysis of these judgments follows:

\(^{60}\) Rand Refinery case.
\(^{61}\) Zaaiplaats Tin case.
\(^{62}\) ITC 1455.
\(^{63}\) ITC 1455.
5.2.1 Henderson case

In the *Henderson* case the court had to decide whether Gold Dumps Pty Ltd was carrying on mining operations in Australia for gold.\(^{64}\) Henderson was a metallurgist and assayer who invented a process to extract gold from slime dumps. The slime dumps were the residue of a previous mining process.

Could one be carrying on a mining process on material that lay on the surface of the ground? It was argued that the slime dumps are chattels and the mining operations can only be carried on in what is land as opposed to chattels. ‘Mine’ is not a word of definite meaning and is not limited either to excavation or to subterranean excavation.

To extract the gold from the slime dumps, the dumps had to be sluiced and reduced to floating material. After that it was screened, filtered and treated chemically by the process developed by Henderson. A washing, roasting and melting processed followed and gold was produced.

According to the evidence of the mining expert,\(^{65}\)

‘gold mining includes not only excavation of material by digging or mechanical methods, or hydraulic methods, but also treatment by a battery or otherwise, and by a chemical process, *when carried out at the place where the gold bearing material was obtained*.’

(Emphasis added.)

\(^{64}\) *Henderson v FCOT* (1943) 2 AITR 440.

\(^{65}\) At 2 AITR 449.
The expert agreed that if the dumps were treated at a place other than the place where the gold bearing material was obtained, the other place would not be described as a mining operation.

The court also looked at the objectives of the company as contained in its memorandum of association. Its memorandum authorised it to purchase and to work mines and mineral properties and to carry on and conduct the business of, amongst other things, sluicing, crushing, washing and smelting, ores, metals and minerals.

Based on the evidence given by the expert, the court held that Gold Dumps Pty Ltd was carrying on mining operations.

A mining process includes work done on the property subsequent to the winning of the mineral for the purpose of completing the recovery of the desired end product of the whole activity.66

5.2.2 Parker case

In another case the court was called upon to interpret 67

‘income derived from the working of mining property for the purpose of obtaining gold’.

The taxpayer had the facilities for crushing ore and a treatment plant for the extraction of gold. He obtained ore from various mines. It was then crushed

66 2 AITR 440, 68 CLR 29 at 45 & 50.
67 Parker v FCOT 1953 (5) AITR.
and treated. He was remunerated for this service. The court a quo was of the opinion that ‘working a mining property for gold’ required something to the effect of excavation, or getting the ore from the ground. Gold obtained from another source is not working a mining property, but only a consequential activity.

Dwyer CJ expressed his concern over the requirement in the Henderson case that the treatment should be carried out at the place where the ore was obtained. In his opinion it may be too restrictive as it is mining practice to bring ore from different mines to a central plant for processing. If the processing activity is separate from the excavating activity, it will be difficult to include it in the understanding of the word ‘mining’ and the term ‘mining operations’.

The lower court therefore held that the taxpayer was not deriving income from the working of mining property for the purpose of obtaining gold, since the phrase required that the gold should be linked to an excavation or similar process.

On appeal, the court held that the term ‘mining operations’ is not the same as the term ‘the working of a mining property’. ‘Mining operations’ is a wider term and means operations pertaining to mining, and operations have a wide meaning. The term ‘the working of a mining property’ implies the exploitation of a mining lease or other form of interest in the soil. Therefore, mining
operations does not require the process to start with the excavation of the ore from the earth.

### 5.2.3 Broken Hill South case

In the case of the *FCOT v Broken Hill South Ltd* the court had to determine whether care and maintenance operations were included in the term 'mining operations'. Section 23(1)(i) of the Income Tax Assessment Act 1922 – 1934 allowed a deduction from assessable income equal to the assessable income that is paid in calls on shares in a mining company or syndicate carrying on mining operations in Australia for gold. In arriving at his conclusion Rich ACJ considered the aim of this section. Its objective is to encourage mining activity in Australia by giving tax concessions to companies carrying on mining operations.

In his view the term had to be given a broad interpretation and mining operations includes work which is preparatory or ancillary to the actual winning of metal or ore. Accordingly the care and maintenance fell within this interpretation.

Starke J referred to the *Australian Slate Quarries* case when it was held that the term 'mining operations' is not a term of art, it is popular and not technical. The court *a quo*’s statement that ‘mining operations’ covered activities in connection with a mine additional to the mere extraction of ore or

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68 (1941) 2 ATR 257.
69 At 2 ATR 258.
metals such, for instance, as the provision and maintenance of plant both above and below the surface. It also included work connected with the protection and safety of the mine.

5.2.4 Broken Hill case

Another Australian case dealing with mining operations is the *Broken Hill* case. In the lower court judgment, Kitto J stated that the phrase ‘mining operations’ embraces not only the extraction of minerals from the soil but all operations pertaining to mining and extends to work done on a mineral-bearing property in preparation for, or as ancillary to, the actual winning of the mineral (as distinguished from work for the purpose of ascertaining whether it is worthwhile to undertake mining at all). It also extended to work done on the property subsequent to the winning of the mineral for the purpose of completing the recovery of the desired end product of the whole activity. Furthermore, it is the close association of the work with the mining proper that gives it the character of operations pertaining to mining.

This was a wide view of the term ‘mining operations’. In arriving at this broad interpretation he referred to the *Parker* case when it was held that ‘mining operations’ have a wider scope than the expression ‘the working of a mining property’ and includes all operations pertaining to mining, not only the extraction of the mineral from the soil.

In addition, he considered the judgment in the *Broken Hill South* case when it was determined that ‘mining operations’ includes work that is preparatory
or ancillary to the actual winning of the mineral. It also includes the work done subsequent to the winning of the mineral to obtain the desired end product.\textsuperscript{70}

It is with the statement that the work includes work performed subsequent to the winning of the mineral for the purpose of completing the recovery of the desired end product of the whole activity that the court had its reservation. Accordingly, the court held that the concept will not extend to the treatment of the mineral recovered for the purpose of the better use of that mineral.

5.2.5 Factors to consider

Foreign precedent dictates that the following factors should be taken into consideration when determining when the mining process ends and when manufacturing commences:

- What is the desired end product of the entire activity?\textsuperscript{71}
- When does the taxpayer’s process start in relation to the entire process of recovering the particular mineral?\textsuperscript{72}
- Preparatory and ancillary work to the actual winning of the mineral.\textsuperscript{73}
- Does part of the process result in the better use of the mineral?\textsuperscript{74}

\textsuperscript{70} Henderson case.
\textsuperscript{71} Henderson case.
\textsuperscript{72} Parker case – the taxpayer’s process is not required to start with excavation activities.
\textsuperscript{73} Broken Hill South case.
\textsuperscript{74} Broken Hill case – process that results in the better use of a mineral is not part of the mining process.
5.3 Conclusion

The mining process can either end when the mineral is available or accessible to be removed from the earth or when the mineral is in metal or its purest form.

Various factors have been laid down by domestic and foreign precedent that will influence the distinguishing point between mining and manufacturing. There are no general rules that can be deduced from the various cases that have been included in this treatise. Each situation will have to be determined on its facts and the type of mineral being mined.

Mining operations cover more processes than the mere excavation of the ore from the earth. It includes the procedures necessary to recover or liberate the mineral. Procedures that are performed after the mineral has been won or that are embarked on for the better use of the mineral would not qualify as a mining process, but may qualify as a process of manufacture.

In the event that the typical mining operations are separated either by location or corporate entity, this may pose an obstacle to a taxpayer to qualify its process as a mining operation for income tax purposes.
CHAPTER 6  FOSKOR CASE

6.1  Facts

The dispute arose as a result of the inclusion of R203 205 437 in Foskor’s taxable income for its year of assessment ended 30 June 1999. The Commissioner contended that the amount represented closing stock in terms of s 22 read with s 1 of the ITA. The taxpayer was unsuccessful in objecting to the inclusion in its taxable income. The matter was then heard by the tax court. The tax court found in favour of Foskor. The matter was then taken on appeal to the Supreme Court of Appeal by the Commissioner.

Foskor acquired the rights to mine base minerals, including phosphates, belonging to the State during 1952. Phalaborwa Mining Co Ltd (PMC) obtained the right to mine copper and other base minerals, except phosphorous minerals, over the same areas over which Foskor held its rights during 1963. Since the copper and the phosphates are located in the same portion of earth, Foskor and PMC entered into an Extension – 100F Agreement and the Ancillary Agreement on 8 October 1979.

In terms of this agreement, PMC extracted the ore from the earth and Foskor bore a portion of the mining costs incurred. The phosphate-bearing rock was allocated to, and dumped by PMC, for Foskor to recover the phosphates. The extensive procedures applied by Foskor resulted in the

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liberation of the mineral, namely apatite, from the ore. The court a quo described the process as follows: 76

‘The phosphate-bearing ore is loaded and hauled to a primary crusher and then conveyed to secondary and tertiary crushers for crushing;

‘The crushed material is then conveyed to Rod and Ball Mills for milling to liberate the minerals from the rock;

‘The pulp containing the materials is then pumped to a flotation plant where the minerals of economic importance are separated by means of three metallurgical separation processes, which is a froth flotation process, a magnetic concentration step and a gravity separation process. During the froth flotation process certain ingredients (reagents) are added to the froth. During this process the minerals that have been released stick to the bubbles. At the end of the process the reagents are removed.

‘The final product from these separation steps are concentrates consisting of phosphates which are then dried, stockpiled and sold to worldwide customers, which use the minerals mainly for the manufacture of fertilisers.’

It is important to note that the facts of the case were not disputed by either of the parties. The Commissioner and Foskor agreed to the facts.

In this regard the following statement is relevant:77

‘The facts relevant to this appeal are not in dispute.’

76 In para 12 at SATC 119.
77 In para 5 at SATC 118.
Despite this statement, there are a number of discrepancies between the court *a quo* and the Supreme Court of Appeal with regard to the nature of Foskor’s income, the agreement and the transfer of ownership and the nature of its activities.\(^78\)

### 6.1.1 Nature of Foskor's income

The taxpayer’s income-producing activities were described as follows by the tax court:\(^79\)

‘[T]he appellant’s main business is mining, although it derives mining as well as non-mining income. The mining income relates to the mining of phosphates, the most important mineral being apatite, a phosphorous mineral of which the phosphorous mineral content is expressed as percentage \(P_2O_5\). The appellant’s non-mining income relates to its secondary business, namely the recovery and marketing of baddeleyite and the production of electrofused zirconia from zircon sand.’

The Supreme Court of Appeal describes the business activities of Foskor as follows:\(^80\)

‘Foskor’s main business is mining, although it derives non-mining income as well, which it asserts is related to its secondary business, namely, the recovery and marketing of baddeleyite (a mineral) and the production of electrofused zirconia from zircon sand.’

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79 In para [6] at SATC 118.
From the wording used by the Supreme Court of Appeal it would indicate that it was not convinced that Foskor’s non-mining income related to its secondary business. If Foskor is not deriving non-mining income from its secondary business, is it then derived from its primary business? This point is considered in further detail below.

6.1.2 Agreement and transfer of ownership

Secondly, the court *a quo* and the Supreme Court of Appeal interpreted the terms of the agreement differently and how ownership of the mineral is transferred. The tax court stated that\(^{81}\)

> ‘[t]he essence of the agreements was that instead of appellant extracting the phosphate-bearing ore from the earth itself YMC extracted the ore from the earth and appellant bore a portion of the mining costs incurred by YMC. ‘Upon separation from the earth by YMC, appellant, *by operation of law*, acquired ownership of the aforementioned phosphate-bearing ore.’

(Emphasis added.)

The Supreme Court of Appeal interpreted the agreements to mean that\(^ {82}\)

> ‘PMC undertook to mine the foskorite as a by-product of its copper mining operations and to deliver the ore to Foskor, which agreed to pay its mining and transport costs. *Upon delivery of the ore Foskor became the owner thereof.*’

(Emphasis added.)

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\(^{81}\) In para [10 & 11] at SATC 118

\(^{82}\) In para [7] at SATC 178
As correctly observed by the author, the tax court interpreted the agreement to be that of agency. PMC extracted the phosphate-bearing ore on behalf of Foskor. In its capacity as agent, PMC was allowed to recover the costs incurred by it to excavate the rock. The ownership of the phosphates had passed from the State to Foskor in terms of the mineral rights held by it. PMC never became the owner of the phosphate-bearing rock – it was not entitled to mine it in its own capacity since the mineral rights were awarded to Foskor.  

From the Supreme Court of Appeal interpretation, one is lead to believe that the ownership of the foskorite transferred in terms of a contract of sale and as such I agree with the author’s elucidation. PMC mined the foskorite as a by-product. Ownership transferred to Foskor upon delivery. The judgment is silent on the exact details around the transfer of ownership – it is therefore unclear whether the Supreme Court of Appeal considered the transfer to happen from the State to Foskor or from PMC to Foskor.  

PMC was never in a legal position to sell the foskorite to Foskor. PMC did not have the mineral rights to mine the foskorite.

Foskor never exercised discretion over the ore supplied by PMC. It was never in a position to refuse ‘delivery’ by PMC. This is indicative of an

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83 Fertilizer Decision article at 297.
84 Fertilizer Decision article at 297.
agency agreement as opposed to a sale agreement. Foskor therefore bore the risk of the mining process.

The two courts also differed with reference to the intention with which the parties entered into the agreements. According to the court a quo the agreement was entered into:

‘[i]n order to utilise the full potential of the ore body . . .’

The Supreme Court of Appeal stated that:

‘[t]he agreement was intended to maximise the benefit for both institutions, allowing PMC to concentrate on copper mining and Foskor on the phosphate-bearing ore, called foskorite’.

6.1.3 Nature of Foskor’s activities

In the third instance, it is interesting to note the differences in the wording used to describe the facts of the case. The tax court refers to a mining process when it describes the operations conducted by Foskor:

‘Approximately 183 million metric tonnes of ore consisting of phosphate-bearing rock were allocated and dumped by YMC for further mining by the appellant.

‘Appellant mines the phosphates and other minerals from the ore . . .’

(Emphasis added.)

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85 In para [9] at SATC 118.
86 In para [7] at SATC 178.
87 In para [11 & 12] at SATC 118.
The Supreme Court of Appeal refers to processing when it describes the same operations. 88

‘Between the 1979 and 1998 tax years approximately 183 million metric tons of foslkorite were allocated and dumped by PMC for further processing by Foskor.

‘From the ore dumped by PMC Foskor extracted phosphates and other minerals by way of the following processes . . ..’

(Emphasis added.)

From the language used by the Supreme Court of Appeal it is apparent that the process was never considered to be a mining process.

6.2 Trading stock provisions

The definition of ‘trading stock’ is contained in s 1 of the ITA. It provided as follows prior to its amendment in 2001:

“‘Trading stock” includes anything produced, manufactured, purchased or in any other manner acquired by a taxpayer for purposes of manufacture, sale or exchange by him or on his behalf, or the proceeds from the disposal of which forms or will form part of his gross income, or any consumable stores and spare parts acquired by him to be used or consumed in the course of his trade, but does not include a foreign currency option contract and a forward exchange contract as defined in section 24l(1).’

88 In para [8] at SATC 178.
In the Court a quo’s judgment the legal questions to be determined are postulated. The court had to decide whether\textsuperscript{89}

‘the phosphate-bearing ore was acquired for the purpose of manufacture, as contemplated in the first part of the definition; or

the proceeds from the disposal of the phosphate-bearing ore would have formed part of the Appellant’s gross income, as contemplated in the second part of the definition’.

6.2.1 Gross income

The tax court referred to the judgment in \textit{De Beers Holdings (Pty) Ltd v CIR}.\textsuperscript{90} It was argued by the Commissioner in that case that items will be included in the definition of ‘trading stock’ if the proceeds would constitute gross income, even if the taxpayer had no intention to dispose of the items at any time. Corbett JA did not agree with the Commissioner’s view stating that\textsuperscript{91}

\[ \text{'[s]uch an interpretation would do violence to the plain meaning of the words used: words simply denoting futurity would be stretched to cover at the same time not only futurity but also a hypothetical state of affairs which in fact did not and would not come to pass.'} \]

The court a quo therefore held that the Foskor never had the intention to dispose of the phosphate-bearing ore. There is no market in South Africa for the sale of phosphate-bearing ore, and exports of the ore would not be

\textsuperscript{89} In para [20] at SATC 120.

\textsuperscript{90} 47 SATC 229.

\textsuperscript{91} At SATC 256.
economically viable. The first saleable point of the mineral is only after the ore has been subject to the process described above. The following statement is relevant in this regard:\textsuperscript{92}

‘In order to fall within the second part of the definition it is essential, however, that the thing in question must be amenable to being disposed of for value. Otherwise stated, the one thing must be in a realisable state.’

As a result the court \textit{a quo} held that the phosphate-bearing ore did not fall within the second part of the definition of ‘trading stock’. It could therefore only be included as trading stock if it was held for purposes of manufacture.

\textbf{6.2.2 Purpose of manufacture}

The tax court referred to the Appellate Division case of \textit{Richards Bay Iron & Titanium}. In this case the court held that the items had to be produced, manufactured, purchased or in any other manner acquired by the taxpayer for the specific purpose of manufacture, sale or exchange by the taxpayer or on his behalf. It was also held that the words\textsuperscript{93}

‘for purposes of manufacture . . . by him or his behalf’ means ‘for use in manufacture’.

The court \textit{a quo} then considered legal precedent regarding the phrase ‘process of manufacture’. The \textit{Safranmark} case when the court held that\textsuperscript{94}

\textsuperscript{92} ITC 1662 (1999) 61 SATC 357 at 361.
\textsuperscript{93} At SATC 75.
\textsuperscript{94} 3 All SA 212 (AD) at 220.
‘[t]he conclusion to be drawn from the above is that not only did each of the ingredients cease to retain its individual qualities but upon completion of the process a different compound substance having a special quality as such... has been produced and moreover produced in quantity for purposes of trade’ was relevant.

The distinction between mining and manufacturing is discussed below.

6.3 Mining versus manufacturing

‘Mining operations’ and ‘mining’ is defined in s 1 of the ITA. The term ‘process of manufacture' is not defined in the ITA. It is therefore the definition of ‘mining operations’ and ‘mining’ that distinguishes a mining process from a process of manufacture.

Both the tax court and the Supreme Court of Appeal had to determine whether Foskor’s activities constituted mining or manufacturing.

Since the term ‘process of manufacture’ is not defined, the tax court had to look at legal precedent on the matter. A leading case on the matter is the Safranmark case and, as stated previously, a different compound substance has to be produced to fall within the meaning of a ‘process of manufacture’.

The court a quo referred to ITC 1455 which gives some direction as to the distinction between mining and manufacturing. This case has been discussed in detail above.
It was held by the court *a quo* that

‘the essence of the aforementioned processes is the extraction or winning of the phosphates, without a different finished product emerging. What is sold to customers is the phosphates originally found in the phosphate-bearing ore, and that no different substance with different qualities has been produced. All that occurs is a process which liberates the mineral particles from the ore and which separates the mineral particles’.

The court *a quo* therefore concluded that

‘[i]n the result it must be held that the phosphates sold by the appellant occurs naturally in the earth and the phosphates is not, and cannot be manufactured, just as gold or diamonds cannot be manufactured, but can only be mined’.

The *Richards Bay Iron & Titanium* case was relied upon by the Commissioner to conclude that the process as applied by Foskor was a manufacturing process. The way in which the court *a quo* dealt with this argument differs substantially from the way that the *Supreme Court of Appeal* dealt with it.

What is of significance is the fact that in the *Richards Bay Iron & Titanium* case the parties did *not* argue whether the process was mining or manufacturing. The court stated the following:

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95 In para [26] at SATC 122.
96 In para [29] at SATC 123.
97 *Fertilizer Decision* article at 300.
98 At SATC 75.
‘The contentions which rested upon the proposition that the stockpiles in question were not “produced” or “manufactured” within the meaning of the definition of trading stock but were “mined” within the meaning of the definition of “mining” in s 1 were not pressed in oral argument by counsel for the appellant. He conceded that, save possibly for the initial dredging operation, he could not argue with any conviction that in carrying out any of the ensuing processes which resulted in the existence of the stockpiles appellants had not “produced” or “manufactured” them “for the purposes of manufacture” within the meaning of the definition of trading stock in s 1.’

(Emphasis added.)

In the Foskor case this was the main argument – namely, that the process was mining and not manufacturing. The court a quo said99

'[a]ccordingly, the Richards-Bay judgment does not assist respondent in regard to the appellant’s argument that the ore was acquired by appellant for the purpose of mining’.

When reference is made as to how the Supreme Court of Appeal dealt with this issue in the Richards Bay Iron & Titanium case, there is not even a slight resemblance to the conclusion reached by the tax court. Based on the decision of the court a quo, it would seem that the Foskor case was distinguishable from the Richards Bay Iron & Titanium case. It is difficult to

99 In para [28] at SATC 123
follow how the Supreme Court of Appeal made the following conclusion on the *Richards Bay Iron & Titanium* case:\(^{100}\)

‘[T]he central issue in that case was whether or not the stockpiles had been manufactured or produced within the meaning of the definition and this court answered it in the affirmative.’

This was not the main issue in the case – the court did not have to answer that question, since it was never argued and it was conceded that the stockpiles were part of a manufacturing process. No explanation is given by the court as to why it differs from the conclusion reached by the tax court.\(^{101}\)

The Supreme Court of Appeal then went on to consider various cases that dealt with the issue of a ‘process of manufacture’. It is important to note that in all these cases when the courts were called upon to interpret the term ‘process of manufacture’, the relevant provision in the ITA excluded its application to entities carrying on mining activities. As a result, the courts have not considered its application to entities involved in mining.

All the cases referred by the Supreme Court of Appeal in the *Foskor* judgment have been dealt with in Chapter 4.\(^{102}\) The factors which the Supreme Court of Appeal considered to arrive at its conclusion that the stockpiles were part of a process of manufacture came from these cases.

These factors include the following:

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\(^{100}\) In para [32] at SATC 183.

\(^{101}\) *Fertilizer Decision* article at 300 & 301.

\(^{102}\) In para [33 – 35] at SATC 183.
The term ‘process of manufacture’ cannot be precisely defined. The facts of each situation will determine if the process is a process of manufacture.

The end product of the process should be essentially different from the various components before it was subjected to the process.

The court then went on to consider the judgment in the *Cape Lime* case. It would appear that the Supreme Court of Appeal saw the judgment from this case as authority for the finding that the crushing of ore is part of a manufacturing process.

The ‘mining’ cases that the Supreme Court of Appeal looked at were the *Richards Bay Iron & Titanium* case and ITC 1455. Based on the judgment delivered in ITC 1455, the court *a quo* came to the conclusion that the process carried on by Foskor was a mining process. The Supreme Court of Appeal was of the opinion that the tax court did not see that case in the proper perspective. Since ITC 1455 was decided on the definition of ‘mining operations’ as defined in the Sales Tax Act, the Supreme Court of Appeal held that ‘mining operations’ were more broadly defined in terms of that Act.

It followed from this broader definition that the treatment of ore beyond its extraction from the earth was included as a mining operation.\(^{104}\)

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\(^{103}\) Act 103 of 1978.

\(^{104}\) In para [42] at SATC 184.
‘In ITC 1455 the distinction between mining operations and manufacturing was important for the ensuing sales tax implications. The extended definition as can be seen from the text of the amendment, set out in the preceding paragraph, clearly covers treatment of ore beyond its extraction from the earth and includes the further treatment of the raw material.’

From this comment it can be concluded that the court considered mining operations ended when the ore was extracted from the soil. Processing beyond the extraction of the ore would then not form part of the mining process.

The court then states the following:105

‘Furthermore, it is true that when a mining house extracts gold ore and then subjects it to processes including refinement one would be hard-pressed not to concede that the mining house in question has mined the gold. So too, when diamonds are extracted from the earth by a diamond mining company and then subjected by it to cutting and other processes one would readily concede that the diamonds it then onwards sells to jewellers and other had been mined by it.’

From this paragraph it would appear that the Supreme Court of Appeal is in agreement with the court a quo that a process of mining may extend further than the mere extraction of the ore from the earth. This interpretation is consistent with the broader interpretation given to the term ‘mining operations’.

105 In para [43] at SATC 184.
The question is now – which should it be the narrow or the broad interpretation? The Supreme Court of Appeal reaches no conclusion on this point in its judgment.

There should be a distinction between the entity winning the mineral from the soil and the entity which produces another product from the mineral that was won from the soil. For example, the entity mining the gold and the manufacturer of gold coins or jewellery.

Another question that is unanswered is whether the introduction of another entity between the excavation process and the process to liberate the mineral will result in the ending of the mining operations and the commencement of a possible manufacturing process. Whether a court of law will confirm this remains to be seen.

This issue may be important in the current mining environment when mining operations are split to accommodate a Black Economic Empowerment (BEE) partner. If this interpretation is followed, it may result in a situation when neither of the companies involved in the transaction are allowed the benefits of mining tax. This would seem to be against the intention of the legislature.

The Supreme Court of Appeal disagrees with the conclusion reached by the tax court with regard to the mining versus manufacturing argument:106

[i]n my view, the submission that the phosphate minerals that occur naturally in the earth are contained in what is sold to fertilizer producers

106 In para [45] at SATC 185.
worldwide and that the end product was therefore not manufactured, is too simplistic. It ignores not only the complexity of the processes to which the ore was subjected but the fact that in the result several minerals are separated and sold independently. It also ignores the fact that before the process referred to the ore is not saleable but that what is produced thereafter has a worldwide market. Put simply, the end products that emerge after the processes referred to above are significantly different from the raw ore.’

Minerals are not contained in neat pockets in the earth allowing the miner to only mine the specific mineral that he is entitled to. It is a common occurrence to mine more than one mineral at a time. A company involved in the platinum industry will mine not only platinum. As part of the mining process palladium, gold, rhodium, osmium, rhenium, iridium and ruthenium may also be won from the soil. In all instances the liberated mineral will be in a different form to the form that it had when it was still in the ore-bearing rock.

The Supreme Court of Appeal goes on to say that the distinction between mining and manufacture as argued by Foskor is ‘unhelpful’. In addition, the court stated the following:

‘[W]e were, however, not referred by Foskor to any provision of the Act or to any other statute which, in the circumstances of this case, would have entitled Foskor to the benefits of a distinct tax regime or which would in

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107 In para 46 at SATC 185.
108 In para [46] at SATC 185.
some other way have afforded it tax relief in the form of an allowance or deduction. More importantly, it does not appear that Foskor, during the lengthy period when it completed tax returns on the basis that the ore stockpiles did not constitute trading stock within the meaning of s 1 of the Act, claimed any particular mining deduction, allowance or other benefit.’

The Commissioner and Foskor agreed that Foskor’s main business activity is that of mining. If the activities carried on by Foskor are not mining, then how can it be that Foskor has been earning mining income and been classified by the Commissioner as a mining taxpayer? Foskor has also been assessed for income tax purposes on this basis. Based on the Supreme Court of Appeal judgment, the same process is therefore regarded as a manufacturing process for trading stock purposes but as a mining process for all other purposes of the ITA.

6.4 The accounting treatment

Australian case law was referred to when it was held that, only\textsuperscript{109}

‘by taking account of stock-in-trade in the conventional way can a correct reflex of the trader’s income for the accounting period be obtained.’

This concept is also referred to in the \textit{Richards Bay Iron & Titanium} case: \textsuperscript{110}

‘If he were permitted to deduct the cost of purchasing that stock from the income generated by his sales, without acknowledging the benefit of the stock acquired, he would be escaping taxation in that year on income which

\textsuperscript{109} FCOT v St Hubert’s Island Pty Ltd (in Liquidation) (1978) 78 ATR 452.

\textsuperscript{110} At SATC 65.
otherwise would have been taxable by the simple expedient of converting it into trading stock of the same value. The process could be repeated every year *ad infinitum*. It is true that there would ultimately have to be a day of reckoning when trading finally ceases, but the fact remains that the taxpayer will have been enabled to avoid liability for tax until that point is reached.

Was this possible tax avoidance a contributing factor to the Supreme Court of Appeal deciding that the stock piles were trading stock for purposes of the ITA? Did the court see the agreement between PMC and Foskor as a possible tax avoidance arrangement?

What tax benefit would either party have gained from the scheme? In applying the Supreme Court of Appeal interpretation to this arrangement it would actually work to the tax detriment of both parties:

- PMC would not qualify for the beneficial mining tax regime since it does not receive income from mining operations (it merely receives a fee for services rendered).
- Foskor should also not qualify for the mining tax regime since it is not carrying on mining operations as defined in s 1 of the ITA.

### 6.5 The result

The sole question that the Supreme Court of Appeal had to answer was whether the phosphate-bearing ore stock piles were part of a process of manufacture.
In arriving at its conclusion the court should have considered the mining tax principles to distinguish the mining and manufacturing processes. It failed to identify when the mining process ends and when the manufacturing process commences.
CHAPTER 7 CONCLUSION

The judgment of the Supreme Court of Appeal in the Foskor case is unlikely to have a significant impact with reference to the trading stock provisions. Following the judgment of the tax court in ITC 1836, the legislature enacted s 15A. Mining stock piles are trading stock resulting in s 22 of the ITA applying to them.

Section 15A provides that

'[f]or the purposes of section 22, trading stock related to mining operations –

(a) Includes anything that is –

(i) won or in any other manner acquired during the course of mining operations by the taxpayer for the purposes of extraction, processing, separation, refining, beneficiation, manufacture, sale or exchange by the taxpayer on the taxpayer's behalf; and

(ii) taken into account as inventory in terms of South African Generally Accepted Accounting Practice; and

(b) must not be valued at an amount less than the amount so taken into account'.

The trading stock provisions as reflected in the ITA are now following accounting practice and the commercial concept of the term.
The concerning part of the judgment is how the Supreme Court of Appeal arrived at its conclusion that the stock piles were trading stock, namely, that it is part of a process of manufacture.\textsuperscript{111}

7.1 Applying the mining tax principles

‘Mining operations’ and ‘mining’ are defined as to

\begin{quote}
‘include any method or process by which any mineral is won from the soil or from any substance or constituent thereof’.
\end{quote}

The processes of crushing, milling and flotation are generally understood mining processes and therefore satisfy the method or process requirement that is laid down by the definition.

Foskor has been granted the right to mine phosphorous minerals. A mineral right is not required to qualify as a mining operation for income tax purposes. Foskorite is a mineral as it is a substance that can be found within the surface of the earth. It possesses a value in use as opposed to merely possessing bulk and weight.\textsuperscript{112}

The part of the definition that is problematic is when the mineral is won.

\begin{itemize}
  \item Can it be said that the mineral was won by PMC when it extracted the phosphate-bearing rock from the earth?
  \item Or is the mineral won when then concentrate phase of the operations are reached?
\end{itemize}

\textsuperscript{111} Fertilizer Decision article at 307.
\textsuperscript{112} Great Western Railway case.
It is submitted that it is this point that the Supreme Court of Appeal should have considered. Instead it found the distinction between mining and manufacturing ‘unhelpful’. Once the mineral is won, the mining operation ends. A subsequent process is an industrial process and will have to satisfy the requirements of a process of manufacture as laid down by the Safranmark case to qualify for the capital allowances granted for assets used in this process.

It would seem that the court a quo was correct in describing the processes by Foskor as

‘the extraction or winning of the phosphates, without a different finished product emerging. What is sold to customers is the phosphates originally found in the phosphate-bearing ore. . . All that occurs is a process which liberates the mineral particles from the ore and which separates the mineral particles.’

The mineral has not been won until Foskor has submitted the ore to the extensive processes of crushing, milling, flotation and separation. Once the concentrate is formed, the mineral is won. Furthermore, the chemical composition of the phosphates did not change as a result of the processes applied to liberate the mineral. The phosphates have the same chemical composition as when it was excavated from the earth. If the chemical composition has changed, this may be an indication of an industrial or

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113 In para [26] at SATC 122.
manufacturing process as the item that is produced is not something that can be found in the earth’s crust.

The last matter to consider whether the process is a mining operation for purposes of the ITA, is the requirement that it must be won from soil or from a substance or constituent of it.

Foskor did not excavate the phosphate-bearing ore from the soil. But the ore that was dumped at Foskor’s premises by PMC is a constituent of the soil. No additional procedures were performed on the ore by PMC.

Foskor’s operations should therefore satisfy the definition criteria as set out in s 1 of the ITA.

Does Foskor generate mining income from this process? For a taxpayer to be earning mining income there must be a causal connection between the physical activity of mining and the income earned.\textsuperscript{114}

It is at this point that the different interpretations of the facts between the court \textit{a quo} and the Supreme Court of Appeal really create a paradox. The parties did not disagree on the fact that the taxpayer’s main business activity was that of mining. They agreed that the

- mining income was derived from the mining of phosphates, and
- non-mining income relates to its secondary business.

\textsuperscript{114} \textit{Western Platinum} case.
Foskor submitted its tax returns with the required mining schedules. Its industry classification by SARS was mining. Foskor was also assessed on this basis.

It follows that SARS was satisfied that Foskor was earning mining income. If the process carried on by Foskor is a manufacturing process, then where it generate its mining income from?

The anomaly gives rise to the question whether the same process may be classified as a mining process for certain provisions of the ITA and as manufacturing for other provisions of the Act? This should not be the situation.

Foskor carried on mining operation as defined in s 1 of the ITA. It earned mining income when it sold the concentrates to its customers who would use it to make fertilizer.

The only matter on appeal was whether the foskorite was used in a process of manufacture. Based on all the relevant mining tax principles, it would seem that the Supreme Court of Appeal should not have found the foskorite to be part of a process of manufacture. If this approach is followed, mining operations will extend only to the excavation process and will end once the rock is severed from the earth. This narrow approach to mining operations cannot be substantiated considering the wide language used to define ‘mining operations’ in the ITA and the general terms used in that definition. Few minerals are taken from the soil that requires no additional procedures
to liberate them from the soil and to separate them from other minerals that occur naturally with them.

The fact that the ore was processed at a place other than the place where the ore was obtained should not be an obstacle to the taxpayer in meeting the criteria of a ‘mining operation’.\textsuperscript{115}

The mining principles that were considered to be ‘unhelpful’ are the same principles that formed the crux of the matter. The case presented the Supreme Court of Appeal with the perfect opportunity to distinguish when mining operations end and when manufacturing commences. Since the Supreme Court of Appeal did not draw the necessary conclusions from the mining tax cases cited, the matter is still not clear.

It is therefore submitted that legislative intervention is required to give a mining taxpayer legal certainty over which processes will qualify as ‘mining operations’ for ITA purposes. This will ensure that the accelerated capital allowances serve the purpose for which they were intended, namely to stimulate investment in the mining industry and to give relief to the taxpayer taking the immense risk of making a substantial capital investment.

\subsection*{7.2 Proposed legislative amendments}

The mining industry is crucial to the South African economy. Even though the GDP contribution by the mining industry has decreased to about 5,8\% in

\textsuperscript{115} Refer to the \textit{Parker} case.
2007 it remains South Africa’s biggest employer, employing 460 000 people and another 400 000 are employed by suppliers to the mining industry.\textsuperscript{116}

If a narrow interpretation is followed in interpreting the term ‘mining operations' and ‘mining’, this can affect direct foreign investment into South Africa. The GDP contribution from gold mining has been decreasing. This decrease has been offset by an increase in the downstream or beneficiated minerals industry. This industry has also been identified by Government as a growth sector.\textsuperscript{117}

The ITA definition of ‘mining operations' and ‘mining’ may not cater for the downstream or beneficiated mineral industry. These related mining operations are important to the South African economy. Some modern day luxuries are attributable to them, for example, stainless steel and metallic paints.

Is it equitable to attribute a special tax regime to only the traditionally perceived mining operations? Certainly this would be against the objective of the legislature in wanting to stimulate investment into the mining industry.

In addition, a beneficiation process undertaken by a local miner is invaluable to South Africa in that it generates additional benefits from the minerals

\textsuperscript{116} www.southafrica.info
\textsuperscript{117} www.mbendi.com
extracted from the soil. Export sales of beneficiated minerals totalled R41,7 billion in 2007.\textsuperscript{118}

It can be argued that Government has provided for the stimulation of investments into projects of a manufacturing nature in the form of the s 12I allowance. The Minister of Trade and Industry may not approve an industrial project when the potential additional investment allowance may in aggregate exceed R20 billion. In the situation of mining companies, the additional allowance could easily exceed the R20 billion limit. This would mean that a mining project would not qualify for the s 12I allowance.

A proposed legislative amendment should take the following factors into account:

- The objective of accelerated capital allowances is to encourage foreign direct investment into South Africa.
- South Africa receives more value for its minerals if further beneficiation is carried out by local mining entities, instead of exporting mineral bearing ore to foreign countries for further beneficiation.
- Entities doing business in South Africa need to accommodate BEE transactions. This may lead to the separation of the mining processes between various legal entities. The fact that the process may be split between various legal entities should not create a position when

\textsuperscript{118} www.dmr.gov.za
accelerated capital allowances are unavailable on the mere fact that the process has been separated between different legal entities.

It is therefore proposed that the word ‘won’ should be defined in s 1 of the ITA. This definition should be in-line with the provisions for mining trading stock as provided for in s 15A.

A mineral is ‘won’ when all the requisite and necessary processes, including, amongst other things, refinement, beneficiation, smelting, separation, have been undertaken to the mineral to render it saleable in an open and general market.

This amendment would provide legal certainty to a mining taxpayer and would help ensure that South Africa obtains direct foreign investment and maximum value for its minerals. This will then contribute to economic growth for its developing economy that may result in job creation.
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