

When does mining stop and manufacturing commence?

Trading stock of mining operations:

A critical evaluation of section 15A of the Income Tax Act of South Africa

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Introduction



- **Research objective: Evaluation of the newly introduced section 15A into the Income Tax Act (ITA) of South Africa**
- **Research method: Literature review**

Manufacturing

VS.

Mining

Definition?

All industries (incl. mining)

Trading stock

Section 1

Section 22

Add stock on hands to gross income of the taxpayer

FOSKOR

Mining industry

Trading stock

Section 15A

SA Accounting Practice (GAAP)

Accounting guidelines for classification & valuation

Before ruling (CSARS v FOSKOR) and section 15A



- Section 1 of the ITA defined trading stock for all industries, including mining
- Once defined as trading stock in terms of section 1, stock is accounted for in terms of section 22 of the ITA
- Section 22: Effectively results in the value of stock on hand on year end (that was originally deducted) to be added back / included into taxable income
- No separate treatment for mines

Before ruling (CSARS v FOSKOR) and section 15A



Section 1 definition provides for trading stock to include:

“...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 ”

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CSARS v FOSKOR ruling



- FOSKOR had “stockpiles” on hand. Question raised before courts was if the value of these stockpiles (R203 million) was to be included in as trading stock and therefore accounted for in terms of section 22 of the ITA?
- Tax court ruled not trading stock – not part of a process of manufacture (as required by section 1), not section 22, therefore not included as taxable income
- Decision appealed by SARS to the Supreme Court of Appeal

CSARS v FOSKOR ruling



- Supreme Court ruled that stockpiles (trading stock) were created / part of a process of manufacturing & therefore within the scope of section 1 (thus to be included in the gross income of FOSKOR as per section 22)
- No reason as to why Supreme Court differed from the Tax Court's decision

CSARS v FOSKOR ruling



Problem with the FOSKOR stockpiles:

- Already extracted from the earth – but was the “mining” process fully completed? Stated otherwise, were the mine dumps readily saleable in an open market value, or to be applied in a process of manufacture? (answered in the affirmative by the Supreme Court)

OR

- Were the dumps still part of the “process of mining” – with many different minerals to be liberated yet from these stockpiles by means of complex processes (still within the process of mining) (answered in the affirmative by the Tax Court)

CSARS v FOSKOR ruling



- It is common to mine **more than one** mineral at a time. Minerals not contained in neat pockets in the earth allowing a miner to mine only the specific mineral that he is entitled to. Mining also often involves **many complex processes** to liberate the required mineral into its purist form
- A company involved in for example the platinum industry will mine not only platinum. As part of the mining process palladium, gold, rhodium and other elements may also be won from the soil and different processes is required to “mine” the different elements from the earth

CSARS v FOSKOR ruling



- Therefore, the actual question raised in FOSKOR was where does “mining” stop and “manufacturing” commences?
- Both the Tax Court as well as the Supreme Court failed to address this crucial distinction

CSARS v FOSKOR ruling



While FOSKOR was still in the process of appeal Section 15 A was introduced into the ITA with the purpose to provide a definition for what would constitute trading stock for the mining industry & to prevent the reoccurrence of a similar problem as experienced in FOSKOR

Introduction of Section 15A



“...Insertion of section 15A (Taxation laws amendment Act 17/2009) **FOSKOR**

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. **Section 15A**

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 Act at a value that is not less than that used for accounting purposes...”

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“Amounts to be taken into account in respect of trading stock derived from mining operations”

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;...”

Section 15A



- Introduction of section 15A provides clear guidance for what would constitute trading stock for the taxpayer conducting mining operations
- Specifically providing for the following of the treatment applied for accounting purposes.
- Effectively “link” well established accounting guidelines for what will be regarded as trading stock to be applied for purposes of taxation as well
- No need to “re-invent” the wheel

Section 15A



- Section 15A therefore does provide clear guidance on the classification of the trading stock, especially by aligning the prescribed treatment with very well established accounting principles

BUT

- There is still a lack of clarity as to when or, up until which point exactly a taxpayer is considered to be conducting “mining operations” (the very entrance into section 15A)

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Mining vs Manufacturing



- Therefore needs to differentiate between Mining and Manufacturing activities
- “Point of access”- section 1 or section 15A?
- In FOSKOR both the Tax Court and the Supreme Court failed to address this question: “*when does mining stop and manufacturing commences?*”
- Only once this is clear, the taxpayer will fully be able to utilize and appreciate the introduced section 15A that were suppose to be the solution for the problem experienced in FOSKOR

Mining vs Manufacturing



- 'Process of manufacture' or 'manufacturing' not defined in the ITA
- Guidance sought from case law
- *SIR v Safranmark (Pty) Ltd* (1982:122 G-H), defines 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.'

Mining vs Manufacturing



- Manufacturing therefore involves a process (action or series of actions) where the original material used in the process differs from the finished product
- Once “process of manufacturing” – section 1 applicable (not section 15A)

Mining vs Manufacturing



Definition?

- 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’***
- Once “process of mining” – section 15A (follow the accounting guidelines)

Mining vs Manufacturing



- Problem however, often mining of a mineral and the subsequent manufacturing of the mineral into a final product is a continuous process
- A second problem is that “mining” in itself can also include many complex processes in order to actually liberate the mineral into its purist form which can be, as was the case in FOSKOR, easily be confused with “manufacturing”

Mining vs Manufacturing



Example:

- Gold particles mined from the earth- extraction of the particles from the earth itself not constitute the 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 (with many different, sometimes complex processes followed, but still within the scope of mining): therefore, apply section 15A
- The extracted gold is processed further to manufacture gold earrings, this(finished product) substantially different from the original gold extracted – therefore, process of manufacturing has occurred; s 15A no longer applicable: apply section 1 & section 22 of the ITA

Mining vs Manufacturing



- Problem may arise where processes are conducted by the taxpayer that is in fact still part of a “mining process”, may be incorrectly viewed as “a process of manufacture” (like in FOSKOR), due to relative complex processes that may be necessary to merely liberate a particular mineral from the earth
- Therefore, proposed inclusion into the ITA in alignment with section 15A as well as the existing definition of “mining”: a definition of when a mineral will be considered to be “won” for purposes of mining (and therefore accounted in terms of section 15A) as follows:

Mining vs Manufacturing



Proposed inclusion:

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

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Conclusion



- Valid problem presented itself in the case of SARS v Foskor
- Cannot account for the trading stock of a unique industry such as mining within a general provision that applies to all industries
- Section 15 A was introduced and does in fact provide valuable guidance, especially with the reference to well established accounting guidelines

Conclusion



- However, “point of access still needs to be clarified – when does mining stop and manufacturing commences, the question that both the Tax court as well as the Supreme Court failed to address
- Suggestion: clarify / define the term “**won**” for purposes of the mining definition that will clarify that “**winning for purposes of a mining process**” may include different complex processes that should not be confused with a “**manufacturing process**”

Questions?