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South African Revenue Service
Private Bag X923
PRETORIA
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BY E-MAIL: policycomments@sars.gov.za

Dear Sir/Madam,

SUBMISSION: DRAFT INTERPRETATION NOTE ON WHETHER CERTAIN QUARRYING OPERATIONS CONSTITUTE MINING OPERATIONS

The South African Revenue Service’s (“SARS”) draft interpretation note on whether certain quarrying operations constitute mining operations refers. Please find below SAICA’s National Tax Committee’s response to the request for comments on the draft public notice.

Interpretative approach

1. From the outset it should be acknowledged that the distinction that SARS is trying to make is a challenge of immense proportions which does not lead itself to hard and fast conclusions.

2. In a similar challenge, Windeyer J in the Australian high court\(^1\), when dealing with manufacturing stated\(^2\):

   “I have considered cases to which I was referred and also some others concerning the denotation of the word “manufacture” appearing in other Acts. I have gained only two things from them. One is a conviction of the futility of trying to decide the present case by observations made about other facts and other Acts. The other is that the expression “manufactured goods” is not a technical term capable of precise definition universally applicable.”

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\(^1\) *MP Metals Pty Ltd v FCT* [1968] HCA 89 at para 16

\(^2\) As quoted in *CSARS v FOSKOR Ltd* (375/09) [2010] ZASCA 45 at para 37
3. In our view the same caution should be applied to the interpretive approach for the words “mining”, “mineral” and “mining operations”.

4. This is no clearer than in what we see as a flawed approach in the Foskor case at 44 which seems to apply a purpose test but in relation to what the customer is producing, namely fertiliser. If the tribunal case of CSR Ltd is to follow the same, namely that the purpose is that of the ultimate user and not what the miner supplies to the end user, such deduction is also flawed in our view.

5. The purpose of use by the end user is in our mind only relevant as to determining if a mineral was provided or not to him by the miner, what such end user’s actual purpose and use is remains irrelevant otherwise.

6. We also note that the majority of the references in the draft Interpretation Note are to Australian case law. There are sufficient South African cases that dealt with the issue of mining operations and quarrying operations. South African case laws should therefore take precedence over the Australian case laws even though the latter provides useful and persuasive guidance.

Section 1(1) Definition of “Mining Operations” and “Mining”

7. The Income Tax Act No. 58 of 1962 (“the Income Tax Act”), as amended, defines “mining operations” and “mining” as including:

   “every method or process by which any mineral is won from the soil or from any substance or constituent thereof”.

8. In point 4.1 of the draft Interpretation Note it is stated that a taxpayer’s operations will qualify as “mining operations” and “mining” for income tax purposes if ALL the elements of the definition are present in its operation, namely:

   • There must be a method or process;
   • By which any mineral;
   • Is won;
   • From the soil or from any substance or constituent thereof.

9. However, in point 5 of the draft Interpretation Note, SARS concludes that:

   “the terms “mining operations” and “mining” must be interpreted to mean those operations conducted by a person to win minerals form the earth for their inherent mineralogical qualities”.

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3 Draft IN at footnote 25
10. Such conclusion, in the context used, is in contradiction with the “mining operations” and “mining” definition in the Income Tax Act. The current definition refers merely to the extraction of any mineral from the soil.

11. We are not in agreement with SARS’ interpretation of the definition that the mineral extracted must possess inherent “mineralogical qualities” to the limited extent as discussed in clause 4.4.1.

12. Though used as the critical distinction, no real distinction of mineralogical vs. physical is actually made and all the case law relied upon refer back to only the purpose of construction and building activities, where limited physical attributes such as size and weight are used, though physical attributes is a much broader concept.

13. For example, are gemstones not “mined” for physical attributes such as hardness, colour and the way it reflects light? How is this different to granite used for kitchen countertops?

14. Is coal not “mined” for the way it burns? How is this different to agricultural lime which is used to balance the pH of acidic soil?

15. Especially in the latter instance, the fallacy of this approach is illustrated in the citation of Boral Resources⁴:

   “There was no evidence that any end user specification contained a requirement that this or that particular mineral should be present in the aggregate. What the purchaser requires in all cases is a product that will have engineering qualities to meet the demands likely to be made upon it”.

16. Clearly this is not true for agricultural lime or foskorite⁵ used in fertilizer. It is true for industrial diamonds where the hardness of the stone is the physical attribute sought (i.e. engineering quality) yet diamonds are mined without question and correctly so.

17. We are of the view that the determination is probably more correct if determined what is won and the distinction currently between mining and quarrying seems fickle. The focus should remain as stated in State Rail Authority of the New South Wales v Collector of Customs case, that:

   “at all times, the concept of the recovery of the minerals is retained as the central point of reference”.

18. In our view the enquiry should have this focus, but be applied in the same vein as for determining “essential difference” for manufacturing per the Hersamar case⁶, which stated the following (our emphasis):

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⁴ Footnote 24 in the Draft SARS IN
⁵ See Foskor case supra
It must be recognised that the term “essentially” obviously imports an element of degree into the determination of the sufficiency of the change that must be effected for a process to be one of “manufacture”. As a result of being processed, a change may take place in regard to the nature or form or shape or utility, etc., of the previous article or material or substance. There can be no fixed criteria as to when any such change can be said to have effected an essential difference. It is a matter to be decided on the particular facts of the case under consideration. The most exhaustive examination of imaginary examples of change really does not carry the matter further.

19. Therefore, once the method or process is done (i.e. it is ready to be sold by the person as miner), the question is whether such process included a process whereby the end product is a mineral won from the soil based on those specific facts, if so, the taxpayer is conducting mining.

20. For example if I sell sand, have I in my process won a mineral from the soil? The answer is clearly no. If I “quarry” granite or rock, then a mineral is maybe not won from the soil because granite and other rock mainly consist of multiple minerals and not a specific mineral is won though diamonds are a specific mineral won (i.e. carbon compound). The use for physical or other attributes is therefore irrelevant.

21. This would also result in lime (i.e. calcium oxide/calcium hydroxide) to be a mineral won from the soil even though it is quarried and used for its mineralogical rather than physical attributes.

22. It is submitted that mining does not exclude all quarrying as concluded and that a proper exclusion for the activities that are not to be considered mining should be legislatively added. Ironically Wikipedia gives a telling definition for quarrying which states:

“The only trivial difference between the two (i.e. mining and quarrying) is that open-pit mines that produce building materials and dimension stone are commonly referred to as quarries.”

23. This seems to summarise the case law on the matter as well where quarrying for building materials seems to be what is commonly sought to be excluded from mining and if that is what the legislature also intended, then this should be legislatively done and not by the impossible task of interpretation.

24. This flawed distinction also results in irrelevant criteria such as in the discussion in 4.7.3, i.e. on the differences between mining and quarrying operations, that mining commonly occurs at ‘remote locations’. This statement is misleading and is likely to cause confusion. It is unclear whether a taxpayer might be prejudiced if there were some dispute as to whether its activities constitute mining or quarrying operations, but

6 Secretary for Inland Revenue v Hersamar (Pty) Ltd 1967 (3) SA 177 (A)
such activities were conducted close to a metropolitan hub. Particularly in a South African context one should bear in mind that Johannesburg was established entirely due to its proximity to valuable minerals and so also many other mining towns.

Method or process

25. “Method or process” is one element of the “mining operations” and “mining” definition that should be present in a taxpayer's operations in order to qualify as “mining operations” and “mining” for income tax purposes.

26. The draft Interpretation Note makes reference to the *State Rail Authority of the New South Wales v Collector of Customs* case, where, in considering whether an activity falls within the meaning of “mining operations”, it was held that:

   “at all times, the concept of the recovery of the minerals is retained as the central point of reference”.

27. We are in agreement with this conclusion as it is line with the definition of the “mining operations” and “mining” in the Income Tax Act.

28. The draft Interpretation Note further makes reference to the concept of “mineral processing” as explained in Wills’ Minerals Processing Technology. That concept refers to the process that happens after a mineral is extracted from the soil, for example, the regulation of the size of the mineral for transportation and further processing purposes and the physical separation of the valuable mineral from their waste. Unfortunately, SARS does not conclude on the relevance of the “concept of recovery” in relation to the concept of “method or process” as included in the “mining operations” and “mining” definition in the Income Tax Act.

29. It is submitted that a conclusion should be inserted.

30. In our view the method of extraction used in quarrying and other mining operations cannot be distinguished on a mining technical basis. The determination of a mining method and general exploitation strategy is based on the physical characteristics of the deposit of interest, which typically include, but are not limited to:

   • the size of the deposit in terms of its lateral and vertical extend, which determines the size and duration of mining operations;
   
   • the depth of occurrence of the deposit, which determines whether surface or underground operations will be conducted;
   
   • the dip and strike of the deposit, which determines the specific type of surface or underground mining method; and
• the competence (geotechnical nature) of the deposit, which dictates whether free digging, blasting or caving methods will be used.

31. Quarrying operations in South Africa for example, clay, granite, stone, etc., are often very similar to open pit operations for example, iron ore, coal, diamonds etc., with the exception being that quarries are mostly smaller in scale which are open at the top and the sides, while open pits are usually bigger in scale and open only at the top.

32. It is submitted that the method of extraction of any mineral is a result of the physical characteristics of the deposit of interest, there is no real difference in the process of extraction used in quarrying operations relative to mining operations. Therefore the “method or process” used in quarrying operations and mining operations will, in both cases, meet the “method or process” element of the “mining operations” and “mining” definition of the Income Tax Act.

The meaning of a “mineral”

33. The second element of the definition of a “mining operations” and “mining” in section 1(1) of the Income Tax Act is that there must be a mineral. However, a “mineral” is not defined in the Income Tax Act.

34. Since no definition of a “mineral” is given in the Income Tax Act, the draft Interpretation Note states that reliance can be placed on definitions contained in dictionaries or case law or definitions in other legislation.

35. The normal grammatical meaning is to be sought which could be done from dictionaries as noted. This is however not always appropriate as stated in the Richards Bay case at pg.24:

“But whereas both expressions may have had this limited meaning in times gone by, trading stock has acquired a more extensive denotation in modern times. It is a commercial term, ordinarily employed by accountants and auditors and it is to usage by commercial men that we must look in determining what it signifies, rather than to the standard dictionaries which often fail to reflect current usage and just as frequently fail to reflect modern commercial usage.”

36. Though the canons of interpretation allow this literal meaning to be derived from the same word in the same enactment⁷, the direct application of a defined word in other legislation would in our view fall foul of the rules of interpretation, unless the defined term is also held to be the commercial term that better denotes the literal meaning in the tax Act.

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⁷ Minister of Interior v Machadodorp Investments Pty Ltd 1957 (2) SA 395 (A)
37. This would ensure that the principles in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2 ALL SA 262 that an interpretation should not be impractical or lead to an unbusinesslike result will be avoided.

38. The Mining and Petroleum Resources and Development Act No. 28 of 2002 (“MPRD Act”) is the primary source legislation dealing with mining operations and activities in South Africa and contains a definition for a mineral. However, SARS concludes in the draft Interpretation Note that the definition of a “mineral” in the MPRD Act is of little consequence for purpose of interpreting the meaning of “mining operations” or “mining” for income tax purposes on the basis that the two Acts have different legislative purposes.

39. Though this may be so the question is rather whether the MPRD better reflects the commercial meaning or a practical meaning as it in fact regulates mining in the commercial sense. We therefore disagree with SARS grounds for dismissing this definition.

40. Van Blerk mentions on page 7-9 that in the absence of a definition of a “mineral” in the Income Tax Act, interpretation of its meaning in terms of other legislations or case law can be wide or narrow. SARS mentions in point 4.3.2 of the draft Interpretation Note that the definition of a “mineral” in the MPRD Act has wider application that that of the Income Tax Act. The latter does not seem to accord with the dictionary definitions cited which are in fact much broader in scope than the MPRDA definition, the latter which still has exclusions.

41. From an interpretative approach, it is unclear whether SARS concludes that a wider or narrower interpretation should be followed and how it got to that conclusion.

**Extraction for physical attributes versus extraction for mineralogical qualities**

42. According to the draft Interpretation Note, the extraction of a material for its inherent mineralogical qualities constitutes mining operations while the extraction of a material for its physical attributes does not constitute mining operations. We strongly believe that such a distinction cannot be made as the mineralogical qualities of any substance manifest themselves in its physical attributes.

43. An attempt to segregate the mining of the listed deposits from the mining of other deposits on the basis that the listed deposits are mined for their physical attributes is flawed. The listed deposits are made up of certain minerals which are key to their resultant physical attributes and thus affords them a commercial value. The mineralogy of the listed deposits determines their physical properties, which then determines their applicable use.

44. From the table above, two examples can be drawn to show the importance of the mineralogy of the listed commodities, namely:
• Clay is an aluminium silicate but the type of clay is determined by the kind of aluminium silicates (kaolinite, illite etc.) that constitute the particular clay deposit and therefore its applicable use from the various possibilities listed above; and

• The mineralogy of limestone is also important as a rock can only classify as a limestone if it is made-up of at least 50% calcite or dolomite (Dictionary of Mining, Mineral, & Related Terms (2nd edition, 1996)). The major mineral also determines the kind of limestone; calcite rich limestones are called calcific limestones and those rich in dolomite are called dolomitic limestone. These different kinds of limestones have their respective uses out of the options listed in the table above.

45. It is submitted that no real distinction can be made between the mineralogical and physical attributes of the listed deposits as the latter attribute is a result of the former. We therefore strongly disagree with the proposal that only minerals extracted for their mineralogical qualities will be considered as mining operations while minerals extracted for their physical attributes will be considered to be non-mining operations.

**Process of mining versus process of manufacturing**

46. In determining the difference between mining and manufacturing, the draft Interpretation Note indicates that mining stops at extraction of the mineral and that manufacturing commences from the crushing, screening and washing processes of the same mineral. We do not entirely agree with this view to the extent that the crushing, screening and washing processes do not result in a different material from that which was extracted from the earth. We base our argument on the *SIR v Safranmark (Pty) Ltd* case where it was held that:

> “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”

47. We cannot support the view as also held in the *Foskor* case whereby the winning of a mineral can be said to be completed once an aggregate has been extracted from the earth but not the relevant mineral sought to be won. This principle contradicts known case law and principles as to what is a process of manufacture.

48. We recommend that SARS provides taxpayers with a conclusive view of what the differences between mining and manufacturing process will be as such conclusion is currently not evident from the draft Interpretation Note. This should include guidance on the timing of these processes.
Quarrying operations versus process of manufacture

49. We note that although the heading in point 4.7 of the draft Interpretation Note is “quarrying operations versus process of manufacture”, SARS does not provide an explanation of the differences between the two concepts, other than the conclusion of whether the extraction of certain aggregates constitute mining operations.

50. As this goes to the core of the distinction sought by SARS, which we don’t believe exists, SARS should at least in detail provide such distinction to clarify its position on the matter.

Summary of the differences between quarry operations and mining operation

51. We note that the differences provided in point 4.7.3 between quarry operations and mining operations are not adequate to sufficiently guide taxpayers as to when they are conducting quarry operations and when they are conducting mining operations. We recommend that SARS revises the draft Interpretation Note in this regard to provide better clarity to taxpayers.

Specific tax calculations – paragraph 4.6.

52. We do see in the wording of the Act any circumstances in which a separate calculation of taxable income derived from mining operations is ‘not warranted’ and therefore need not be performed.

53. As per page 14, the Act requires a separate calculation of taxable income for each trade that is carried on. If SARS’ practice is to accept various circumstances in which a separate calculation is not required, then more examples should be given of situations in which the trade of mining would be considered to be merely ancillary to another trade and therefore at the option of the taxpayer such calculation need not be performed.

Thank you again for the opportunity to engage on the development of the tax law in South Africa. Should you have enquiries in respect of this submission we will gladly meet with you to discuss and clarify our submissions.

Yours faithfully


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