Dear Sir/Madam

CALL FOR COMMENT: DRAFT INTERPRETATION NOTE: SECTION 12C (1) OF THE INCOME TAX ACT, 1962: PRODUCTION OF COLD AIR AND CHILLING OR FREEZING OF PERISHABLE PRODUCTS

We refer to the call for comment regarding the above-mentioned document that was placed on your website. Set out below please find the SAICA National Tax Committee’s submission.

1. Questions on the process of manufacture
On page 4 questions are presented, presumably to assist the taxpayer in concluding whether or not he/she is involved in a process of manufacture. We suggest that guidance be provided as to what impact the answers to these questions will have on the final decision. For example, what difference will the type of products that are being stored have on the conclusion as to whether one qualifies for section 12C or not?

2. Cooling of milk
It is important for the Draft Interpretation Note to address the case of National Co-operative Diaries Ltd v CIR (54 SATC 1) which held that the cooling of fresh milk did not change its substance of chemical composition and was not a process of manufacture.

3. Examples 1 and 2 in the Draft Interpretation Note
The two examples (Examples 1 and 2 on pages 3 to 5 of the Note) given are confusing. The Note does not sufficiently explain the distinction between the treatment given to the cold-air producing facilities in Example 1 and the cold-air producing facilities in Example 2. In both cases the facilities produce cold air in order to preserve goods, yet in Example 1 the deduction is permitted but in Example 2 the deduction is not permitted. The distinction seems to rest on the fact that in Example 1 only a portion of the income-producing activities of the taxpayer relates to cold air
production and cold air is produced on a large scale, whilst in Example 2 all the
taxpayer’s income-producing activities relate to cold air production and cold air is
produced on a small scale. This distinction is arbitrary, since it is possible that a
business could produce cold air on a large scale, yet the production of cold-air
constitutes a relatively small portion of the taxpayers overall income-producing
activities.

4. The process of manufacture
The Draft Interpretation Note does not go far enough into discussing a process of
manufacture, when it begins and when it ends. It deals with a number of Income Tax
Court cases but does not mention for instance the appeal court decision, *SIR v Cape
Lime Co Ltd* 29 SATC 131 (1967 (4) SA 226 (A)).

This case considers when a process of manufacture begins and where it ends. It
appears quite obvious air conditioned or chilled during a process of manufacture is
clearly part of the said process.

Examples:

a) **The manufacture of Nitroglycerin for explosives**
The manufacture of Nitroglycerin is an exothermic reaction which means that
heat is generated in the process, if the liquid overheats a large explosion
results. Hence the liquid must be cooled throughout the manufacturing process.

b) **The manufacture of Sorghum beer**
The fermentation of this beer begins from the plant, continues on the truck
from the plant to the shebeen, at the shebeen before consumption. It is even
fermenting as it is being consumed by the consumer.

c) **The manufacture of wine (especially aged wine)**
It is accepted that red wine gets better with age, then peaks (some wines peak
after 10 years of ageing) and then it gets worse. A bottle has a cork that is
semi-permeable to air, the rate of ageing is controlled by factors such as the
amount of air that makes contact with the wine through the cork and the
temperature at which the wine is kept while the ageing process takes place. It
is considered that fluctuating temperatures are most damaging to wine. A wine
estate usually tastes the wine to come to a decision when the wine is good
(aged) enough to be released to market.

d) **The manufacture of tampons**
The air has to be clean because this pharmaceutical product must not have any
dust contamination. Therefore the air is treated to ensure the correct moisture
level and also a positive air pressure is maintained in the manufacturing
facility. Since the air pressure is higher inside the building than the air pressure outside, dust does not come into the manufacturing facility from the outside.

Also the store of cotton has to be kept at a particular level of moisture. Firstly the moisture levels of the cotton are adjusted either by increasing the moisture level or reducing it, then it is kept at the level which is ideal for the manufacturing process until it reaches the manufacturing plant and through the process until packing /packaging and shrink wrapping.

The decision about where the manufacturing process begins and where it ends is therefore crucial to deciding whether the air conditioning of “air” has been added to a process of manufacture.

The assertion that the production of cold air may need to be on a major scale is therefore limited and favours large business. The provision of cold air to a small business should not preclude a taxpayer from claiming this benefit if this is the taxpayer’s major business and he/she is a small operator.

Please do not hesitate to contact me should you wish to discuss the above.

Yours faithfully

Muneer Hassan CA(SA)
PROJECT DIRECTOR: TAX
The South African Institute of Chartered Accountants