TRADING STOCK DERIVED FROM MINING OPERATIONS – A CRITICAL EVALUATION OF SECTION 15A OF THE INCOME TAX ACT OF SOUTH AFRICA

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ABSTRACT

Prior to 2010, there has never been a section in the Income Tax Act of South Africa(ITA) that provided specifically for the classification and treatment of trading stock for taxpayers conducting mining operations. The lack of a specific provision resulted in increasing difficulties experienced by taxpayers conducting mining operations, in proving to the South African Revenue Services that an item does or does not constitute trading stock for taxation purposes.

In March 2010, section 15A was introduced into the ITA. This section provided for the classification and treatment of trading stock specifically applicable to the mining industry. The main purpose of this article is to critically evaluate the clarity and guidance provided by section 15A on both the classification and consequent treatment of trading stock for taxpayers conducting mining operations.

Section 15A creates a simple and uncomplicated measure to determine the classification for trading stock derived from mining operations, by providing for a similar treatment as has been utilised for accounting. This results that the guidelines and measures that were already available and developed for the classification and measurement of assets for accounting purposes, effectively became applicable and relevant for taxation purposes as well, creating an interdisciplinary (accounting as well as taxation) means for the classification of the subject matter.

The only part of the definition that still needs clarification is the exact meaning of “course of mining” and “mining operations” in order to determine the exact point when something will be considered to be won as part of a mining operation. Formulated differently, when does the process of mining stop and when does the process of manufacturing commence. This was found a crucial point for consideration, as only when this is established, section 15A becomes applicable.

The current definition provided in the ITA of what constitutes mining may prove to be inefficient if viewed in isolation. It is proposed that in addition to this definition provided in section 1 of the ITA the term “won” should be defined in alignment with the latter definition as well as with the newly introduced section 15A of the ITA.

1. Introduction

Prior to 2010, there has never been a section in the Income Tax Act of South Africa (ITA) that provided specifically for the classification and treatment of trading stock for taxpayers conducting mining operations. The general definition provided in section 1 of the ITA, as well as the general section prescribed for the treatment of such defined trading stock applicable on all other industries (provided in section 1 and section *22* of the ITA) were also to be applied by taxpayers conducting mining operations. This lack of a specific provision resulted in increasing difficulties experienced by taxpayers conducting mining operations, in proving to the South African Revenue Services (SARS) that an item does or does not constitute trading stock for taxation purposes. The latter difficulties experienced were highlighted in the *Commissioner of South African Revenue Services v Foskor*, 2010, (375/09) ZASCA 45 (72 SATC 174).

In March 2010, section 15A was introduced into the ITA, a section that provided for the classification and treatment of trading stock specifically applicable to the mining industry. The main purpose of this article is consequently to critically evaluate the clarity and guidance provided by section 15A of the ITA on both the classification and consequent treatment of an asset as trading stock, specifically applicable to taxpayers conducting mining operations.

2. Background

2.1 Taxation of stockpiles (trading stock) of the mining industry prior to the introduction of section 15A

Manuel *(*2009:22), the then Minister of Finance, made the following statement during the 2009/2010 budget proposal:

> *"…*recent court decisions may require legislative intervention to preserve the *status quo*. In the first decision, the Tax Court held that mining stockpiles could not be considered to be trading stock. While this decision will be appealed, it may be necessary to amend the Income Tax Act with immediate effect to prevent other taxpayers engaged in mining from taking this position while the appeal is under way."

The above reference to "recent case law" specifically referred to the case appealed by SARS in *CSARS v Foskor.*

The "legislative intervention" referred to above materialised in the form of a new section 15A by the Taxation Laws Amendment Act 17 of 2009 (hereafter referred to as the Taxation Laws Amendment Act) introduced into the ITA, a section that provided for a definition of trading stock specifically applicable to the mining industry. The addition to the ITA was a proactive change from the side of the legislator (as the *CSARS v Foskor* decision had not yet been reached*),* in order to avoid similar problems repeating themselves as was experienced in latter case.

Before the introduction of section 15A, the general definition of trading stock in section 1 of the ITA was applied to all industries, including taxpayers conducting mining operations. In the latter definition "**trading stock**" includes –

> *(a)* anything –
>
> (i) produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by him or on his behalf, or
>
> (ii) the proceeds from the disposal of which forms or will form part of his gross income, otherwise than in terms of paragraph (*j*) or (*m*) of the definition of 'gross income', or a recovery or recoupment contemplated in section 8(4) which is included in gross income in terms of paragraph (*n*) of that definition; or
>
> *(b)* 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 24I (1); (section 1 of the ITA).

This definition of trading stock contains subparagraphs (*a*) and (*b*), with paragraph *(a)* in turn containing paragraphs *(i)* and *(ii)*, effectively resulting in a generally accepted and established three-part division of the definition (Faber 2008:28). These three parts of the definition were analysed below.

2.2 The general definition of trading stock (section 1)

2.2.1 Part 1 of the general definition of trading stock

The first part of the definition of trading stock, as mentioned above, provides that:

> "…anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by him or on his behalf (section 1 of ITA)".

The first part of the definition focuses on ways in which the subject matter has been acquired as well as the intention behind the acquisition of the subject matter (*CIR v Richards Bay Iron and Titanium (Pty) Ltd,* (1996:324 I-J)).The following summary was used to provide clarity on the construction of part 1 of the definition of trading stock:

Table 1: Grammatical and functional analyses of definition of trading stock section 1 of the ITA

Object subject to acquisition	**Method of acquisition**	**Intention of acquisition**
Anything	Produced, manufactured, constructed, assembled	Manufacture or sale or exchange
Anything	Purchased	Manufacture or sale or exchange
Anything	Or in any manner acquired	Manufacture or sale or exchange

The different identified methods of acquisition as well as the possible intentions of the taxpayer that existed during acquisition are briefly analysed below.

Methods of acquisition

For purpose of this paper, a pure grammatical analysis of the words contained in the definition was performed.

“Produced” is defined as “to make things to be sold, especially in large quantities” (Oxford Advanced Learners Online Dictionary: Not dated).

“Manufactured” or “process of manufacturing” was approved in *SIR v Safranmark(Pty)Ltd***,** 1982(1) SA 113(A) (43 SATC235)(1982: 238) to include and accepted for purpose of this study as:

> “...an action or series of actions directed to the production of an object or thing which is different from the materials or components which went into its making appears to have been generally accepted. The emphasis has been laid on the difference between the original material and the finished product.”

“Constructed” is defined as “to form something by putting different things together” (Oxford Advanced Learners online dictionary: Not dated).

“Assembled” is defined as “to fit together all the separate parts of something” (Oxford Advanced Learners online dictionary: Not dated).

“Purchased” is defined as “the act or process of buying something”
(Oxford Advanced Learners online dictionary: Not dated).

The phrase “or in any other manner acquired”, read together with the aforementioned verbs, interpreted on a grammatical basis, creates a very wide ambit of the method of acquisition of the subject matter if a subject matter is tested against the definition of trading stock.

The legislator prevails, grammatically spoken, with a wide ambit resulting in a rather difficult exclusion from the definition as a result of the method of acquisition of the subject matter.

Intention for acquisition

Part one of the definition of trading stock provides for the intention of the taxpayer acquiring the asset to be for the intention to either manufacture, sell or exchange the subject matter.

If something is acquired with the intention to sell or to exchange, it would imply the subject matter to have an independent existence and value as a saleable article, product or commodity (*CIR v Richards Bay Iron*). These two terms naturally differ from such cases where something acquired for purposes of manufacture that imply a change in form and in all likelihood include a conversion into, or form part of, something other than the state in which it was acquired. It would therefore, if acquired for purposes of manufacture, not (yet) be in a saleable form and the attribute of saleable or not saleable would, in any case, be deemed irrelevant. On the other hand, if the item was acquired for purposes of sale or exchange, it should be in a saleable or exchangeable form.

The first part of the definition, if a pure grammatical interpretation is applied, entails something of “inclusiveness”. Therefore, for the first part of the definition, both the intention of the taxpayer for the acquisition of the subject matter, as well as the method of acquisition, need to be considered in the determination of whether an item would constitute trading stock or not.

2.1.2 Part 2 of the general definition of trading stock

The second part of the definition of trading stock states that:

> "...the proceeds from the disposal of which forms or will form part of his gross income, otherwise than in terms of paragraph (*j*) or (*m*) of the definition of 'gross income', or a recovery or recoupment contemplated in section 8(4) which is included in gross income in terms of paragraph (*n*) of that definition."

This part of the definition, read together with the "or" of the first part of the definition, clearly provides for the situation where the first part of the definition is not met, the item will still be considered trading stock on the premise where the subject matter is sold and the income derived from the sales transaction is included in the taxpayer's gross income (except for the sections paragraph (*j*) or (*m*) or (*n*) specifically provided for to be excluded). The latter sections were specifically excluded for purposes of this article. *CIR v Richards Bay* confirmed that the second part of the definition only has the objective requirement that the proceeds from the sale of the subject matter must be included in gross income (CIR v *Richards Bay*:72), for the subject matter to meet the requirement of the second part of the definition of trading stock.

Part two of the definition therefore postulates an objective question that is not dependant on the intention or the possibility to sell the subject matter in future. The only relevant factor for consideration as per this part of the definition is whether the subject matter has been disposed of or not. Once the item is disposed of, the only additional requirement is that the subject matter sold must be revenue in nature (a requirement of inclusion the definition of gross income per section 1 of the ITA). Should the subject matter constitute an asset of a capital nature, the proceeds will not constitute gross income and thus fall outside the ambit of the second part of the definition.

2.1.3 Part 3 of the general definition of trading stock

The third part of the definition provides for any consumable and spare parts acquired by the taxpayer to be used in the course of his trade. This part is excluded from the scope of the research and therefore does not form part of this analysis.

If the subject matter acquired by the taxpayer meets the definition of trading stock as per section 1 of the ITA, the subsequent treatment of the asset for taxation purposes is in terms of section 22 of the ITA.

2.2 The valuation of trading stock (Section 22)

The general framework of the ITA, within which the sections of the ITA (including section 22) function were described by the courts in *CSARS v Foskor* (own emphasis):

> "…the South African system of taxation of income entails determining what the taxpayer's gross income was, subtracting from it any income which is exempt from tax, subtracting from the resultant income any deductions allowed by the Act, and thereby arriving at the taxable income. It is on the latter income that tax is levied."(*CSARS v Foskor:*18).

The general effect on the deduction of expense where trading stock is acquired by the taxpayer and the consequent inclusion of the amount received as a result of the selling of this trading stock or the effect where trading stock acquired during the year and was still unsold on year end are described in *CSARS v Foskor* (2010:18):

> "…where a taxpayer is carrying on a trade, any expenditure incurred by him in the acquisition of trading stock is deductible in terms of section 11 *(a)* of the Act because it is expenditure incurred in the production of income and it is not of a capital nature. Income generated by the sale of such stock is of course part of the trader's gross income. Where in his first year of trading a trader has bought, and thereafter sold, all the stock which he acquired during that year, no problem arises. There will be a perfect correlation between the trading income earned and the expenditure incurred in that particular year in purchasing and selling the stocks sold, and the difference between the two sums will give a true picture of the result of the year's trading. There will be no stock on hand at the close of the year of which account need be taken" (own emphasis).

Section 22 of the ITA therefore provides for the situation where trading stock has been acquired during the year of assessment, and a deduction has been allowed in terms of section 11*(a)* of the ITA, but where the trading stock was unsold at year end. Section 22 creates provisions for the inclusion of this closing stock on year end in order effectively only to allow the original deduction permitted in terms of section 11(*a*) to the extent that the stock has actually been sold and accounted for as part of gross income in the year of assessment. Section 22 of the ITA therefore provides for the treatment where expenses are incurred and allowed as a deduction in the current year of assessment but the gross income due to a selling transaction is only received and accounted for in gross income in subsequent years, or the situation where stock in trade is used as a manipulation to artificially increase the deduction of an expense incurred just before year end.

It is therefore important to determine firstly if a subject matter meets the definition of trading stock as per section 1 of the ITA. Only when the subject matter is considered trading stock will the section 22 of the ITA be applicable. In cases where the expenditure incurred does not meet the general definition of trading stock, the deduction will simply be allowed as a section 11(*a*) general deduction in the year incurred. No additional adjustments as prescribed in section 22 of the ITA will be required at the end of the tax year or in the subsequent year of assessment.

Subsequently, government found it necessary to introduce a new definition to be applied in respect of trading stock derived from mining operations. The introduction of section 15A in the ITA resulted from the difficulties experienced with the classification of stockpiles held by the taxpayer in *CSARS v Foskor*.

2.3 CSARS v Foskor

The next section will analyse this court case and present related comments.

2.3.1 The facts

The dispute arose as a result of the inclusion of an amount of R203million in Foskor's taxable income in respect of the year of assessment ended 30 June 1999. The Commissioner contended that the amount represented closing stock in terms of section 22 read with section 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 (ITC 1836). The Tax Court (in ITC 1836) found in favour of Foskor and the matter was then taken on appeal by the Commissioner to the Special Court of Appeal (SCA) in *CSARS v Foskor.*

Foskor acquired the rights to mine base minerals, including phosphates, belonging to the State during 1952. Phalaborwa Mining Company (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 agreement. 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 and dumped by PMC for Foskor to recover the phosphates. The extensive procedures applied by Foskor resulted in the liberation of the mineral, apatite, from the ore. The Court *a quo* described the process as follows:

> ‘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*(ITC 1836: 119)’.*

The Commissioner and Foskor agreed to the facts of the case. Despite this agreement however; there were a discrepancy between the Court *a quo* and the SCA with regard to the nature of Foskor’s activities.

2.3.2 Nature of Foskor's activities

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 (own emphasis):

> 'Approximately 183 million metric tonnes of ore consisting of phosphate-bearing rock were allocated and dumped by PMC for further **mining** by the appellant.'
> 'Appellant **mines** the phosphates and other minerals from the ore…(*ITC 1836:118*)'.

The SCA refers to processing when it describes the same operations (own emphasis)

> 'Between the 1979 and 1998 tax years approximately 183 million metric tons of foskorite 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**… (*CSARS v Foskor:178*)'.

From the language used by the SCA it is apparent that the process was not considered to be a mining process.

2.3.3 Mining versus manufacturing

'Mining operations' and 'mining' is defined in section 1 of the ITA. The term 'process of manufacture' is not defined in the Act. 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 SCA 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.

The Court *a quo* referred to *ITC 1455* which gives some direction as to the distinction between mining and manufacturing. It was held by the Court *a quo* in paragraph [26] 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' *(ITC 1836:122).*

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'. *(ITC 1836:122).*

It is important to note that both the Court *a quo* as well as the SCA incorporated a reference to *Richards Bay Iron & Titanium*. The way, however, in which the Court *a quo* dealt with its arguments (based on the latter case), differs substantially from the way that the SCA dealt with it.

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

> '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 section 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 section 1(*Richards Bay Iron & Titanium*: 75)'.

In *CSARS v Foskor* this classification between mining and manufacturing was the main argument, namely that the process carried out was that of mining and not manufacturing. The Court *a quo* in the Foskor case correctly noted:

> ‘[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’. (*ITC 1836: 123)*

The SCA, on the other hand, in its reference to *Richards Bay Iron & Titanium* surprisingly concluded the following

> ‘[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’(*CSARS v Foskor: 183)*

No explanation is given by the SCA as to why it differs so drastically from the conclusion reached by the Tax Court.

The only ‘mining’ cases that the SCA considered were *Richards Bay Iron & Titanium* and ITC 1455. Based on the judgment delivered in ITC 1455, the Court *a quo* in IYC 1836 came to the conclusion that the process carried on by Foskor was a mining process. The SCA, on the other hand was of the opinion in CSARS v Foskor that the Court *a quo* did not see that case in the proper perspective. The SCA was of the view that mining operations ends when the ore was extracted from the soil. Any processing beyond the extraction of the ore would not form part of the mining process.

The SCA therefore disagrees with the conclusion reached by the Tax Court with regards to when the mining process ends and the manufacturing process starts, as was illustrated by the following (own emphasis):

> ‘[i]n my view, that **the submission the phosphate minerals** that occur naturally in the earth are contained in what is sold to fertilizer producers 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 (*CSARS v Foskor:185*)'.

2.3.4 Comments relating to *CSARS v Foskor*

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

The only legal question that the SCA had to answer was whether or not the phosphate-bearing ore stock piles were part of a process of manufacture and therefore included in trading stock. In arriving at its conclusion the Court should have considered the mining tax principles to distinguish the mining and manufacturing processes. The Court failed to decide the case on the core matter, namely where the mining process ends and where the manufacturing process commences.

Once the mineral is won, the mining operation ends. Any subsequent process is an industrial process and will have to satisfy the requirements of a process of manufacture as laid down by *SIR vs Safranmark* to qualify for the capital allowances granted with respect to assets used in such a process. The Court *a quo* described 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'.(*ITC 1836: 112*).

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 manufacturing process as the item that is produced is not something that can be found in the earth's crust.

As illustrated above, the difference in interpretation of the facts between the Court *a quo* and the SCA clearly create a paradox. The only matter on appeal was whether or not the foskorite was used in a process of manufacture, and based on all the relevant mining tax principles, the SCA found the foskorite to be part of a process of manufacture. If this approach, however, is to be followed, mining operations will only extend to the excavation process and will end once the rock is severed from the earth. This is however a very narrow approach to what would constitute mining operations. Very little minerals are taken from the soil and require no additional procedures to liberate the mineral from the soil and to separate it from other minerals that occur naturally with the particular mineral being mined.

3. Critical analysis of the new legislation applicable in respect of trading stock derived from mining operations (section 15A)

The problems experienced by the Commissioner in the decided case of *CSARS v Foskor* served as the catalyst for the introduction of section 15A into the ITA. This section provides for a definition of trading stock, specifically applicable on the mining industry of South Africa. The reason for the introduction of the definition was clear from clause 30 of the Explanatory Memorandum of the Taxation Laws Amendment Bill of 2009 that stated the:

> "…insertion of section 15A: A recent Tax Court judgment regarding the recognition of mining stockpiles as trading stock has given rise to the concern that taxpayers may attempt to exclude mining stockpiles from trading stock for tax purposes while an appeal against the judgment is underway. The proposed amendment is aimed at ensuring that such mining stockpiles continue to be reflected as trading stock in terms of section 22 of the ITA at a value that is not less than that used for accounting purposes. This accounting treatment of mining stockpiles is intended to maintain the *status quo* based on information supplied by the mining industry (Clause 30, Explanatory memorandum Taxation Laws Amendment Act)'.

Section 15A was introduced into the ITA with the Taxation Laws Amendment Act and is formulated as follows (own emphasis):

> ‘‘[a]mounts to be taken into account in respect of trading stock derived from mining operations
>
> 15A**.** For the purposes of section 22, trading stock related to mining operations—
>
> *(a)* includes anything that is—
>
> (i) <u>won</u> or in <u>any other manner acquired</u> during the <u>course of mining</u> operations by a taxpayer for the purposes of <u>extraction, processing, separation, refining, beneficiation, manufacture, sale or exchange</u> by the taxpayer or on the taxpayer's behalf; <u>and</u>
>
> (ii) <u>taken into account</u> as inventory in terms of South African Generally Accepted Accounting Practice; <u>and</u>
>
> *(b)* must not be valued at an amount less than the amount so taken into account.’’.

The definition, for purposes of this study, was divided into two parts, (a) and (b). Part (a) was further subdivided into (i) and (ii).

The critical words and phrases included in the section 15A definition are the following:

- “won“ was included as a “method of acquisition”,
- “course of mining” was specifically added to the definition,
- “extraction, processing, separation, refining, beneficiation” were all included intentions of acquisition of the subject matter by the taxpayer, in addition to the intentions identified for the section 1 definition discussed above; and
- the provision for the accounting treatment of the subject matter that needs to be determined and applied once the criteria of the first part of the definition is met.

The concepts that were duplicated in the section 15A definition were already discussed under the section 1 definition, and were therefore not repeated.

3.1 Grammatical analyses of section 15A of the ITA: Part 1

“won or in any other manner acquired” (ita, section15A (*a)(i*))

Section 15A (*a) (i)* provides for the methods of acquisition for purposes of the section to be “won or in any other way acquired”. The Collins Concise Dictionary defines ‘win’ as

> ‘to extract (ore, coal, etc.) from a mine or (metal or other minerals) from ore’.

The phrase “in other manner acquired” read together with the word “won” concerning the methods of acquisition for purposes of this definition expresses the notion of “all-inclusiveness” by the legislator, not excluding anything as a result of “method of acquisition” therefore, acquisition of the subject matter by any possible method would be accepted for purpose of defining the subject matter for this part of the definition.

“in the course of mining” (ITA, section 15A(*a)(i))*

Section 15A (a)(i) of the ITA makes specific provision for the phrase “in the course of mining”. This implies that where the subject matter is acquired by any means other than “in the course of mining”, the definition of section 15A will not be applicable to the subject matter. This phrase therefore limits the initial expectation of a wide scope that was introduced in the first part of the definition, as described in the previous paragraph.

As was illustrated in the difficulties experienced in *CSARS v Foskor* as well as the discrepancies between the views held by the court a quo and the SCA, it was clear that the Foskor case did not address the problem to distinguish between a “mining” and a “manufacturing” process. The distinction between these two processes is considered crucial in order to provide a clear and definite “point of access” to the provisions of the newly inserted section 15A. It is submitted that without a clear differentiation as to when mining ends and when manufacturing starts, the objective of the legislator with the introduction of section 15A, being to provide clarity in guidance for taxpayers in the mining industry, cannot be considered achieved since this crucial element that needed clarification was not addressed.

This section refers to anything that is "won or in any other way acquired" provided that it is in the "course of mining", in other words, the taxpayer must conduct mining operations in order for section 15A to be applicable.

The distinction between the mining and manufacturing processes is therefore of great significance. The nature of these processes makes the distinction problematic. In most instances the mining and manufacturing processes are part of one continuous process. In addition to the comments raised in the discussion above of the Foskor case on the differences between a mining a manufacturing process, the following factors may influence the discernment between the mining and manufacturing processes.

Process (course) of manufacture

As a "process of manufacture" or "manufacturing" is not defined in the ITA. Guidance in the courts on what a process of manufacturing would constitute was found in the decided case of *SIR v Safranmark (Pty) Ltd* (1982: 122 G-H) namely a:

> "…[p]rocess of manufacture is an action or series of actions directed to the production of an object or thing which is different from the materials or components which went into its making [which] appears to have been gradually accepted. The emphasis has been laid on the difference between the original material and the finished product(*own emphasis*)".

From this description of what manufacturing would entail, there is clearly a process (action or series of actions) where the original material used in the process differs from the finished product. The moment this can be verified as true, we are dealing with a manufacturing process and section 15A will no longer be applicable.

For example, in a case where gold particles are mined from the earth, the extraction of the particles from the earth itself does not constitute the creation of a new subject matter – the item originally won in the process was gold, and remained gold as it was only isolated from the earth. Generally speaking, section 15A will be applicable to the classification of the gold in this stage of the process. The moment, however, the extracted gold is processed further to manufacture gold earrings, the earrings (finished product) is substantially different from the original gold extracted from the earth. A process of manufacturing has occurred, the section 15A definition is no longer applicable and one must revert to the section 1 definition and application in terms of section 22 provided in the ITA.

Process (course) of mining

Mining and mining operations are defined in section 1 of the ITA as "…<u>every method or process</u> by which any mineral is <u>won</u> from the soil or from any substance or constituent thereof (own emphasis)".

An excellent formulation of the essence of the process of mining is contained in *ITC 1455 (*1989: 19-20)**.** In the latter case the court described the process of mining in the following way:

> "…it is tempting to compare appellant's operation to the production of gold bullion in a gold mine. The gold ore exists in discreet 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."

In the abovementioned example, the gold already existed in the earth, and were merely isolated from the earth, which is considered a mining process, thereby falling under the ambit of section 15A.

Domestic precedent on the differentiation between mining and manufacturing

The case of *ITC 1455* has been referred to in numerous cases where the distinction between mining and manufacturing had to be made, for example in *CSARS v Foskor* as well as in *Richards Bay Iron & Titanium*. It is therefore considered to be of valuable guidance with reference to establish the point where the mining process ends and the manufacturing process commences. In *ITC 1455* the main business objective of the company was the manufacture of steel and vanadium products. The appellant 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 appellant admitted to conducting both a manufacturing and a mining enterprise. The Court was therefore required to decide where the mining operations ended and where the manufacturing process commenced. The appellant argued that its mining operations ended at site B. In terms of the ordinary meaning of 'mining operations' the Court was therefore satisfied that the operations of the appellant ended at site B.

Summary on the distinction between mining and manufacturing

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 the definition contained in the ITA is wider than the ordinary meaning of the concept. Based on local precedent, the following factors may have an impact on where the mining process ends and where the manufacturing process commences:

- whether any part of the taxpayers process is a distinct and separate operation (*Rand Refinery Ltd v Town Council of Germiston*);
- whether the entire process is carried on by the same taxpayer (*Zaaiplaats Tin Mining Co., Ltd v Union Government*);
- whether the end product of the process occur naturally in the earth or whether it exists in another form (ITC 1455); and
- whether the end product a result of an industrial process (ITC 1455).

It can therefore be concluded that he 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. A number of factors exist that will influence the cut off point between mining and manufacturing. Each case, however, 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. Any procedures that are performed after the mineral has been won or that is embarked on for the better utilisation of the mineral would not qualify as a mining process, but may qualify as a process of manufacture.

The purposes (intention) of extraction, processing, separation, refining, beneficiation

For the purpose of this document the grammatical meaning of the words was considered sufficiently clear and no further analysis on the words was included. The following table provides a summary of the respective grammatical meanings of the inserted intentions of holding the asset by the taxpayer. The definitions were obtained from the Merriam Webster Online Dictionary.

Table 2 Definitions of intentions included in the section 15A of the ITA

Verb/Intention	**Definition**
Processing	"…to subject to a special process or treatment"(Merriam Webster online: Not Dated).
Separation	"…to isolate from a mixture"(Merriam Webster online: Not Dated).
Refining	"…free (as metal, sugar, or oil) from impurities or unwanted material"(Merriam Webster online: Not Dated).
Beneficiation:	"…treatment of raw material (as iron ore) to improve physical or chemical properties especially in preparation for smelting" (Merriam Webster online: Not Dated).

Based on the abovementioned grammatical definitions, the legislator clearly had a wide scope, including a very wide ambit of intentions appertaining to the categories of taxpayer that will quality under this part of the definition.

This next paragraph of the document deals with section 15A *(a)(ii).* It is important, to note the conjunction "and" which implies that the first part of the definition (section 15A(i)) needs to be read together with section 15A(*a*)(ii). All the requirements and specifications stipulated discussed in the previous paragraphs therefore need to be met, in addition to the criteria stipulated in section 15A (*a*)(ii), that is described below.

Section 15A part 2: Relevance of accounting practise

The second part of the definition as per section 15A of the ITA provides for the accounting treatment of the subject matter to drive and determine the classification and treatment for taxation purposes.

Financial accounting of trading stock in the mining industry and classification between current assets as oppose to non current assets.

The International Accounting Standards 1 (IAS1) statement issued by International Financial Reporting Standards, which is the statement that deals with the Presentation of Financial Statements, provides guidelines to be considered when an asset is to be classified as a current asset. In terms of IAS1, the asset will be classified as a current asset if it:

- is expected to be realised, or intended to be sold or to be consumed, in its normal operating cycle;
- is held primarily for the purpose of trading;
- is expected to be realised within twelve months after the reporting period; or
- is cash or a cash equivalent (as defined in IAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

Any assets not meeting these criteria should be classified as non-current assets.

Stockpiles as inventory (current assets)

IAS 2 classifies inventory as assets either:

- held for sale in the ordinary course of business;
- in the process of production for such sale; or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services.

As mentioned, section 15A prescribes that the accounting treatment of the subject matter provides the guidance for the classification and treatment for taxation purposes. Therefore, based on the assumption that these stockpiles do in fact meet the criteria of section15A(*a*)(*i*), section 15A(*a*)(*ii*) merely prescribes that whatever the treatment and classification for accounting purposes is, will be followed for purposes of the tax treatment.

Section 15A*(a)(ii)* therefore creates a simple and uncomplicated measure to determine the classification for these trading stock, by providing for a similar treatment as has been utilised for accounting. Effectively this results in a situation where the guidelines and measures that were already available and developed for the classification and measurement of assets for accounting purposes, effectively became applicable and relevant for taxation purposes as well, creating an interdisciplinary (accounting as well as taxation) means for the classification of the subject matter. The formulation of section 15A(*a*)(*ii*), provides for valuable guidance on the classification of what would constitute trading stock for the mining industry. The reference to the accounting treatment widens the application of the specific section without creating difficulty where the tax treatment of assets differs from the accounting treatment. The formulation of section 15A*(a)(ii)* therefore effectively opens this door from a taxation point of view, to access all the established guidelines already existing from an accounting point of view.

4. Conclusion

The problems experienced by the Commissioner with the classification of what constitutes trading stock in the mining in *CSARS v Foskor* were one of the main catalysts that resulted in the introduction of section 15A into the ITA. In general, if lack of classification and clarification of what would constitute a “course of mining” is ignored, the grammatically provisions of section15A*(a)(i)* is concluded to be formulated very clear and broad from the perspective of the taxpayer. Section 15(A) (*a*) (*ii*) follows that whatever treatment used by the taxpayer for the classification of the subject matter for accounting purposes should be followed for purposes of the classification of taxation. The formulation of this part of the definition effectively provides for the provisions, frameworks and guidelines applicable to financial accounting and valuation as well as disclosure for financial purposes, effectively being applicable (as well as available) also for taxation purposes.

The only part that still remains unclear and is in need of further clarification is when something will be won “from mining operations”. If formulated differently, when does the process of mining stop and when does the process of manufacturing commence.

Neither the decision reached in *CSARS v Foskor*, nor the newly inserted section 15A provides for clarity on exactly when a mineral is “won” for the purpose of conduction a “mining operation”, therefore ignoring the very core element that will provide access to the newly inserted section 15A of the ITA.

The current ITA definition of what constitutes mining may prove to be inefficient if viewed in isolation. It is proposed that in addition to the definition provided in section 1 of the ITA of what constitutes mining, that the term ‘won’ should be defined in section 1 of the ITA, in-line with the definition of mining trading stock as defined in section 15A:

> A mineral is said to be won when all the requisite and necessary processes, including *inter alia* refinement, beneficiation, smelting, separation etc, have been undertaken to the mineral to render that mineral saleable in an open and general market (generally saleable).

This proposed amendment might provide the intended clarity and certainty to taxpayers conducting mining operations and will lead to certainty as to when section 15A of the ITA should be applied.

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