

# Where does mining stop and manufacturing commence? A critical analysis of section 15A of the Income Tax Act

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## OPSOMMING

### Waar eindig mynbou en waar begin vervaardiging? 'n Kritiese ontleding van artikel 15A van die Inkomstebelastingwet

Die doel van die artikel was om die resultate van 'n kritiese ontleding gedoen op die duidelikheid sowel as waarde toegevoeg vir belastingpligtiges in die mynbedryf, met die toevoeging van artikel 15A tot die Inkomstebelastingwet, weer te gee. 'n Literatuurstudie is gedoen wat die verskille tussen wat "’n proses van myn" teenoor "’n proses van vervaardig" sou behels, ondersoek het. Die artikel lig voorts die feit uit dat in werklikheid die myn van 'n mineraal en die daaropvolgende vervaardiging van die mineraal in iets nuuts heel dikwels as deel van 'n aaneenlopende proses plaasvind, wat dikwels moeilik onderskeidbaar is van mekaar (soos prominent uitgewys is in die saak van *CSARS v Foskor* [2010] 3 All SA 594 (SCA)). Die literatuurstudie het gefokus op die relevante artikels van die Inkomstebelastingwet, sowel as relevante regspraak, met die hoofokus op *CSARS v Foskor*. Daar is gevind dat, ten spyte van die toevoeging van artikel 15A tot die Inkomstebelastingwet, ('n artikel wat pertinent toegevoeg is tot die wet as 'n direkte gevolg van die probleme deur die Suid-Afrikaanse Inkomstediens in *CSARS v Foskor* ondervind), is die onderskeid tussen die begrippe "proses van myn" teenoor "proses van vervaardig" steeds onduidelik. Presies wanneer iets "gewin" word as deel van 'n mynproses is steeds onduidelik. Die artikel stel voor dat die term "gewin", wat tans slegs deel vorm van die omskrywing van "mynbou" in artikel 1 van die Inkomstebelastingwet, apart omskryf moet word in artikel 1 van die Inkomstebelastingwet. Hierdie artikel dui dat 'n die toevoeging van 'n omskrywing vir "gewin" 'n wesenlike bydrae sal lewer tot die waarde wat artikel 15A werklik toevoeg, aangesien artikel 15A net van toepassing is op belastingpligtiges wat mynboubedrywighede beoefen. Anders gestel, slegs waar 'n belastingpligtige seker is dat in werklikheid "mynbou" beoefen word, is die toepassing en riglyne verskaf in artikel 15A van die Inkomstebelastingwet, soos deur die wetgewer beoog is, van toepassing op die belastingpligtige. Wanneer dit dus makliker is om te bepaal of die belastingpligtige in werklikheid "mynbou" beoefen, deur "gewin" vir 'n mynbouproses apart te omskryf, sal dit duideliker wees om te bepaal of artikel 15A van die Inkomstebelastingwet op die belastingpligtige van toepassing is.

## 1 Introduction

The mining industry constitutes a large part of the South African economy, with mining contributing 32 percent of all exports.<sup>1</sup> Mining is therefore a significant industry in South Africa, and any change in fiscal legislation that imposes a change on the calculation of tax in the industry naturally must be carefully analysed.

Trevor Manuel, the former Minister of Finance, made the following statement:

... 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.<sup>2</sup>

The above reference to “recent case law” specifically referred to the case of *Commissioner of South African Revenue Services v Foskor*.<sup>3</sup> The “legislative intervention” referred to above materialised in the form of a new section 15A that was introduced into the Income Tax Act<sup>4</sup> (ITA), a section that provides a definition of trading stock specifically applicable to the mining industry. This addition to the ITA was a proactive change from the side of the legislator in order to avoid taxpayers in future experiencing similar problems in distinguishing between a process of mining as opposed to a process of manufacturing, as was experienced in *CSARS v Foskor*.<sup>5</sup>

A mining process, at its very core, is unique and different from, for example, a manufacturing process. Mining differs from manufacturing, as the essence of mining constitutes the removal of a naturally occurring mineral from the soil or ore, and not the manufacturing of a new mineral. It is therefore to be expected that the nature of what would constitute trading stock for a mining industry, as opposed to trading stock for a manufacturing industry, is expected to be different.

In March 2010, section 15A was introduced into the ITA, a section that provides guidance for the classification and treatment of trading stock specifically applicable to the mining industry. Before section 15A was introduced, there was no specific provision that provided for the classification and treatment of trading stock applicable to the mining industry specifically. Rather, the general definition provided in section 1

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1 Department of Minerals and Energy (2007) 5.

2 Manual *2009 Budget Speech 2009/2*. Available at <http://www.sars.gov.za/?sa's tax system/?budget 2009/2010/budget tax proposals> (accessed 2009-04-07).

3 *Commissioner of South African Revenue Services v Foskor* [2010] 3 All SA 594 (SCA).

4 58 of 1962.

5 *Op cit*.

of the ITA, as well as the general section prescribed for the treatment of trading stock for purposes of taxation (in section 22 of the ITA) was applicable to all industries, including mining and manufacturing. Section 1 of the ITA defines trading stock, and then the defined stock is accounted for in terms of section 22 of the ITA for the valuation purposes of taxation (section 22 stipulates the adjustments required for purposes of calculating income tax on year end as well as for the subsequent year of assessment.)

The lack of a specific definition and guidance as to what should be defined as trading stock for the mining industry was highlighted in *CSARS v Foskor*.<sup>6</sup> This case served as a catalyst for the introduction of section 15A into the ITA.

A pure grammatical and literate analysis of section 15A was found to provide for simple and uncomplicated guidance from the side of the legislator to determine what would constitute trading stock of mining operations. The newly inserted section further aligned the treatment and accounting of such stock for purposes of taxation with the very well-established guidelines that already existed for accounting of trading stock in the mining industry. Stated differently, where the subject matter therefore meets the definition of trading stock that forms part of a “mining operation” as stipulated in the new section 15A, the subject matter is then accounted for in terms of the prescribed accounting guidelines established in the General Accepted Accounting Standards (GAAP) and not only in terms of section 22 of the ITA as for non-mining industries. It therefore became crucial to determine whether the subject matter is part of a process of mining, in which case the inserted section 15A of the ITA becomes applicable, as opposed to a “course of manufacturing”, in which case, section 1 and section 22 of the ITA remain applicable.

The section 15A definition however, was found not to provide clarity on the exact meaning of when a taxpayer is in fact conducting mining operations. It does not clarify the difference between “course of mining” as opposed to “course of manufacturing”. This was found a crucial point for consideration, as well as – in the author’s view – an omission from the side of legislator, as section 15A becomes applicable only when a “process of mining” is established.

The research on which this article is based, attempted to critically evaluate the clarity and guidance provided to taxpayers in the mining industry with the distinction between mining and manufacturing in the context of section 15A of the ITA. To achieve this purpose, a literature review was conducted. This article firstly aims to provide broad guidance on the existing concepts of what constitutes a “process of mining” as opposed to a “process of manufacturing”. This is followed by an overview of the position of taxpayers in mining industry that relates to the

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6 *Op cit.*

classification and consequent treatment of trading stock, prior to 2010, when section 15A was introduced. This is followed by a critical analysis of the inserted section 15A into the ITA, with the focus of determining whether guidance was provided to distinguish between a “process of mining” as opposed to a “process of manufacturing”. The article closes with conclusions and recommendations.

## 2 Difference Between a Process of Mining and a Process of Manufacturing

### 2.1 Background

One of the main questions that needed to be addressed by the courts in *CSARS v Foskor*,<sup>7</sup> was whether the taxpayer was involved in a “process of mining” or in a “process of manufacturing”. The distinction between the mining and manufacturing processes was therefore important, but not easy. It is a common practice to mine more than one mineral at a time as minerals are not contained in neat pockets in the earth that allows the miner to mine only the specific mineral that it wants. A company involved in the platinum industry will, for example, not only mine platinum, but as part of the mining process, palladium, gold, rhodium, osmium, rhenium, iridium and ruthenium may also be extracted from the soil. In all instances, the liberated mineral will be in a very different form from that which it had when it was still in the ore-bearing rock and the processes involved in an attempt to isolate the existing mineral into its purest form can very easily be incorrectly viewed as a process of manufacturing. The nature and complexity of these processes make the distinction between mining and manufacturing problematic. In addition to this, the mining and manufacturing processes are often part of one continuous process.

“Mining operations” and “mining” are defined in section 1 of the ITA. The term “process of manufacture” however, is not defined in the ITA. The following paragraphs aim to provide a general background on the difference between the processes.

### 2.2 Process (Course) of Mining

Mining and mining operations are defined in section 1 of the ITA as “... every method or process by which any mineral is *won* from the soil or from any substance or constituent thereof” (own emphasis).<sup>8</sup>

An excellent formulation of the essence of the process of mining is contained in *ITC 1455*.<sup>9</sup> In that case, the court described the process of mining in the following way:

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7 *Op cit.*

8 S 1 ITA.

9 *ITC 1455* 51 SATC 111

... 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 was merely isolated from the earth, which is considered a mining process.

### **2 3 Process (Course) of Manufacture**

“Process of manufacture” or “manufacturing” is not defined in the ITA. Guidance in the courts regarding what a process of manufacturing would constitute was found in the decided case of *SIR v Safranmark (Pty) Ltd*.<sup>10</sup>

Process 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).

Based on this description of what manufacturing would entail, there is 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) are 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.

### **2 4 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*<sup>11</sup> as well as in *Richards Bay Iron &*

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<sup>10</sup> *SIR v Safranmark (Pty) Ltd* 1982 1 SA 113 (A).

<sup>11</sup> *Op cit.*

*Titanium*.<sup>12</sup> 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.

## 2 5 Summary on the Distinction Between Mining and Manufacturing

Whether a mineral forms part of a mining process or part of a manufacturing process will depend on commodity being extracted and the level of purity and refinement. Based on local precedent, the following factors may have an impact on where the mining process ends and where the manufacturing process commences:

- (a) whether any part of the taxpayer's process is a distinct and separate operation;<sup>13</sup>
- (b) whether the entire process is carried on by the same taxpayer;<sup>14</sup>
- (c) whether the end product of the process occurs naturally in the earth or whether it exists in another form;<sup>15</sup> and
- (d) whether the end product is a result of an industrial process.<sup>16</sup>

The mining process can therefore end either 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.

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12 *Commissioner for Inland Revenue v Richards Bay Iron & Titanium (Pty) Ltd and Another* 1996 1 SA 311(A).

13 *Rand Refinery Ltd v Town Council of Germiston* 1929 WLD 63.

14 *Zaaiplaats Tin Mining Co v Union Government* 1945 TPD 42.

15 *ITC 1455* 51 SATC 111.

16 *ITC 1455* 51 SATC 111.

### 3 Taxation of Trading Stock of the Mining Industry Prior to the Introduction of Section 15A: Background of Section 1 and Section 22 of the ITA

#### 3 1 Background

Prior to the introduction of section 15A into the ITA, if a subject matter met the definition of trading stock as per section 1 of the ITA, the subject matter was considered trading stock and was accounted for income tax purposes in terms of section 22 of the ITA. In cases where the expenditure incurred on the subject matter did not meet the general definition of trading stock, the deduction was allowed as a section 11(a)<sup>17</sup> deduction, and 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.

Before the introduction of section 15A, the definition of trading stock provided in section 1 of the ITA was applicable 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)<sup>18</sup>

This definition of trading stock contains subparagraphs (a) and (b), with paragraph (a) in turn containing subparagraphs (i) and (ii), effectively resulting in a generally accepted and established three-part division of the definition.<sup>19</sup> This definition (with the exclusion of part three that was not included for purposes of this article) is analysed below.

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17 ITA.

18 Definition of “trading stock” s 1 ITA.

19 Faber *An analysis of the Tax Implications of ore stockpiling in the mining industry* (LLM dissertation 2008 UP).

### 3 2 Part 1 of the Section 1 Definition of Trading Stock

The first part of the definition of trading stock, as mentioned above, provides for trading stock to be:

... 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.<sup>20</sup>

The phrase “or in any other manner acquired”, read with the aforementioned extensive list of verbs, interpreted on a grammatical basis, creates a very wide ambit of the method of acquisition of the subject matter if such subject matter is tested against the definition of trading stock. The legislator therefore clearly provided for a wide range of methods of acquisitions of the subject matter.

#### 3 2 1 Reason for Acquisition

Part one of the definition of trading stock provides for the reasons of the taxpayer acquiring the asset. These reasons provided are either to be for manufacturing, selling or exchanging of the acquired subject matter by the taxpayer.

If something is acquired with the intention to sell or to exchange, it would imply that the subject matter will have an independent existence and value as a saleable article, product or commodity.<sup>21</sup> These two terms naturally differ from such cases where something was 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 purely grammatical interpretation is applied, entails something of “inclusiveness”. Therefore, for the first part of the definition, both the purpose 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.

### 3 3 Part 2 of the Section 1 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)

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20 Part 1 definition of “trading stock” s 1(a)(i) ITA

21 *CIR v Richards Bay Iron and Titanium* 1996 1 SA 311 (A).



which is included in gross income in terms of paragraph (n) of that definition.<sup>22</sup>

Except for the exclusions specifically provided for in this part of the definition, the second part read with the “or” of the first part of the definition, provides for a situation where the first part of the definition is not met, the item will still be considered trading stock on the premise that the subject matter is sold and the income derived from the sales transaction is included in the taxpayer’s gross income. *CIR v Richards Bay Iron and Titanium*<sup>23</sup> 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,<sup>24</sup> 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 dependent 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 for the inclusion as per 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 will thus fall outside the ambit of the second part of the definition.

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, which is discussed below.

### 3 4 The Valuation of Trading Stock

The general framework of the ITA, within which the sections of the ITA (including section 22<sup>25</sup> function were described by the courts in *CSARS v Foskor*.<sup>26</sup>

... 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<sup>27</sup> (own emphasis).

22 Definition of “trading stock” part 2 s 1 ITA.

23 *Commissioner for Inland Revenue v Richards Bay Iron & Titanium (Pty) Ltd* 1996 1 SA 311(A).

24 *Idem*.

25 S 22 ITA.

26 *Op cit*.

27 *Commissioner of South African Revenue Services v Foskor* [2010] 3 All SA 594 (SCA) par 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 was still unsold on year end are described in *CSARS v Foskor*.<sup>28</sup>

... 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).<sup>29</sup>

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 at year end effectively in order 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 allows 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 where stock in trade is used as a manipulation to artificially increase the deduction of an expense incurred just before year end.

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*.<sup>30</sup>

#### 4 The Problem that Manifested in *CSARS v Foskor*

In the case of *CSARS v Foskor*,<sup>31</sup> one of the main questions posed to the court was the question whether Foskor's activities constituted a process

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28 *Op cit.*

29 *Idem.*

30 *Op cit.*

31 *Op cit.*

of mining or a process of manufacturing. This problem posed to the Commissioner served as the catalyst for the introduction of section 15A into the ITA, a section to be applied in respect of trading stock derived from mining operations.

The following paragraphs aim to analyse the background of *CSARS v Foskor*.<sup>32</sup>

#### 4 1 The Background and Facts of *CSARS v Foskor*

The dispute arose as a result of the inclusion of an amount of R203 million in Foskor's taxable income in respect of the year of assessment ended 30 June 1999. The Commissioner contended that the amount represented trading stock (closing stock) in terms of section 22 read with section 1 of the ITA. The matter was heard by the Tax Court in *ITC 1836*,<sup>33</sup> which found in favour of the taxpayer (therefore the R203 million was found not to be included in the gross income of Foskor). The matter was taken on appeal by the Commissioner to the Supreme Court of Appeal (SCA) in *CSARS v Foskor*.<sup>34</sup>

A brief background of the facts of the case is that Foskor acquired the rights to mine base minerals, including phosphates, belonging to the State, during 1952. In 1963, Phalaborwa Mining Company (PMC) obtained the right to mine copper and other base minerals, except phosphorous minerals, over the same areas on which Foskor held its rights. Since the copper and the phosphates were 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

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32 *Op cit.*

33 *ITC 1836* 71 SATC 115.

34 *Op cit.*

then dried, stockpiled and sold to worldwide customers, which use the minerals mainly for the manufacture of fertilisers.<sup>35</sup>

The Commissioner and Foskor agreed to the facts of the case. Despite this agreement, however, there was a discrepancy between the Tax Court in *ITC 1836* and the SCA with regard to the nature of Foskor's activities, as discussed below.

## 4 2 Nature of Foskor's Activities: Mining or Manufacturing?

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 precedents on the matter.

The Tax Court referred to *ITC 1455*, which gives some direction as to the distinction between mining and manufacturing. It was held by the Tax Court:

... 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.<sup>36</sup>

The Tax Court concluded:

In the result it must be held that the phosphates sold by the appellant occur 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.<sup>37</sup>

Once the mineral is extracted, 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 in *SIR v Safranmark*.<sup>38</sup> The Tax Court 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.<sup>39</sup>

The mineral was not extracted until Foskor submitted the ore to the extensive processes of crushing, milling, flotation and separation. Once the concentrate had been formed, the mineral was extracted. Furthermore, the chemical composition of the phosphates did not

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35 *ITC 1836* 71 SATC 115 118.

36 *Ibid* 122.

37 *Ibid* 122.

38 1982 1 SA 113 (A).

39 *ITC 1836* 71 SATC 115 112.

change as a result of the processes applied to liberate the mineral. The phosphates had the same chemical composition as when it was excavated from the earth. If the chemical composition had changed, this could have been an indication of an industrial or manufacturing process as the item that was produced was not something that can be found in the earth's crust.

In *ITC 1856*, the Tax Court concluded that the taxpayer (Foskor) was carrying on a process of mining and viewed all the processes in dispute as part of the process of extracting the mineral from the earth to render it in its purest form. This decision of the Tax Court was appealed to the SCA.

The SCA disagreed with the conclusion reached by the Tax Court with regard to when the mining process ends and the manufacturing process starts, as was illustrated by the following statement:

In 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<sup>40</sup> (own emphasis).

The SCA found that the taxpayer was carrying on a process of manufacturing. It was of the view that mining operations end when the ore is extracted from the soil. Any processing beyond the extraction of the ore would not form part of the mining process but would constitute mining.

The only legal question that the SCA had to answer was whether or not the phosphate-bearing ore stockpiles 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 SCA found the foskorite to be part of a process of manufacture. If this approach 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 a very narrow approach to what would constitute mining operations. Very few 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.

The Court failed to decide the case on the core matter, namely where the mining process ends and where the manufacturing process

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40 *Commissioner of South African Revenue Services v Foskor* [2010] 3 All SA 594 (SCA).

commences. The legislator tried to prevent similar problems presenting themselves in future, and introduced section 15A as part of the ITA. It can therefore be said that the problems experienced by the Commissioner in the case of *CSARS v Foskor*<sup>41</sup> served as the catalyst for the introduction of section 15A into the ITA. Section 15A is analysed in the following section of the article.

## 5 Taxation of Trading Stock of the Mining Industry After the Introduction of Section 15A: A Critical Analysis

Section 15A was introduced into the ITA, and provided a definition of trading stock, specifically applicable to the mining industry of South Africa. It was justified as follows:

... 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.<sup>42</sup>

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

Amounts 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) *won* or in any other manner acquired during the course of mining operations by a taxpayer for the purposes of extraction, processing, separation, refining, beneficiation, manufacture, sale or exchange by the taxpayer or 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.<sup>43</sup>

The critical words and sections of the abovementioned definition are discussed in the following paragraphs.

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41 *Op cit.*

42 Explanatory Memorandum to the Taxation Laws Amendment Bill of 2009 (cl 30).

43 Sec 22 ITA; S 15A ITA.

## 5 1 “[a]mounts to be taken into account in respect of trading stock derived from mining operations”<sup>44</sup>

This introductory provision of section 15A 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 entire section to taxpayers conducting mining operations only.

As was illustrated in the difficulties experienced in *CSARS v Foskor*<sup>45</sup> as well as the discrepancies between the views held by the court *a quo* and the SCA, it was clear that in *CSARS v Foskor*<sup>46</sup> the court 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 therefore provides guidance and clarity on the classification and treatment of trading stock in the mining industry, *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.

## 5 1 “won or in any other manner acquired”<sup>47</sup>

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 the purpose of defining the subject matter for this part of the definition. The term “won” is however not defined for purposes of the ITA. As mentioned earlier in the article, this may prove to be problematic, due to the relative complex nature of the processes involved in the

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44 S 22 ITA.

45 *Op cit.*

46 *Op cit.*

47 S 15A(a)(i) ITA.

process of mining that can be easily confused with a process of manufacturing.

### **5.3 “taken into account as inventory in terms of South African Generally Accepted Accounting Practice”<sup>48</sup>**

This provision relates to the consideration of the general accepted accounting treatment of the subject matter to be considered once it is established that section 15A does in fact apply. It is important, to note the conjunction “and”, which implies that the first part of the definition (section 15A(a)(i)) needs to be read with section 15A(a)(ii).

The second part of the definition as per section 15A of the ITA provides for the accounting treatment as prescribed by the General Accepted Accounting practice (GAAP) of the subject matter to drive and determine the classification and treatment for taxation purposes. It is beyond the scope of this article to analyse the detailed provisions for accounting purposes, but the following comments will provide a broad overview of the understanding of the significance of this second part of the section 15A definition.

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 the first part of the definition, the second part then provides for whatever the treatment and classification for accounting purposes are and 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 this 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, 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.

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48 S 15A(a)(ii) ITA.



## 6 Conclusion

The aim of this article was to give a critical evaluation of the clarity and guidance provided to taxpayers in the mining industry with the distinction between mining and manufacturing in the context of section 15A of the ITA.

This question was at the heart of the problem experienced by the taxpayer in *CSARS v Foskor*,<sup>49</sup> where the court had to decide whether the taxpayer was busy with a process of mining or with a process of manufacturing. *CSARS v Foskor*<sup>50</sup> served as a catalyst for the introduction of section 15A, in an effort from the side of the legislator to prevent the occurrence of similar problematic situations relating to the distinction between mining and manufacturing as was experienced in *CSARS v Foskor*.<sup>51</sup>

A grammatical analysis of the section 15A definition shows that it provides guidance to the taxpayer in the mining industry as to what would constitute trading stock, as well as the subsequent treatment thereof for taxation purposes, if it is assumed in the first place that the taxpayer is in fact conducting mining operations. The definition however, does not provide clarity on exactly when a taxpayer is in fact conducting mining operations in the “course of mining” (as opposed to “course of manufacturing”). The legislator has missed this most crucial point for consideration in *CSARS v Foskor*.<sup>52</sup> Thus, despite the introduction of section 15A into the ITA, the ITA still remains unclear and is in need of further clarification as to when exactly something is extracted as part of a mining operation.

The term “mining” was analysed as part of this article and is defined in section 1 of the ITA as “... every method or process by which any mineral is *won* from the soil or from any other substance or constituent thereof” (own emphasis). In order to provide more certainty to taxpayers engaged in mining operations, it is suggested that, in addition to this definition of mining, the term “won” should also be defined in section 1 of the ITA. A proposed definition of the term “won” for purposes of mining is as follows:

A mineral is said to be won when all the necessary processes, including *inter alia* refinement, beneficiation, smelting, separation etc, have been applied 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 the process of mining stops and the process of

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49 *Op cit.*

50 *Op cit.*

51 *Op cit.*

52 *Op cit.*

manufacturing commences. A clarification of this concept may provide more certainty as to exactly when section 15A of the ITA becomes applicable.