

**THE UTILISATION OF ASSESSED LOSSES BY MINING COMPANIES:  
CRITICAL ANALYSIS OF THE ARMGOLD/HARMONY FREEGOLD  
JUDGMENT**

by

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## **ABSTRACT**

### **THE UTILISATION OF ASSESSED LOSSES BY MINING COMPANIES: CRITICAL ANALYSIS OF THE ARMGOLD/HARMONY FREEGOLD JUDGMENT**

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The method of taking into account assessed losses in calculating the taxable income of mining companies is of significant importance following the Armgold/Harmony Freegold case. In this case, the court had to determine the method of calculating a mining company's taxable income where at least one of its mines incurred a loss and where non-mining income was also derived. What constitutes an assessed loss, and the order in which it should be applied in calculating a mining company's taxable income, was central to this case. In this study, the different approaches adopted by the parties to the case in order to determine whether there is an assessed loss, and the order in which it should be utilised in calculating taxable income, was analysed and compared to an analysis of the provisions of the Income Tax Act. In terms of this comparison, the judgment was found to be in accordance with the current legislation in the Income Tax Act. There is, however, a lack of updated guidance on matters relating to mining tax as is evident from the different interpretations of the provisions of the Income Tax Act by the parties to the case. Further research is therefore recommended in order to provide updated guidance to mining companies.

#### **KEY WORDS:**

Armgold/Harmony Freegold

Assessed loss

Mining tax

Section 36(7F)

Section 36(7E)

Taxable income

## OPSOMMING

### **DIE AANWENDING VAN VASGESTELDE VERLIESE DEUR MYNMAATSKAPPYE: KRITIESE ANALISE VAN DIE ARMGOLD/HARMONY FREEGOLD-UITSPRAAK**

Deur

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Die metode waarvolgens vasgestelde verliese aangewend word in die berekening van die belasbare inkomste van mynmaatskappye is van beduidende belang ná die Armgold/Harmony Freegold-hofsaak. In hierdie saak moes die hof die metode bepaal waarvolgens 'n mynmaatskappy se belasbare inkomste bereken moet word waar ten minste een van die maatskappy se myne 'n verlies ly en waar nie-mynbouinkomste ook deur die maatskappy verdien word. Wat gedefinieer word as 'n vasgestelde verlies en die volgorde waarin dit aangewend moet word om 'n mynmaatskappy se belasbare inkomste te bereken, was sentraal tot hierdie saak. In hierdie studie is die verskillende metodes wat deur die partye tot die hofsaak aangewend is om te bepaal of daar 'n vasgestelde verlies is, sowel as die volgorde waarin dit aangewend moet word om belasbare inkomste te bereken, ontleed en vergelyk met 'n ontleding van die bepalings van die Wet op Inkomstebelasting. Volgens die vergelyking is bevind dat die regter se beslissing in ooreenstemming was met die huidige wetgewing wat vervat is in die Wet op Inkomstebelasting. Vanuit die verskillende interpretasies van die bepalings van die Wet op Inkomstebelasting deur die partye tot die saak, is dit egter duidelik dat daar 'n gebrek aan opgedateerde leiding is oor sake wat verband hou met mynboubelasting. Verdere navorsing word dus aanbeveel om opgedateerde leiding aan mynboumaatskappye te bied.

#### **SLEUTELWOORDE:**

Armgold/Harmony Freegold

Vasgestelde verlies

Mynbou belasting

Artikel 36(7F)

Artikel 36(7E)

Belasbare inkomste

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## KEY TERMS AND ABBREVIATIONS

Table 1 sets out the meaning of key terms and abbreviations used in this study.

**Table 1: Key terms and abbreviations used in this study**

<b>Abbreviation</b>	<b>Meaning</b>
Armgold	African Rainbow Minerals Limited Gold Division
Armgold/Harmony Freegold	Armgold/Harmony Freegold Joint Venture (Proprietary) Limited, a limited liability company established by Armgold and Harmony Gold Mining Company Limited
Armgold/Harmony Freegold case/judgment	Armgold/Harmony Freegold Joint Venture v CSARS (703/2011) [2012] ZASCA 152 (1 October 2012)
Capex	Capital expenditure
Capital redemption	Allowance for deduction of capex incurred by mining companies as determined in terms of sections 36(7E) and 36(7F)
CSARS	Commissioner of the South African Revenue Service
Harmony	Harmony Gold Mining Company Limited
Income Tax Act	Income Tax Act No. 58 of 1962
SARS	South African Revenue Service
The Act	Income Tax Act No. 58 of 1962
Mining companies	Companies that derive income from mining activities
SCA	Supreme Court of Appeal of South Africa



# THE UTILISATION OF ASSESSED LOSSES BY MINING COMPANIES: CRITICAL ANALYSIS OF THE ARMGOLD/HARMONY FREEGOLD JUDGMENT

## CHAPTER 1

### INTRODUCTION

#### 1.1 BACKGROUND

The taxable income of companies that derive their income from mining activities (henceforth referred to as mining companies) are, similar to that of other companies, determined in terms of the general provisions of the Income Tax Act, No. 58 of 1962 (the Act). In addition to the general provisions, certain specific provisions also apply to mining companies. These specific provisions are, amongst others, contained in section 15(a) read with section 36 of the Act (Van Blerck, 1992:6-2).

The approach adopted by mining companies in calculating their taxable incomes has become especially important following the Supreme Court of Appeal (SCA) judgment delivered on 1 October 2012 in the Armgold/Harmony Freegold case (*Armgold/Harmony Freegold Joint Venture v CSARS* (703/2011) [2012] ZASCA 152 (1 October 2012)) (the case). This case is said to provide “welcome clarity regarding the taxation of a mining company that owns and operates more than one mine” where not all of the mines are profitable and where non-mining income is also derived by the mining company (PwC Tax Synopsis, 2012).

The issue dealt with in the case was the method that should be applied in calculating a mining company’s taxable income where at least one of the mining company’s mines incurred a loss and where non-mining income was also derived by that mining company (PwC Tax Synopsis, 2012).

The question of what constitutes an assessed loss, and in which order it should be applied in calculating a mining company's taxable income, was central to the aforementioned issue (PwC Tax Synopsis, 2012).

The Act provides in section 20(1)(b) that taxpayers are, subject to the provisions of section 20A, allowed to set off an assessed loss from any trade, from the income derived from carrying on another trade, for the purpose of determining their taxable income derived from carrying on that trade.

Section 20A provides for the ring-fencing of assessed losses from certain trades. None of these ring-fencing provisions are, however, applicable to the assessed losses of companies.

Where the company is a mining company, section 15(a) read with section 36 of the Act provides for the deduction of certain qualifying capital expenditure in the year in which it is incurred (capital redemption). This deduction is subject to the limitations contained, amongst others, in sections 36(7E) and (7F).

Sections 36(7E) and (7F), amongst other sections, prescribes how the capital redemption should be calculated and essentially introduces a ring-fencing requirement for mining companies in respect of mining income.

The practical application of the abovementioned sections has historically been problematic where at least one of the mines of the mining company operates at a loss and where non-mining income is also derived. This is evident from the three different approaches that were adopted by the Armgold/Harmony Freegold Joint Venture (Armgold/Harmony Freegold), the South African Revenue Service (SARS) and Judge Leach, JA in calculating Armgold/Harmony Freegold's taxable income in the case.

The difference in opinion on the practical application of these sections can mainly be ascribed to the fact that there is limited guidance available on income tax matters specific to mining companies. Prior to the Armgold/Harmony Freegold case, the guidance available

was mainly limited to Marius Cloete van Blerck's *Mining Tax in South Africa*, published in 1992. In respect of court precedence, SARS conceded in *ITC 770* that, in practice, an assessed loss on one trade should be apportioned between the remaining trades. In *ITC 1420*, however, the contrary was held (Van Blerck, 1992:11-20).

## **1.2 PROBLEM STATEMENT**

Despite the SCA judgment in the Armgold/Harmony Freegold case, it is still unclear whether the method of the utilisation of assessed losses imposed by the judgment is in accordance with the legislation currently contained in the Act. This is due to the three different interpretations of the Act that were applied by the parties involved in the case.

## **1.3 PURPOSE STATEMENT**

The purpose of this study was to identify whether the judgment delivered in the Armgold/Harmony Freegold case was:

- in accordance with the current legislation contained in the Act; and
- whether the current legislation should be amended based on the outcome of the study in order to support the decision reached in the judgment.

## **1.4 RESEARCH OBJECTIVES**

The following specific research objectives guided this study:

- To critically analyse the order of the utilisation of assessed losses in calculating the taxable incomes of mining companies in terms of the Armgold/Harmony Freegold judgment;
- To analyse the order of the utilisation of assessed losses in calculating the taxable incomes of mining companies in terms of the current legislation contained in the Act; and

- To compare the order of utilisation of assessed losses between the judgment and current legislation in order to determine whether amendments should be made to the current legislation to support the judgment.

## **1.5 IMPORTANCE AND BENEFITS OF THE STUDY**

The principles laid down by the judge in the Armgold/Harmony Freegold judgment could have significant implications on the manner in which mining companies prepare their tax calculations, as it may result in higher taxes becoming payable by these mining companies (De Jager, 2012).

The importance and benefits of the study is thus:

- To provide clarity on the method to be adopted by mining companies in calculating their taxable incomes; and
- To indicate whether the current legislation contained in the Act should be amended to support the judgment.

## **1.6 DESCRIPTION OF ENQUIRY STRATEGY AND BROAD RESEARCH DESIGN**

This study was non-empirical and conducted in the form of a qualitative analysis and interpretation of current literature.

A detailed analysis and interpretation of the Armgold/Harmony Freegold judgment and the provisions of sections 1, 15(a), 20 and 36 of the Act were required.

The primary sources of information were the Armgold/Harmony Freegold Supreme Court of Appeal judgment and the Income Tax Act, No. 58 of 1962.

They were supplemented by the following sources:

- *Mining Tax in South Africa* (Van Blerck 1992), being the main guidance available on tax-related matters applicable to mining companies;

- The views of commentators published in articles; and
- Relevant case law.

Searches were also performed on the following key words (including combinations of these key words) on the University of Pretoria's library journal platforms, EbscoHost and Proquest as well as on GoogleScholar:

“Armgold”;

“assessed loss”;

“loss”;

“mining loss”;

“mining tax”;

“section 15(a)”;

“section 20”

“section 36”; and

“taxable income”

## **1.7 DELIMITATIONS AND ASSUMPTIONS**

The following delimitations and assumptions guided the study:

- The context of the study was limited to the determination of taxable income as provided for in the Act. The determination of taxable income in terms of the tax legislation of other countries was not considered.
- The analysis of the utilisation of assessed losses and the calculation of the capital redemption were limited to the provisions of sections 1, 11(a), 15(a), 20(1)(b), 36(7C), 36(7E) and 36(7F) of the Act.
- The section 36(7F) capital expenditure (capex) per mine restriction is subject to three major qualifications. However, none of these qualifications are applicable to the Armgold/Harmony Freegold case and were therefore not addressed in this study.

- The meaning of the words “capital expenditure”, “capital expenditure incurred”, “mining” and “mineral” as envisaged in sections 15(a) and 36 were not analysed in specific detail.
- Section 20A of the Act, which provides for the ring-fencing of assessed losses of natural persons, was not analysed in specific detail for the purposes of this study, although the section is mentioned in the literature review.
- The literature review was limited to literature relating to South African income tax legislation. Literature from other disciplines was only considered in passing.
- The provisions of sections in the Act analysed in the literature review section were interpreted based on the literal approach of English Law. Explanatory Memoranda, Interpretation Notes and opinions of experts were considered only where the text in the provision was unclear or if a strict literal meaning would be absurd (De Swardt, Jordaan, Koekemoer, Stiglingh, Van Schalkwyk & Wilcocks, 2010:9).

## **1.8 OVERVIEW OF THE CHAPTERS**

Chapters 2 to 5 of this study follow an order similar to the research objectives as described in subchapter 1.4.

Chapter 2 addressed the first research objective. In this chapter, the different approaches adopted by Armgold/Harmony Freegold, SARS and Judge Leach, JA in utilising the mining loss in order to calculate Armgold/Harmony Freegold’s taxable income were analysed in detail.

Chapter 3 addressed the second research objective. In this chapter, the order in which losses should be utilised in calculating the taxable incomes of mining companies was analysed with reference to the provisions of the Act.

Chapter 4 addressed the last research objective. In this chapter, the order in which the respective parties to the Armgold/Harmony Freegold case utilised the mining loss as

analysed in Chapter 2 was compared to the provisions of the Act as analysed in Chapter 3. This analysis was done to determine whether the judgment was in accordance with the provisions of the Act.

Chapter 5 contains the conclusion to this research study. This chapter provides an overview of the Armgold/Harmony Freegold case, concluding summaries of the research findings in Chapters 2 to 4, as well as a recommendation for future research.

## CHAPTER 2

# ANALYSIS OF THE ORDER OF UTILISATION OF ASSESSED LOSSES IN TERMS OF THE ARMGOLD/HARMONY FREEGOLD JUDGMENT

### 2.1 INTRODUCTION

This chapter aims to critically analyse the different approaches adopted by the respective parties in the Armgold/Harmony Freegold case in utilising assessed losses in order to calculate the taxable income of the Armgold/Harmony Freegold Joint Venture (Armgold/Harmony Freegold).

### 2.2 BACKGROUND TO THE CASE

The appellant, Armgold/Harmony Freegold, operated three gold mines respectively known as Freegold and Joel (both acquired with effect from 1 January 2002 from the Anglo-American Group) and the St Helena mine acquired in 2003. Mining income was derived by these mines (*Armgold/Harmony Freegold Joint Venture v CSARS: 2*)(Pwc Tax Synopsis, 2012).

During the 2003 and 2004 years of assessment, a loss was incurred by the St Helena mine whilst the Freegold and Joel mines derived an operating profit before taking into account the capital redemption allowed for in section 15(a) read with section 36. Non-mining income was also earned by Armgold/Harmony Freegold during these years (*Armgold/Harmony Freegold Joint Venture v CSARS: 8*).

The capex incurred in relation to the profitable Freegold and Joel mines were sufficient to reduce the tax liability of those mines to nil should it be deducted from their taxable income in terms of section 15(a) read with section 36. Furthermore, none of the mines had a balance of assessed loss as envisaged in section 20(1)(a) of the Act that was carried



forward from the preceding year of assessment (*Armgold/Harmony Freegold Joint Venture v CSARS: 8*).

In September 2008, SARS issued Armgold/Harmony Freegold with revised tax assessments in which its income tax liability was adjusted for, amongst others, the 2003 and 2004 years of assessment. One of the grounds on which the revised assessments were issued, and the ground relating to this court case, is the fact that SARS disagreed with the method in which Armgold/Harmony Freegold utilised the loss from its St Helena mine in determining its taxable income (*Armgold/Harmony Freegold Joint Venture v CSARS: 2*).

Armgold/Harmony Freegold objected to SARS in respect of the revised assessments, which objection was disallowed. Armgold/Harmony Freegold then appealed to the Tax Court in *ITC 12856*. The appeal was dismissed on 1 August 2011 (*Armgold/Harmony Freegold Joint Venture v CSARS: 3*).

Armgold/Harmony Freegold, with leave from the Tax Court, appealed to the Supreme Court of Appeal (SCA) (*Armgold/Harmony Freegold Joint Venture v CSARS: 3*).

The question before the court in this case, the respective approaches adopted by Armgold/Harmony Freegold and SARS in determining Armgold/Harmony Freegold's taxable income and the final judgment by Judge Leach, JA (Leach, JA) are set out in the rest of this section.

### **2.3 QUESTION BEFORE THE COURT**

The question that had to be answered by the court pertained to the method for applying assessed losses and capital redemptions in calculating a mining company's taxable income where at least one of the mining company's mines are operating at a loss and where non-mining income is also derived by that mining company (*Armgold/Harmony Freegold Joint Venture v CSARS: 2*)(PwC Tax Synopsis, 2012).

## 2.4 APPROACH ADOPTED BY ARMGOLD/HARMONY FREEGOLD IN CALCULATING ITS TAXABLE INCOME

During its 2003 and 2004 years of assessment, Armgold/Harmony Freegold set off the operating loss from its St Helena mine against the non-mining income derived by its non-mining operations instead of setting it off against the profits derived from the profitable Freegold and Joel mines. Mining capex was redeemed against the profitable Freegold and Joel mines in terms of section 15(a) read with section 36 of the Act to reduce the tax liability in relation to these mines (*Armgold/Harmony Freegold Joint Venture v CSARS: 9-10*). This approach is illustrated in Table 2.

**Table 2: Illustrative example of the calculation of taxable income by Armgold/Harmony Freegold**

(In Rand millions)	St Helena	Freegold	Joel	Non-mining income	Total
Balance of assessed loss	-	-	-	-	-
Taxable income (before capital redemption)	(51)	1 177	20	156	<b>1 302</b>
Capex deductible in 2003	n/a	(1 177)	(20)	n/a	<b>(1 197)</b>
Assessed loss utilised against non-mining income	51	-	-	(51)	-
Taxable income (after capex and assessed loss)	-	-	-	105	<b>105</b>

(*Armgold/Harmony Freegold Joint Venture v CSARS: 9*)

As can be seen from Table 2, Armgold/Harmony Freegold contended that its overall taxable income for the 2003 year of assessment should be assessed at R105 million, being its non-mining income of R156 million less the R51 million operating loss incurred by the St Helena mine (*Armgold/Harmony Freegold Joint Venture v CSARS: 9*).

Armgold/Harmony Freegold's rationale for using this approach can be summarised as follows:

- Armgold/Harmony Freegold contended that the loss derived from the St Helena mine effectively amounted to its assessed loss as envisaged by section 20(1)(b) of the Act (*Armgold/Harmony Freegold Joint Venture v CSARS: 10*).

- The assessed loss should thus be deducted in terms of section 20(1)(b) in order to determine its taxable income. Each mine must be regarded as being a separate trade and should therefore calculate its taxable income (after capital redemption) before taking into account the assessed loss of the St Helena mine (*Armgold/Harmony Freegold Joint Venture v CSARS*: 10).
- Armgold/Harmony Freegold furthermore contended that section 36(7F) required that each mine's taxable income should be determined separately. Therefore the assessed loss could only be utilised after the capital redemption and resultant taxable income of each mine was determined (*Armgold/Harmony Freegold Joint Venture v CSARS*: 11).
- As the capital redemption was sufficient to eliminate the tax liability of the profitable Joel and Freegold mines, no taxable mining income remained against which the assessed loss of the St Helena mine could be utilised (Van der Zwan & Van der Merwe, 2011).
- Therefore the assessed loss could be utilised to reduce the tax liability in terms of its non-mining income (*Armgold/Harmony Freegold Joint Venture v CSARS*: 10).

## 2.5 APPROACH ADOPTED BY SARS IN CALCULATING ARMGOLD/HARMONY FREEGOLD'S TAXABLE INCOME

SARS, on the other hand, set off the loss derived by the St Helena mine proportionately against the taxable income derived before the capital redemption from the profitable Freegold and Joel mines. Mining capital was redeemed against the remaining taxable income of the Freegold and Joel mines in terms of section 15(a) read with section 36 to reduce the tax liability in relation to these mines (*Armgold/Harmony Freegold Joint Venture v CSARS*: 9-10). This approach is illustrated in Table 3.

**Table 3: Illustrative example of the calculation of taxable income by SARS**

(In Rand millions)	St Helena	Freegold	Joel	Non-mining income	Total
Balance of assessed loss	-	-	-	-	-
Taxable income (before capex)	(51)	1 177	20	156	<b>1 302</b>
Assessed loss utilised proportionately against profitable mines' taxable income before capex	51	(50)	(1)	-	-

(In Rand millions)	St Helena	Freegold	Joel	Non-mining income	Total
Capex deductible in 2003	-	(1 127)	(19)	-	(1 146)
Taxable income (after capex and assessed loss)	-	-	-	156	156

(*Armgold/Harmony Freegold Joint Venture v CSARS*: 9-10)

As can be seen from Table 3, SARS argued that Armgold/Harmony Freegold's overall taxable income for the 2003 year of assessment should be assessed at R156 million, being its non-mining income.

SARS' rationale for using this method to calculate Armgold/Harmony Freegold's taxable income can be summarised as follows:

- SARS contended that all three of Armgold/Harmony Freegold's mines should be regarded as a single trade, i.e. being the trade of mining as envisaged by section 11(a).
- The mines' operating expenses therefore had to be deducted from mining income before the capital redemption, as operating expenses must be deducted from "income" and the capital redemption must be deducted against "taxable income" on a ring-fenced basis.
- Section 11(a) requires that the operating loss from a trade must be deducted from the income derived by that trade. The loss from the St Helena mine therefore constituted an operating loss as envisaged in section 11(a) and not an assessed loss as envisaged in section 20(1)(b).
- The intention of sections 36(7E) and 36(7F) was to prevent the "erosion of the non-mining tax base" (*ITC 12856*:13-14).

## 2.6 APPROACH HELD BY LEACH, JA TO BE THE APPROPRIATE METHOD FOR CALCULATING ARMGOLD/HARMONY FREEGOLD'S TAXABLE INCOME

In his judgment, Leach, JA, held that the capital redemption of the two profitable mines should first be calculated based on the provisions of subsections 36(7E) and (7F). Following the calculation of the capital redemption, the current year loss from the St Helena mine should be apportioned between the two profitable Joel and Freegold mines based on its taxable income after the capital redemption (*Armgold/Harmony Freegold Joint*

*Venture v CSARS*: 15-16)(PwC Tax Synopsis, 2012). This approach is illustrated in Table 4.

**Table 4: Illustrative example of the calculation of taxable income in terms of the judgment**

(In Rand millions)	St Helena	Freegold	Joel	Non-mining income	Total
Balance of assessed loss	-	-	-	-	-
Taxable income (before capex)	(51)	1 177	20	156	<b>1 302</b>
Capex deductible in 2003	-	(1 127)	(19)	-	(1 146)
Assessed loss utilised proportionately against profitable mines taxable income after capex	51	(50)	(1)	-	-
Taxable income (after capex and assessed loss)	-	-	-	156	<b>156</b>

(*Armgold/Harmony Freegold Joint Venture v CSARS*: 15)

As can be seen from Table 4, Leach, JA held that Armgold/Harmony Freegold's overall taxable income for the 2003 year of assessment should be assessed at R156 million, being its non-mining income (*Armgold/Harmony Freegold Joint Venture v CSARS*: 15).

Leach, JA therefore rejected both Armgold/Harmony Freegold and SARS' approaches of calculating Armgold/Harmony Freegold's taxable income. The reasons are set out below.

### **2.6.1 The judge's rejection of Armgold/Harmony Freegold's approach**

The judge rejected Armgold/Harmony Freegold's argument that each mine must be regarded as a separate trade, based on the following:

- The definition of what constitutes a trade. As quoted from the case, "a company which carries on mining operations certainly carries on the 'trade' of mining, but it would be both fanciful and artificial to regard its mining operations at the St Helena mine as being a different trade from the operations it conducts at its other two mines. Had the legislature intended each mine's operations to be regarded as separate, it could easily have said so" (*Armgold/Harmony Freegold Joint Venture v CSARS*: 11).

- Section 36(7E) refers to the aggregate amount of capex in relation any mine or mines, which excludes different mines from being regarded as different trades (*Armgold/Harmony Freegold Joint Venture v CSARS*: 11).
- Armgold/Harmony Freegold's method of calculating taxable income also effectively excluded the provisions of section 36(7E), which sets a general cap for the capital redemption that may be deducted in order to calculate taxable income (*Armgold/Harmony Freegold Joint Venture v CSARS*: 12).

### **2.6.2 The judge's rejection of SARS' approach**

The judge rejected SARS' argument that the loss from the St Helena mine should be set off against the taxable incomes before the capital redemption of the Joel and Freegold mines, as section 36(7F) provides that the capital redemption in relation to each mine must be calculated having regard to the taxable income of that mine (*Armgold/Harmony Freegold Joint Venture v CSARS*: 11).

Furthermore, in *ITC 1420 Kriegler*, J held that the purpose of the formula which determines a variable tax rate that is levied against different gold mines is "to tax richer mines at a higher rate than poorer mines". If the operating expenses of a loss-making mine were to be utilised against profitable mines' profits as was contended by SARS, this effect would be "nullified" (*Armgold/Harmony Freegold Joint Venture v CSARS*: 11-12).

Section 36(7C) provides that the capital redemption on a particular mine under section 15(a) must be determined with reference to the income derived from working that mine. Therefore, if the operating expenses of one mine were set off against the income of another, this section would be contravened (*Armgold/Harmony Freegold Joint Venture v CSARS*: 12).

### **2.6.3 New approach adopted by the judge**

Section 36(7E) provides that the capital redemption in aggregate for all of a mining company's mines may not exceed its aggregate taxable income from mining. In order to determine the aggregate taxable income of all the mines, the gross incomes and operating

expenses of all the mines must be taken into account. The St Helena loss must therefore be taken into account in determining the aggregate taxable income, and therefore capital redemption, of all the mines. The capital redemption was thus limited in terms of section 36(7E) to R1 146 million, being the total profit of Freegold and Joel of R1 197 million less the R51 million loss of the St Helena mine (*Armgold/Harmony Freegold Joint Venture v CSARS*: 13).

Section 36(7F) on the other hand provides for the maximum amount of capital redemption that is allowed per mine. In terms of section 36(7F), the maximum amount of the capital redemption per mine may not exceed the taxable income of that mine. Therefore the operating loss of another mine cannot be taken into account in order to calculate the capital redemption per mine. The total capital redemption is thus limited to R1 197 million, being the total profit of the profitable Freegold and Joel mines. This amount is however limited to R1 146 being the maximum allowable redemption calculated in terms of section 36(7E) (*Armgold/Harmony Freegold Joint Venture v CSARS*: 14).

The loss from the St Helena mine should be proportionately set off against the remaining taxable incomes of the mining operations similar to the apportionment of a balance of assessed loss brought into account from a previous year of assessment as described by Silke: “It is submitted that the assessed loss must be apportioned among the different trades in proportion to the income derived from each. For example, if in one year a company had an assessed loss of R100 000 and in the next year it derived an income from mining of R200 000 and an income from manufacturing of R300 000, the assessed loss must be apportioned between the two trades ... In practice SARS accepts this view” (*Armgold/Harmony Freegold Joint Venture v CSARS*: 15).

## **2.7 COMPARISON OF THE THREE DIFFERENT APPROACHES ADOPTED BY ARMGOLD/HARMONY FREEGOLD, SARS AND LEACH, JA**

The three different approaches adopted by Armgold/Harmony Freegold, SARS and Leach, JA in calculating Armgold/Harmony Freegold’s taxable income are summarised and compared in Table 5.

**Table 5: Illustrative comparison of the three different methods adopted in calculating taxable income in the Armgold/Harmony Freegold case**

Steps	Armgold/Harmony Freegold	SARS	Judge Leach, JA
<b>Step 1</b>	Determine taxable income before the capital redemption of each mine separately.		
<b>Step 2</b>	Calculate the capital redemption <b>per mine</b> in terms of section 36(7F) (without taking account the loss from the St Helena mine). The provisions of section 36(7E) are not taken into account.	Utilise the assessed loss of the St Helena mine proportionately against the taxable incomes of the Freegold and Joel mines.	Calculate the maximum capital redemption in terms of section 36(7E) as being limited to the total taxable incomes of the Joel and Freegold mines less the assessed loss of the St Helena mine.
<b>Step 3</b>	As the capital redemption calculated in terms of section 36(7F) reduces the taxable incomes of the profitable Freegold and Joel mines to nil, the assessed loss of the St Helena mine may be set off against the non-mining income.	Calculate the capital redemption in terms of the caps imposed by sections 36(7E) and 36(7F).	Apportion the capital redemption calculated in terms of step 2 above between the taxable incomes of the profitable Joel and Freegold mines.
<b>Step 4</b>	n/a	No reduction of the non-mining income as the assessed loss was already utilised in determining the taxable income before the capital redemption of each mine above.	Apportion the assessed loss of the St Helena mine proportionately between the remaining taxable incomes after the capital redemption of the Joel and Freegold mines.

## 2.8 CONCLUSION

Based on the analysis of the different approaches adopted by Armgold/Harmony Freegold, SARS and Leach, JA in calculating the capital redemption and taxable income of Armgold/Harmony Freegold, the following key questions must be answered with reference to the Act in order to determine whether the judgment was in line with the current legislation contained in the Act:

- How losses should be applied in calculating the taxable income of a mining company.
- What is defined as an assessed loss and when a loss can be set off as envisaged in section 20(1)(b).



- How losses should be applied in calculating the capital redemption of a mining company in terms of sections 36(7E) and 36(7F).

Chapter 3 analyses the provisions of the Act in relation to the taxation of mining companies in order to answer these key questions.

## CHAPTER 3

# ANALYSIS OF THE ORDER OF UTILISATION OF ASSESSED LOSSES IN TERMS OF THE CURRENT LEGISLATION CONTAINED IN THE ACT

### 3.1 INTRODUCTION

This chapter aims to analyse the order in which assessed losses should be utilised in order to determine the taxable income and the capital redemption of mining companies in terms of the current legislation contained in the Act.

### 3.2 TAXABLE INCOME

Taxable income is defined in section 1 of the Act as “ ... the aggregate of-

- (a) the amount remaining after deducting from the **income** of any person all the **amounts allowed under Part I of Chapter II** to be deducted from or **set off** against such income; and
- (b) all amounts to be included or deemed to be included in the taxable income in terms of this Act” (own emphasis).

Based on the analysis of the words contained in the definition of taxable income, the following steps should be followed in order to determine the taxable income of a taxpayer:

*Step 1: Determine part a of the definition of taxable income*

Part a of the definition of taxable income refers to the amount remaining after deducting or setting off all amounts allowed under Part I of Chapter II from income.

Income is defined in section 1 of the Act as “ ... the amount remaining of the **gross income** of any person for any year or period of assessment after deducting therefrom any amounts **exempt** from normal tax under Part I of Chapter II” (own emphasis).

In the case of a resident, gross income is defined in section 1 as “ ... the total amount, in cash or otherwise, received by or accrued to or in favour of ...” that resident during a year of assessment excluding “receipts or accruals of a capital nature”, but including specific amounts as set out in paragraphs (a) to (n) of the definition of gross income.

Exempt income is provided for in section 10 of the Act.

The amounts allowed under Part I of Chapter II of the Act include sections 5 to 37H.

The deductions allowed for in terms of sections 5 to 37H include, amongst others:

- the general deductions allowed for in section 11(a);
- the specific deductions and capital allowances provided for in the rest of section 11 and section 12;
- the deduction of mining capex incurred as calculated in terms of section 15(a) read with section 36 where the trade is mining instead of the allowances provided for in sections 11(e), (f), (gA), (gC), (o), 12D, 12DA, 12F and 13quin;
- the deduction of the balance of assessed loss carried forward from the preceding year of assessment in terms of section 20(1)(a); and
- the set-off of current year assessed losses from other trades in terms of section 20(1)(b).

The definition of taxable income in section 1 does not prescribe the order in which the deductions should be applied against income. Furthermore, in practice, the calculation of the taxable income of a company starts with the profit before tax as on the Statement of Comprehensive Income which forms part of the financial statements of the company submitted to SARS with the annual return. The profit before tax is then adjusted on an item-by-item basis with the differences between the accounting and tax treatment thereof. In terms of this practice, it is also evident that there is no specific sequence in which the deductions must be applied against income in order to determine taxable income. The deduction allowed for in section 18A of the Act is the only exception to this rule due to the limitations placed on the deductibility thereof by the section (De Swardt *et al.*, 2010:4).

The order in which these deductions are permitted will have no significant influence on the result of the calculation, as taxpayers are allowed to create an assessed loss in terms of section 20 of the Act (discussed further in subchapter 3.3).

Where the taxpayer has more than one trade, the resultant taxable income determined by deducting all the amounts mentioned above from income per trade, must be aggregated for all trades in order to determine the taxable income of a taxpayer. Where the deductions of a trade exceed the income, the loss is referred to as an assessed loss. Assessed losses are discussed in further detail in subchapter 3.3.

*Step 2: Determine part b of the definition of taxable income*

Amounts to be included in taxable income would include section 26A “Inclusion of taxable capital gain in taxable income”.

This part of the definition of taxable income will, however, not be analysed in any great detail as it has no bearing on the research objectives of this study.

Table 6 sets out the framework for calculation of taxable income as defined in section 1.

**Table 6: Illustrative framework of the calculation of taxable income**

Description	Section	Amount
Gross income	s 1	Rxxx
<b>Less:</b> Exempt income	ss 10 and 10A	(Rxxx)
<b>Equals:</b> Income	s 1	Rxxx
<b>Less:</b> Deductions and allowances, allowances and assessed loss	Mainly sections 11-19 and 23	(Rxxx)
<b>Plus:</b> Taxable portion of capital gain Amounts included in taxable income	S 26A For example section 8(1)(a)	Rxxx Rxxx
<b>Less:</b> Assessed loss brought forward if applicable	s. 20(1)(a)	(Rxxx)
<b>Equals:</b> Taxable income	s 1	Rxxx

(Haupt, 2013:8)

However, as already mentioned above, this framework is not used in practice when calculating taxable income and is only for illustrative purposes.

Subchapter 3.3 aims to give a more detailed explanation of the set-off of assessed losses in terms of section 20(1)(b) and the calculation of the capital redemption in terms of section 15(a) read with section 36 of the Act. Both of these sections form part of the deductions allowed against income in terms of part a of the definition of taxable income.

### 3.3 SET-OFF OF ASSESSED LOSSES IN TERMS OF SECTION 20(1)(B)

In terms of the set-off of current year assessed losses, section 20(1)(b) of the Act provides that “ ... for the purpose of determining the **taxable income** derived by any person from **carrying on any trade**, there shall, subject to section 20A, be set off against the **income so derived** by such person –

(a) ...

(b) ... any **assessed loss** incurred by the taxpayer during the same year of assessment in carrying on **any other trade ...**” (own emphasis).

In this regard, Van Blerck (1992:11-20) states that “ ... it is quite clear that a taxpayer may set off a loss derived from one trade against income earned in respect of another, even if one of the trades is mining ...”

On analysis of the wording of section 20(1)(b), the following elements must be present in order for section 20(1)(b), and thus the set-off of assessed losses, to apply:

- there must be an assessed loss incurred from carrying on a trade;
- there must be at least two different trades as the section provides that the assessed loss from carrying on any other trade shall be set off against the income derived from carrying on any trade. Therefore, where only one trade is present, the section does not apply; and
- the assessed loss must be set off against the income derived from another trade;

From the elements listed above, the order in which assessed losses should be utilised in calculating taxable income is dependent on:

- what is defined as an assessed loss;
- what is defined as a trade;
- whether the trade is being carried on; and
- what is defined as income.

The next subchapters aim to clarify the aforementioned.

### 3.3.1 What is defined as an assessed loss?

For the purposes of section 20, an assessed loss is defined in section 20(2) as “any amount by which the deductions admissible under section 11 **exceeded** the income in respect of which they are so admissible” (own emphasis)

The definition of an assessed loss does not require the loss to actually have been assessed by SARS.

The definition of an assessed loss does not contain a “trade” or “income from trade” requirement. However, for a deduction to be admissible under section 11, the carrying on of a trade is required (Interpretation Note 33:995).

Section 11 provides for the general and specific deductions that are allowed in order to determine taxable income. The wording of the introductory paragraph states that “[f]or the purpose of determining the taxable income derived by any person from **carrying on any trade**, there shall be allowed as deductions from the income of such person so derived ...” (own emphasis)

From the wording of section 11, it would seem as if the Act contemplated the carrying on of more than one trade and that deductions should initially be made per trade. If the deductions per trade exceed the income of that trade, there is an assessed loss as

contemplated in section 20(2) which can be set off against the income derived from other trades of that taxpayer (De Koker & Williams, 2013:7.2).

In terms of the definition of taxable income described in 3.2, the final income and/or losses per trade must be aggregated in order to determine the total taxable income of a taxpayer.

What is defined as a trade is therefore important in determining whether there is an assessed loss.

Section 11(x) of the Act includes all the deductions in sections 5 to section 37H. Therefore, all of these deductions must be taken into account in order to determine the assessed loss made from a trade (Haupt, 2013:288). This is similar to the calculation of taxable income as provided for in terms of part *a* of the definition of taxable income analysed in 3.2.

Based on the above analysis of the definition of an assessed loss, the calculation of an assessed loss from a trade can be illustrated as in Table 7.

**Table 7: Illustrative example of the calculation of an assessed loss from a trade based on the provisions of section 20(1)(b)**

Description	Section	Amount
Gross income	s 1	Rxxx
<b>Less:</b> Exempt income	ss 10 and 10A	(Rxxx)
<b>Equals:</b> Income	s 1	Rxxx
<b>Less:</b> All deductions provided for in section 11. Section 11(x) includes all deductions contained in sections 5 to 37H, which includes amongst others: <ul style="list-style-type: none"> <li>• General deductions and specific deductions</li> <li>• Capital allowances</li> <li>• Capital redemption in terms of section 15(a) read with section 36.</li> <li>• Balance of assessed loss carried forward from previous year (s 20(1)(a))</li> </ul>	s 11	(Rxxx)
<b>Equals:</b> Assessed loss to the extent that the deductions exceed income.	s 20(2)	

As with the determination of taxable income, this method is not used in practice, but is for illustrative purposes only. In practice, the starting point of the calculation is the profit before tax of the company as described in subchapter 3.2.

### 3.3.2 What is defined as a trade?

The word “trade” is defined in section 1 of the Act as including “ ...every profession, **trade**, business, employment, calling, occupation or venture, including the letting of any property ...” (own emphasis).

The word trade is defined very broadly and even includes the word “trade”. This principle was described as being well established in *Burgess v CIR* (23). A similar definition of the word trade in Act 31 of 1941 was dealt with in *ITC 770* (217) in which Dowling, J said that it was “obviously intended to embrace every profitable activity ... and I think should be given the widest possible interpretation”.

The Paperback Oxford English Dictionary (2006:806) defines the word “trade” amongst others as “a particular area of commercial activity: the tourist trade”.

A trade can also be described as an activity which is undertaken by a person in order to earn income and must be distinguished from a passive activity, like the investment of surplus funds (Haupt, 2013:289).

Despite the wide meaning of the word “trade”, all activities that produce income, for example interest income, dividends, annuities or pensions will not constitute a trade, as the carrying on of a trade involves an “active step”. The earning of passive income does not encompass an “active step” and will therefore not constitute a trade as defined (De Koker & Williams, 2013:7.2).

Based on the preceding analysis of the word “trade”, mining would arguably constitute a particular area of commercial activity which is undertaken in order to earn income.



In the case where a company operates more than one mine, each mine does not constitute a separate trade, but rather a unit of one mining trade. The judgment in the Armgold case stated:

[c]ompelling though this argument is in certain respects, I do not see how the mining activities conducted by the appellant at each one of its three mines can be said to be a separate “trade” – ... – from that conducted at the other mines. A company which carries on mining operations certainly carries on the “trade” of mining, but it would be both fanciful and artificial to regard its mining operations at the St Helena mine as being a different trade from the operations it conducts at its other two mines. Had the legislature intended each mine’s operations to be regarded as a separate trade, it could easily have said so (*Armgold/Harmony Freegold Joint Venture v CSARS*: 11).

Based on the analysis in the judgment, it can be concluded that a taxpayer operating a number of mines is carrying on one mining trade.

### **3.3.3 When is a trade being carried on?**

In order for the set-off of assessed losses in terms of section 20(1)(b) to apply, the taxpayer must be carrying on a trade. SARS is of the view that the taxpayer must have a profit motive notwithstanding the fact that the word “trade” is defined. The taxpayer must have the intention to make a profit, but there must also be a reasonable prospect of making a profit within a reasonable time (Haupt, 2013:289).

The question of whether a trade was being carried on by Armgold/Harmony Freegold was not a matter of dispute in the case. Therefore this requirement will not be analysed in any significant detail as it will have no bearing on the research of this study.

### **3.3.4 What is defined as income?**

Section 20(1)(b) provides that for the purposes of determining a taxpayer's taxable income from carrying on any trade, the assessed loss from any other trade shall be set off from the **income** so derived.

Income is defined in section 1 of the Act as “ ... the amount remaining of the **gross income** of any person for any year or period of assessment after deducting therefrom any amounts **exempt** from normal tax under Part I of Chapter II” (own emphasis).

In the case of a resident, gross income is defined as “ ... the total amount, in cash or otherwise, received by or accrued to or in favour of ...” that resident during a year of assessment, excluding “receipts or accruals of a capital nature”, but including specific amounts as set out in paragraphs (a) to (n) of the definition of gross income.

Exempt income is provided for in section 10 of the Act.

### **3.4 SET-OFF OF ASSESSED LOSSES IN TERMS OF SECTIONS 15(A), 36(7C), 36(7E) AND 36(7F)**

#### **3.4.1 What do sections 15(a), 36(7C), 36(7E) and 36(7F) provide?**

The taxable incomes of mining companies are determined in a similar way to those of other companies in terms of the general provisions of the Act, as set out in subchapters 3.2 and 3.3. There are, however, a few modifications in the form of specific provisions to these general provisions (Van Blerck, 1992:6-2).

Where the taxpayer derives its income from mining operations, section 15(a) read with section 36 provides for the deduction of certain mining capex incurred instead of certain other capital allowances provided for in terms of the Act (Van Blerck, 1992:6-2). This deduction of capex incurred is referred to in this study as capital redemption.

Section 15(a) provides that “[t]here shall be allowed to be deducted from the **income derived** by the taxpayer from **mining operations**–

- (a) an amount to be **ascertained** under the provisions of section 36, **in lieu of** the allowances of sections 11(e), (f), (gA), (gC), (o), 12D, 12DA, 12F and 13quin” (own emphasis).

Mining operations and mining is defined in section 1 of the Act as including “... every method or process by which any mineral is won from the soil or from any substance or constituent thereof”.

The words “in lieu” can be defined as “instead of something”. (oxforddictionaries.com, Not dated.)

Section 36(7C) provides that “[s]ubject to the provisions of subsections (7E), (7F) and (7G), the amounts to be deducted from **income derived** from the working of any **producing mine** shall be the amount of capital expenditure incurred” (own emphasis).

Subsections (7E), (7F) and (7G) in essence provide for the method of calculating the maximum amount of the capital redemption.

Section 36(7E) prescribes how the maximum amount of the capital redemption in aggregate for all mines should be calculated:

... the **aggregate** of the amounts of capital expenditure determined under subsection (7C) in respect of any year of assessment **in relation to any** mine or **mines** shall not exceed the **taxable income** (as determined before the deduction of any amount allowable under section 15(a), but **after the set-off of any balance of assessed** loss incurred by the taxpayer **in relation to such mine or mines in any previous year** which has been **carried forward from the preceding year of assessment**) derived by the taxpayer from mining, and any amount by which the said aggregate would, but for the provisions of this subsection, have exceeded such taxable income as so determined, shall be carried forward and be deemed to be an amount of capital expenditure incurred during the next succeeding year of assessment in respect of the mine or mines to which such capital expenditure relates” (own emphasis).

From the wording of section 36(7E), the provision does not limit the capital redemption to income from a specific mine, but to “taxable income ... from mining” (Van Blerck, 1992:12-

28). It therefore provides for the maximum amount of capex incurred for all of a taxpayer's mines that can be deducted in terms of section 15(a).

The meaning of taxable income is furthermore qualified in section 36(7E) to refer to taxable income (as defined in section 1) as calculated before the allowance provided for in section 15(a) but after the set-off of any balance of assessed loss incurred in any previous year carried forward from the preceding year (provided for in terms of section 20(1)(a)) (Van Blerck, 1992:12-28).

The qualification of the definition of taxable income only refers to the balance of assessed loss incurred in any previous year of assessment as envisaged in section 20(1)(a). However, it does not prescribe how other mining assessed losses incurred in the current year should be dealt with. In this regard, and a very important fact in relation to the Armgold/Harmony Freegold case, Van Blerck (1992:12-29) states that "this is entirely logical as the current assessed loss from mining would in any event be automatically taken into account in determining mining income in the current year."

The wording of section 36(7E) does not clearly outline how assessed losses from other trades as envisaged in section 20(1)(b) should be dealt with in determining the maximum amount of the capital redemption. However, from the wording of section 36(7E), it is evident that the current year assessed losses from other trades as envisaged in section 20(1)(b) should not be taken into account in determining the maximum amount of the capital redemption, as the definition of taxable income is qualified as follows: "... in relation to any mine or mines shall not exceed the taxable income ... from mining" as relating only to the taxpayer's mining trade and not to other trades. Assessed losses from other trades can therefore only be taken into account after the capital redemption is applied against the income from mining (Van Blerck, 1992:12-29).

Based on the above analysis of section 36(7E), where a mining company operates more than one mine, the capital redemption in total for all of the company's mines may not exceed the total taxable income from its mining trade (as qualified by section 36(7E)).

Any amount of capex incurred that does not qualify for redemption, is carried forward to the next year (Norton Rose, 2012).

The calculation of maximum capital redemption in terms of section 36(7E) is illustrated in Table 8.

**Table 8: Illustrative example of the calculation of the maximum capital redemption allowed in terms of section 36(7E)**

Description	Amount
Current total mining income from all mines	R10 000
Current total mine working costs from all mines	(R4 000)
Equals	<b>R6 000</b>
Assessed loss brought forward	(R5 000)
<b>Total mining taxable income before capex</b>	<b>R1 000</b>
Capital redemption limited to mining taxable income	(R1 000)
Taxable income/(assessed loss carried forward)	R0
Current Capital expenditure	R20 000
Unredeemed capital expenditure brought forward	R40 000
Capital redemption limited to mining taxable income	(R1 000)
<b>Unredeemed capital expenditure brought forward</b>	<b>R59 000</b>

(Van Blerck, 1992:12-30)

Section 36(7F) was introduced in 1984 to essentially prevent the erosion of the mining tax base where a company owned more than one mine. Prior to section 36(7F) being introduced, mining companies could set off the unredeemed capex on one of their mines against the mining income of another mine. In the early 80s some major mergers and takeovers caused concern to tax authorities that the new capex could substantially erode the tax base. A “capex per mine” ring-fencing restriction was therefore introduced in the form of section 36(7F) (Van Blerck, 1992:12-29).

Section 36(7F) provides for the maximum amount of the capital redemption that is deductible per mine:

... the **aggregate** of the amounts of capital expenditure determined under subsection (7C) in respect of any year of assessment in relation to **any one mine shall** ... not exceed the **taxable income** (as determined before the

deduction of any amount allowable under section 15(a), but **after the set-off of any balance of assessed** loss incurred by the taxpayer **in relation to that mine** in **any previous year** which has been **carried forward from the preceding year of assessment**) derived by the taxpayer from mining on **that mine**, and any amount by which the said aggregate would, but for the provisions of this subsection, have exceeded such taxable income as so determined, shall be carried forward and be deemed to be an amount of capital expenditure incurred during the next succeeding year of assessment in respect of that mine (own emphasis).

The wording of section 36(7F) reads more or less the same as section 36(7E). However, the section provides that the calculation of the capital redemption should be ring-fenced per mine, whereas section 36(7E) essentially provides that the total of all the amounts calculated in terms of section 36(7F) may not exceed the total taxable income of all mines (Van Blerck, 1992:12-29).

The definition of taxable income is also qualified in a similar way to the qualification in section 36(7F) as being calculated before the allowance provided for in section 15(a) but after the set-off of any balance of assessed loss incurred in any previous year carried forward from the preceding year (provided for in terms of section 20(1)(a)) (Van Blerck, 1992:12-28).

Based on the above analysis of section 36(7F), where a mining company operates more than one mine, the capital redemption per mine may not exceed the taxable income per mine (as qualified by section 36(7E)).

The wording of section 36(7F) does not clearly stipulate how losses from other mines should be dealt with in determining the maximum amount of capital redemption per mine. However, based on the analysis of the wording of the section, it is evident that the current year losses from other mines should not be taken into account in determining the maximum amount of the capital redemption, as taxable income is ring-fenced per mine in terms of section 36(7F) by the words “...in relation to any one mine shall ... not exceed the taxable income ... from mining on that mine ...” Should the set-off of losses from other

mines be allowed, the calculation of the capital redemption will no longer only relate to the taxable income from that one mine and will therefore not comply with the requirements of section 36(7F) (Van Blerck, 1992:12-31).

The calculation of the maximum capital redemption in terms of section 36(7F) is illustrated in Table 9.

**Table 9: Illustrative example of the calculation of the maximum capital redemption allowed in terms of section 36(7F)**

Description	Mine 1	Mine 2	Total
Mining income	R7 000	R3 000	R10 000
Mine working costs	(R2 000)	(R2 000)	(R4 000)
Equals	<b>R5 000</b>	<b>R1 000</b>	<b>R6 000</b>
Assessed loss brought forward	(R5 000)	(R0)	(R5 000)
<b>Total mining taxable income before capex</b>	<b>R0</b>	<b>R1 000</b>	<b>R1 000</b>
Capital redemption limited to mining taxable income	<b>R0</b>	<b>(R1 000)</b>	<b>(R1 000)</b>
Taxable income/(assessed loss carried forward)	R0	R0	R0
Current capital expenditure	R15 000	R5 000	R20 000
Unredeemed capital expenditure brought forward	R30 000	R10 000	R40 000
Capital redemption limited to mining taxable income	(R0)	(R1 000)	(R1 000)
<b>Unredeemed capital expenditure brought forward</b>	<b>R45 000</b>	<b>R14 000</b>	<b>R59 000</b>

Section 36(7G) provides for a partial relief of the ring-fencing requirements of section 36(7F). This section was however not applicable to the Armgold/Harmony Freegold case and will therefore not be analysed in detail.

### 3.5 CONCLUSION

Taxable income as defined in section 1 of the Act should initially be calculated separately for each trade of the taxpayer in order to determine whether there is any assessed loss from a trade as envisaged in section 20(1)(b) (subchapters 3.2 and 3.3).

In determining taxable income, all the deductions as allowed for in sections 5 to 37H of the Act should be taken into account against the income on a “per trade” basis, as required by section 11. With a few exceptions, none of which are applicable to the Armgold/Harmony case, the deductions allowed for in sections 5 to 37H do not have to be applied in any specific order. This will initially not include the set-off of current year assessed losses from other trades as envisaged in section 20(1)(b) as the resultant loss or income should first be determined separately per trade.

An important factor in determining whether there is an assessed loss as defined, which can be set off as envisaged in section 20(1)(b) of the Act, is whether the loss relates to a trade.

Where the loss relates to a unit of the same trade, the loss constitutes an operating loss, which should first be taken into account by the other units within the same trade in order to determine whether there is a loss incurred by the total trade. Only where the loss relates to a trade and not just to a single unit of the same trade, can there be an assessed loss as defined which can be set off against another trade in terms of section 20(1)(b).

Where one or more of the taxpayer’s trades has an assessed loss as envisaged by section 20(1)(b), the assessed loss can be set off against the income derived from the taxpayer’s other trades. The resultant losses and/or incomes from all of the taxpayer’s trades should be aggregated in order to calculate the total taxable income of the taxpayer.

Where the company is a mining company, its taxable income is determined in terms of the general provisions of the Act similar to the calculation of the taxable income of other types of companies. The only exception to this rule is that section 15(a) read with section 36 of the Act prescribes how the capital allowance of mining companies should be calculated.



This can be compared to section 12C, which prescribes how the capital allowance of manufacturing companies should be calculated.

Section 36(7E) limits the maximum capital redemption for all mines in aggregate to the taxable income of all mines in aggregate as calculated before the capital redemption but after the set-off of any balance of assessed loss brought forward from the previous year (qualified definition of taxable income). The assessed losses from other trades are not taken into account in this calculation.

Section 36(7F) on the other hand limits the maximum capital redemption per mine to the taxable income (as qualified) per mine. Therefore, none of the operating results of other mines may be taken into account in calculating the capital redemption per mine in terms of section 36(7F).

From the analysis of the provisions of section 15(a) read with section 36 in 3.4, it is evident that the capital redemption provided for is **calculated** in terms of the provisions of section 36. The heading to section 36 also reads: “[c]alculation of redemption allowance and unredeemed balance of capex in connection with mining operations”.

The purpose of section 15(a) read with section 36 is therefore not to prescribe how the taxable income of mining companies should be calculated, but rather to prescribe how the capital redemption which is allowed as a deduction in order to determine taxable income should be calculated. The provisions of section 36 therefore do not alter the order in which these allowances and assessed losses must be utilised in order to determine taxable income, as section 36 merely prescribes the method of calculating the maximum amount of the capital redemption.

Based on the analysis of the provisions of the Act with regard to the order of utilisation of assessed losses by mining companies in order to calculate taxable income, the steps illustrated in Tables 10 and 11 should be followed in order to calculate the taxable income of a mining company over a two-year period where the mining company operates more than one mine.

**Table 10: Illustrative example of the calculation of taxable income of mining companies in terms of the provisions of the Act: Year 1**

Chapter Reference	Year 1		Mining trade			Other trade
			Mine 1	Mine 2	Total	
3.2, para. 11; 3.3.1, para. 5; 3.5, para. 2.	Determine the taxable income separately <b>per trade</b> on a per mine basis					
3.2	<b>Step 1</b>	Determine income per trade	R100 000	R400 000	<b>R500 000</b>	R300 000
3.2	<b>Step 2</b>	Deduct the s 11(a) general deductions and any other allowable deductions, except for the section 15(a) capital redemption (See <b>Note 1</b> )	(R150 000)	(R50 000)	<b>(R200 000)</b>	(R400 000)
3.2	<b>Step 3</b>	Deduct any balance of assessed loss carried forward from the preceding year of assessment per trade (See <b>Note 1</b> )	(R0)	(R0)	<b>(R0)</b>	(R0)
	<b>Equals</b>	<b>Taxable income per mine and per trade as qualified by sections 36(7E) and (7F)/(assessed loss)</b>	<b>(R50 000)</b>	<b>R350 000</b>	<b>R300 000</b>	<b>(R100 000)</b>
3.4	<b>Step 4</b>	Calculate the capital redemption of the mining trade in terms of section 15(a) read with section 36:  Total capital expenditure incurred  S 36(7E): Total capital redemption limited to total taxable income from mining (as qualified)  S 36(7F): Capital redemption per mine limited to taxable income (as qualified) per mine  Unredeemed capital expenditure carried forward to next year	R500 000  R300 000  R350 000 per mine 2  R200 000	n/a  (R300 000)	(R300 000)	n/a
	<b>Equals</b>	<b>Taxable income/(assessed loss) per trade after capital redemption</b>	<b>(R50 000)</b>	<b>R50 000</b>	<b>R0</b>	<b>(R100 000)</b>
3.3	<b>Step 5</b>	Set-off any mining losses against taxable income of profitable mines	R50 000	(R50 000)	n/a	n/a

Chapter Reference	Year 1		Mining trade			Other trade
			Mine 1	Mine 2	Total	
3.3	<b>Step 6</b>	Set-off any current year assessed losses from other trades as envisaged by section 20(1)(b)	n/a	n/a	n/a	n/a
		<b>Taxable income/(assessed loss carried forward) after taking into account assessed losses from other trades</b>	<b>R0</b>	<b>R0</b>	<b>R0</b>	<b>(R100 000)</b>

**Note 1:** The sequence in which deductions are allowed against income in order to determine taxable income is not significant (refer to subchapter 3.2). The allowance for section 15(a) is omitted at this stage of the calculation in order to determine the taxable income, as qualified by sections 36(7E) and 36(7F), per mine and in aggregate for all mines for the purpose of calculating the maximum capital redemption in terms of these sections.

**Table 11: Illustrative example of the calculation of taxable income of mining companies in terms of the provisions of the Act: Year 2**

Reference	Year 2		Mining trade			Other trade
			Mine 1	Mine 2	Total	
3.2, para. 11; 3.3.1, para. 5;3.5, para. 2.	Determine the taxable income separately <b>per trade</b>					
3.2	<b>Step 1</b>	Determine income per trade	R300 000	R600 000	<b>R900 000</b>	R400 000
3.2	<b>Step 2</b>	Deduct the s 11(a) general deductions and any other allowable deductions, except for the section 15(a) capital redemption (See <b>Note 1</b> )	(R200 000)	(R300 000)	<b>(R500 000)</b>	(R350 000)
3.2	<b>Step 3:</b>	Deduct any balance of assessed loss carried forward from the preceding year of assessment per trade (See <b>Note 1</b> )	(R0)	(R0)	<b>(R0)</b>	(R100 000)
	<b>Equals</b>	<b>Taxable income per mine and per trade as qualified by sections 36(7E) and (7F)/(assessed loss)</b>	<b>R100 000</b>	<b>R300 000</b>	<b>R400 000</b>	<b>(R50 000)</b>
3.4	<b>Step 4</b>	Calculate the capital redemption of the mining trade in terms of section 15(a) read with section 36:  Unredeemed capital expenditure carried forward from the previous year of assessment  Current year capital expenditure incurred  S 36(7E): Total capital redemption limited to total taxable income from mining (as qualified)  S 36(7F): Capital redemption per mine limited to taxable income (as qualified) per mine  Limited to total capital expenditure incurred	R200 000  R50 000  R400 000  R400 000  R250 000	(R62 500)  (R187 500)	(R250 000)	n/a

Reference	Year 2		Mining trade			Other trade	
			Mine 1	Mine 2	Total		
		Unredeemed capital expenditure carried forward to next year	R0				
	<b>Equals</b>	<b>Taxable income/(assessed loss) per trade after capital redemption</b>		<b>R37 500</b>	<b>R112 500</b>	<b>R150 000</b>	<b>(R50 000)</b>
3.3	<b>Step 5</b>	Set-off any mining losses against the taxable income of profitable mines		n/a	n/a	n/a	n/a
3.3	<b>Step 6</b>	Set-off any current year assessed losses from other trades as envisaged in section 20(1)(b). Proportion between mines based on taxable income.		(R12 500)	(R37 500)	(R50 000)	R50 000
		<b>Taxable income/(assessed loss carried forward) after taking into account assessed losses from other trades</b>		<b>R25 000</b>	<b>R75 000</b>	<b>R100 000</b>	<b>R0</b>

## CHAPTER 4

# COMPARISON OF THE ORDER OF UTILISATION OF ASSESSED LOSSES BETWEEN THE JUDGMENT AND THE CURRENT LEGISLATION CONTAINED IN THE ACT

### 4.1 INTRODUCTION

Chapter 4 aims to compare the order in which the loss incurred by Armgold/Harmony Freegold's St Helena mine was utilised in each of the approaches adopted by the respective parties to the Armgold/Harmony Freegold case as analysed in Chapter 2 with the provisions as contained in the Act as analysed in Chapter 3.

### 4.2 COMPARISON OF APPROACH ADOPTED BY ARMGOLD/HARMONY FREEGOLD WITH THE ACT

Armgold/Harmony Freegold contended that the loss incurred by the St Helena mine constituted an assessed loss as envisaged by section 20(1)(b) of the Act. Armgold/Harmony Freegold therefore regarded each of its mines as being a separate trade in order for section 20(1)(b) to be applicable (see subchapter 2.4).

Armgold/Harmony Freegold also contended that section 36(7F) requires that each mine's taxable income should be determined separately and that the assessed loss can therefore only be utilised after the taxable income and capital redemption of each mine has been determined (see subchapter 2.4).

Armgold/Harmony Freegold therefore contended that the assessed loss from its St Helena mine could be set off against its non-mining income as the capital redemption allowed for in section 36(7F) of the Act was sufficient to reduce the taxable income from the profitable Freegold and Joel mines to nil (see subchapter 2.4, paragraph 5).

However, in terms of the definition of the word “trade” in section 1 of the Act, as analysed in subchapter 3.3.2, all three of Armgold/Harmony Freegold’s mines form part of one mining trade. Each mine would therefore be considered a unit of one mining trade (see subchapter 3.3.2, paragraph 7). As the St Helena mine only constitutes a unit of a trade, the loss does not constitute an assessed loss as defined in section 20(2), but rather an operating loss of that specific mine. Therefore, the provisions of section 20(1)(b) do not apply to the St Helena mine’s loss as was contended by Armgold/Harmony Freegold in the court case. This was correctly pointed out by both SARS and Judge Leach, JA.

Furthermore, the contention by Armgold/Harmony Freegold that section 36(7F) requires that each mine’s taxable income should be determined separately and that the assessed loss can therefore only be utilised after the taxable income and capital redemption of each mine is determined is appropriate only in so far as it relates to the calculation of the capital redemption per mine.

However, Armgold/Harmony Freegold neglected to take into account the provisions of section 36(7E) which determines the maximum amount of the capital redemption in aggregate for all mines; a fact which Leach, JA also pointed out in his judgment.

Table 12 provides an illustrative comparison of the method adopted by Armgold/Harmony Freegold in calculating its taxable income with the method that should be followed based on the analysis of the provisions of the Act in subchapter 3.5.

**Table 12: Illustrative comparison of the approach in calculating taxable income by Armgold/Harmony Freegold case with the provisions of the Act**

Steps		Armgold/Harmony Freegold (see subchapter 2.4)					The Act (see subchapter 3.5)				
		Mining trade (in Rand millions)				Non-mining	Mining trade (in Rand millions)				Non-mining (in Rand millions)
		St Helena	Freegold	Joel	Total mining trade		St Helena	Freegold	Joel	Total mining trade	
<b>Step 1</b>	Determine the taxable income before the capital redemption of each mine separately, but after the set-off of the balance of assessed loss from the previous year	(51)	1 117	20	<b>1 146</b>	156	(51)	1 177	20	<b>1 146</b>	156
<b>Step 2</b>	Calculate the maximum capital redemption per mine in terms of section 36(7F)	n/a	(1 177)	(20)	(1 197)	n/a	n/a	(-1 177)	(-20)	(-1 197)	n/a
<b>Step 3</b>	Calculate the maximum capital redemption for all mines in aggregate in terms of section 36(7E)	n/a	n/a	n/a	n/a	n/a	n/a	(1 127)	(19)	(1 146)	n/a
<b>Step 4</b>	Set off any current year mining losses from the taxable incomes of profitable mines.	n/a	n/a	n/a	n/a	n/a	51	(50)	(1)	0	n/a
<b>Step 5</b>	Set off any current year assessed losses from other trades as envisaged in section 20(1)(b)	51	n/a	n/a	51	(51)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)
	<b>Total taxable income/(assessed loss carried forward)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>105</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>156</b>

**Note 2:** The loss from the St. Helena mine is already taken into account in the aggregate taxable income from the mining trade as the loss constitutes an operating loss as envisaged in section 11(a) and not an assessed loss as envisaged in section 20(1)(b) and contended by Armgold/Harmony Freegold. Therefore, no loss is available to set off against the non-mining taxable income.



As can be seen from the comparison in Table 12, the approach adopted by Armgold/Harmony Freegold in determining its taxable income and capital redemption was not in accordance with the provisions of the Act.

#### **4.3 COMPARISON OF APPROACH ADOPTED BY SARS WITH THE PROVISIONS OF THE ACT**

SARS contended that the Joel, Freegold and St Helena mines of Armgold/Harmony Freegold formed part of one mining trade. Therefore, the loss from the St Helena mine constituted an operating loss as envisaged by section 11(a) rather than an assessed loss as envisaged by section 20(1)(b) (see subchapter 2.5).

In terms of the definition of the word “trade” in section 1 of the Act as analysed in subchapter 3.3.2, all of Armgold/Harmony Freegold’s mines form part of one mining trade. The St Helena mine would therefore constitute a unit of that trade. Therefore, the loss from the St Helena mine does not constitute an assessed loss as envisaged in section 20(1)(b) and as contended by Armgold/Harmony Freegold, but rather an operating loss of that specific mine. SARS was therefore correct in its contention that the loss of the St. Helena mine constituted an operating loss as envisaged by section 11(a) and that the loss should be set off from the profits of the Joel and Freegold mines in order to determine the taxable income from the mining trade.

SARS however took the loss from the St. Helena mine into account proportionately against the profits of the Joel and Freegold mines in order to calculate the capital redemption on a “per mine” basis as provided for in section 36(7F) (see subchapter 2.5).

This approach is appropriate for calculating taxable income as defined, as the deductions from income do not have to be made in any specific sequence (see subchapter 3.2).

The approach is nevertheless not in accordance with section 36(7F), which provides that the capital redemption per mine should be limited to the taxable income, as qualified by section 36(7F), **per mine** as analysed in subchapter 3.4 earlier. Should the loss from the St Helena mine be taken into account against the profits of the Joel and Freegold mines in

order to calculate the capital redemption per mine, the calculation will no longer be limited to the qualified taxable income per mine.

Should this approach be followed, the calculation of the capital redemption in terms of section 36(7F) should be done separate from the calculation of the taxable income of the company without taking into account the loss from the St Helena mine (see subchapter 3.5).

Table 13 provides an illustrative comparison of the approach adopted by SARS in calculating the taxable income with the method that should be followed based on the analysis of the provisions of the Act.

**Table 13: Illustrative comparison of the approach adopted in calculating taxable income by SARS with the provisions of the Act**

Steps		SARS (2.5)					the Act (3.5)				
		Mining trade (in Rand millions)				Non- mining	Mining trade (in Rand millions)				Non- mining (in Rand millions)
		St Helena	Freegold	Joel	Total mining trade		St Helena	Freegold	Joel	Total mining trade	
<b>Step 1</b>	Determine the taxable income before the capital redemption of each mine separately, but after the set-off of the balance of assessed loss from the previous year	(51)	1 177	20	1 146	156	(51)	1 177	20	1 146	156
<b>Step 2</b>	Set off the St Helena mines loss proportionately against the profitable Freegold and Joel mines	51	(50)	(1)	0	n/a	n/a	n/a	n/a	n/a	n/a
<b>Step 3</b>	Calculate the maximum capital redemption per mine in terms of section 36(7F)	n/a	(1 127)	(19)	(1 146)	n/a	n/a	(-1 177)	(-20)	(-1 197)	n/a
<b>Step 4</b>	Calculate the maximum capital redemption for all mines in aggregate in terms of section 36(7E)	n/a	(1 127)	(19)	(1 146)	n/a	n/a	(1 127)	(19)	(1 146)	n/a
<b>Step 5</b>	Set off any current year mining losses from the taxable incomes of profitable mines.	n/a	n/a	n/a	n/a	n/a	51	(50)	(1)	0	0
<b>Step 6</b>	Set off any current year assessed losses from other trades as envisaged in section 20(1)(b)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)
	<b>Total taxable income/(assessed loss carried forward)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>156</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>156</b>

**Note 2:** The loss from the St. Helena mine is already taken into account in the aggregate taxable income from the mining trade as the loss constitutes an operating loss as envisaged in section 11(a) and not an assessed loss as envisaged in section 20(1)(b) and contended by Armgold/Harmony Freegold. Therefore, no loss is available to set off against the non-mining taxable income.

As can be seen from Table 13, the order in which the St. Helena mine's loss was utilised by SARS in calculating taxable income is in accordance with the provisions of the Act.

However, the calculation of the capital redemption per mine is not in accordance with the provisions of section 36(7F), as can be seen in step 3 highlighted in Table 13. The set-off of the St. Helena mine's losses against the profitable Freegold and Joel mines in this calculation taints the requirement that the capital redemption must be limited to the taxable income per mine.

There is no difference in the resultant taxable income of Armgold/Harmony Freegold as calculated by SARS' method and the method as provided for in the Act. However, the principle remains contrary to the provisions of the Act, and could possibly lead to a different result given a different set of facts.

#### **4.4 COMPARISON OF THE APPROACH ADOPTED BY LEACH, JA WITH THE PROVISIONS OF THE ACT**

Leach, JA in his judgment held that the Joel, Freegold and St Helena mines of Armgold/Harmony Freegold formed part of one mining trade. Therefore, the loss from the St Helena mine constituted an operating loss as envisaged by section 11(a) rather than an assessed loss as envisaged by section 20(1)(b). This is in accordance with the provisions of the Act as previously described in subchapters 4.2 and 4.3.

Leach, JA, in his calculation of the capital redemption, took the loss from the St. Helena mine into account proportionately against the profits of the Joel and Freegold mines after the capital redemption in order to determine taxable income. This approach is in accordance with the provisions of section 36(7F), namely that the capital redemption per mine should be limited to the taxable income per mine as discussed in subchapters 4.2 and 4.3.

Table 14 provides an illustrative comparison of the method adopted by Leach, JA in calculating Armgold/Harmony Freegold's taxable income with the method that should be followed based on the analysis of the provisions of the Act.

**Table 14: Illustrative comparison of the approach adopted in calculating taxable income by Leach, JA with the provisions of the Act**

Steps		Judge Leach, JA					The Act				
		Mining trade (in Rand millions)				Non-mining	Mining trade (in Rand millions)				Non-mining
		St Helena	Freegold	Joel	Total mining trade		St Helena	Freegold	Joel	Total mining trade	
<b>Step 1</b>	Determine the taxable income <b>before</b> the capital redemption of each mine separately, but after the set-off of the balance of assessed loss from the previous year	(51)	1 177	20	<b>1 146</b>	156	(51)	1 117	20	<b>1 146</b>	156
<b>Step 2</b>	Calculate the maximum capital redemption per mine in terms of section 36(7F)	n/a	<del>(1 177)</del>	<del>(20)</del>	<del>(1 197)</del>	n/a	n/a	<del>(1 177)</del>	<del>(20)</del>	<del>(1 197)</del>	n/a
<b>Step 3</b>	Calculate the maximum capital redemption for all mines in aggregate in terms of section 36(7E)	n/a	(1 127)	(19)	(1 146)	n/a	n/a	(1 127)	(19)	(1 146)	n/a
<b>Step 4</b>	Set off any current year mining losses from the taxable incomes of profitable mines	51	(50)	(1)	0	0	51	(50)	(1)	0	0
<b>Step 5</b>	Set off any current year assessed losses from other trades as envisaged in section 20(1)(b)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)	n/a (Note 2)
	<b>Total taxable income/(assessed loss carried forward)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>156</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>156</b>

**Note 2:** The loss from the St. Helena mine is already taken into account in the aggregate taxable income from the mining trade as the loss constitutes an operating loss as envisaged in section 11(a) and not an assessed loss as envisaged in section 20(1)(b) and contended by Armgold/Harmony Freegold. Therefore, no loss is available to set off against the non-mining taxable income.

As analysed in subchapter 3.2, the sequence in which deductions of a specific trade are made is irrelevant as long as the calculation is initially done on a “per trade” basis. This means that the set-off of assessed losses as envisaged by section 20(1)(b) can only be done after the taxable income per trade is calculated.

The order in which losses are applied in calculating the capital redemption in terms of sections 36(7E) and (7F) is, however, of significant importance, as these sections specifically prescribe the method of calculation.

As can be seen from Table 14, the order in which the loss of the St. Helena mine was utilised by Leach, JA is in accordance with the provisions as contained in the Act and analysed in Chapter 3. Accordingly, no changes to the current legislation contained in the Act are required in order to support the judgment.

#### **4.5 CONCLUSION**

In terms of the provisions of the Act, the loss incurred by the St Helena mine constituted an operating loss of a unit of one mining trade as envisaged in section 11(a). Therefore, the approach adopted by Armgold/Harmony Freegold in calculating its taxable income by treating the loss as an assessed loss from a trade as envisaged by section 20(1)(b), was not in accordance with the provisions of the Act.

Armgold/Harmony Freegold furthermore did not take into account the provisions of section 36(7E), which provides for the maximum amount of the capital redemption in aggregate for all mines.

SARS, in its calculation of the capital redemption per mine in terms of section 36(7F), apportioned the loss of the St Helena mine between the profitable Freegold and Joel mines. This is in contradiction of the provisions of section 36(7F), which provides that the capital redemption per mine is limited to the taxable income per mine.

Leach, JA in his calculation of the capital redemption per section 36(7F), only took into account the loss from the St Helena mine against the remaining profits of the Freegold and

Joel mines, in accordance with the provisions of section 36(7F). The order in which the loss is applied in calculating taxable income per trade is not of any significance, as was analysed in subchapter 3.2, paragraphs 10 and 11.

Accordingly, no changes are required to be made to the current legislation contained in the Act in order to support the judgment.

## **CHAPTER 5**

### **CONCLUSION**

#### **5.1 INTRODUCTION**

Following the Armgold/Harmony Freegold case, the approach adopted by mining companies in calculating their taxable incomes has become especially important. The case dealt with the method that should be applied in calculating a mining company's taxable income where at least one of the mining company's mines incurred a loss and where non-mining income was also derived by that company. Central to the case was the question of what constitutes an assessed loss, and in which order it should be applied in calculating a mining company's taxable income. In this study, the respective parties' approach to the Armgold/Harmony Freegold case was analysed and compared to the analysis of the provisions of the Act. This was done in order to determine whether the judgment was in accordance with the current provisions of the Act.

The concluding chapter of this study provides:

- an overview of the Armgold/Harmony Freegold case;
- the summary of the research findings;
- recommendations for future research;
- an overview of the contribution of the study to the current knowledge base; and
- final concluding remarks.

#### **5.2 OVERVIEW OF THE ARMGOLD/HARMONY FREEGOLD CASE**

Armgold/Harmony Freegold, the appellant in the case, operated three mines, namely the Joel, Freegold and St Helena mines. During the years in question, the Joel and Freegold mines derived a profit from their mining operations whilst the St Helena mine incurred an operating loss before taking into account the capital redemption allowed for in section



15(a) read with section 36 of the Act. Armgold/Harmony Freegold also derived non-mining income.

In September 2008, SARS issued Armgold/Harmony Freegold with revised tax assessments in which its income tax liability was adjusted for, amongst others, the 2003 and 2004 years of assessment. One of the grounds on which the revised assessments were issued, and the ground relating to this court case, was the fact that SARS disagreed with the way in which Armgold/Harmony Freegold utilised the loss from its St Helena mine in determining its taxable income.

The case was eventually heard by the Supreme Court of Appeal, where the judge had to determine the appropriate method in which assessed losses and capital redemptions should be applied in calculating a mining company's taxable income where at least one of the mining company's mines are operating at a loss and where non-mining income is also derived by that mining company.

### **5.3 REVIEW OF RESEARCH FINDINGS**

The following sections set out how each of the research objectives of this study was addressed.

#### **5.3.1 Research objective 1: Critically analyse the order of the utilisation of assessed losses in calculating the taxable incomes of mining companies in terms of the Armgold/Harmony Freegold judgment.**

The first research objective of this study was to critically analyse the order of the utilisation of assessed losses in calculating the taxable incomes of mining companies in terms of the Armgold/Harmony Freegold judgment. This research objective was addressed in Chapter 2 of this study. In this chapter, the three different approaches adopted in utilising the loss of Armgold/Harmony Freegold's St Helena mine in calculating taxable income were analysed and compared in detail in order to identify the difference and rationale of the methodology followed by the respective parties to the case.

The difference in the order in which the loss was utilised by the respective parties can be summarised as follows:

#### **5.3.1.1 *Armgold/Harmony Freegold***

Armgold/Harmony Freegold contended that the St Helena mine constituted a separate trade and that the loss of the St Helena mine therefore amounted to its assessed loss which can be set off against other trades as envisaged by section 20(1)(b) of the Act.

Armgold/Harmony Freegold furthermore took only the provisions of section 36(7F) into consideration in order to calculate its capital redemption in terms of section 15(a). In terms of section 36(7F), the capital redemption is calculated on a “per mine” basis. Therefore, the loss of the St Helena mine was not taken into account by Armgold/Harmony Freegold in determining the maximum capital redemption which was applied against its income in order to calculate its taxable income.

The calculation of the capital redemption in terms of section 36(7F) was sufficient to reduce the taxable income of the profitable Joel and Freegold mines to nil. As Armgold/Harmony Freegold did not take into account the St Helena mine’s loss in calculating the taxable incomes of the Joel and Freegold mines, the loss was applied in order to reduce its non-mining income (subchapter 4.2).

#### **5.3.1.2 *SARS***

SARS contended that the St Helena mine constituted a unit of one mining trade and therefore that the loss of the St Helena mine amounted to an operating loss as envisaged by section 11(a).

SARS, in calculating Armgold/Harmony Freegold’s capital redemption, took into consideration the provisions of sections 36(7E) and 36(7F).

SARS, in its calculation of taxable income and the maximum capital redemption in terms of section 36(7F) on a per mine basis, apportioned the St Helena mine’s loss between the

profitable Freegold and Joel mines in order to calculate the capital redemption per mine (see subchapter 4.3).

### **5.3.1.3 *Leach, JA***

Leach, JA in his judgment held that the St Helena mine constituted a unit of one mining trade and therefore that the loss of the St Helena mine amounted to an operating loss as envisaged by section 11(a).

Leach, JA, in calculating Armgold/Harmony Freegold's capital redemption, took into consideration the provisions of both sections 36(7E) and 36(7F).

In calculating the maximum capital redemption in terms of section 36(7F), Leach, JA did not take into account the loss of the St Helena mine against the profitable Freegold and Joel mines in order to calculate the maximum capital redemption per mine which must be applied against Armgold/Harmony Freegold's income in order to calculate its taxable income.

In order to calculate taxable income, the Judge set off the St Helena mine's loss against the profitable Freegold and Joel mines after deducting the maximum capital redemption as calculated in terms of sections 36(7E) and 36(7F).

### **5.3.2 Research objective 2: Analyse the order of the utilisation of assessed losses in calculating the taxable incomes of mining companies in terms of the current legislation contained in the Act.**

The second research objective of this study was to analyse the order of the utilisation of assessed losses in calculating the taxable incomes of mining companies in terms of the current legislation contained in the Act. This research objective was addressed in Chapter 3 of this study.

The definition of what constitutes an assessed loss as apposed to a normal operating loss was analysed in detail, as the order in which these two different losses should be applied differs considerably in terms of the provisions of the Act.

Based on the analysis of the provisions of the Act, taxable income as defined in section 1 of the Act should initially be calculated separately for each trade of the taxpayer in order to determine whether there is any assessed loss from a trade as envisaged in section 20(1)(b) (see subchapter 3.5).

In determining taxable income, all the deductions as allowed for in sections 5 to 37H of the Act should be taken into account against the income per trade. With a few exceptions, none of which are applicable to the Armgold/Harmony case, the deductions allowed for in sections 5 to 37H do not have to be applied in any specific order. This will initially not include the set-off of current year assessed losses from other trades as envisaged in section 20(1)(b), as the resultant loss or income should first be determined separately per trade (see subchapter 3.5).

An important factor in determining whether there is an assessed loss as defined which can be set off as envisaged in section 20(1)(b) of the Act, is whether the loss relates to a trade.

Where the loss relates simply to a unit of the same trade, the loss constitutes an operating loss which should first be taken into account by the other units within the same trade in order to determine whether there is a loss incurred by the total trade. Only where the loss relates to a trade and not just a single unit of the same trade, can there be an assessed loss as defined, which can be set off against another trade in terms of section 20(1)(b).

Where one or more of the taxpayer's trades has an assessed loss as envisaged by section 20(2), the assessed loss can be set off against the income derived from the taxpayer's other trades. The resultant losses and/or incomes from all of the taxpayer's trades should be aggregated in order to calculate the total taxable income of the taxpayer.

Where the company is a mining company, its taxable income is determined in terms of the general provisions of the Act similar to the calculation of the taxable income of other types

of companies. The only exception to this rule is that section 15(a) read with section 36 of the Act prescribes how the capital allowance of mining companies should be calculated.

The sections applicable to the Armgold/Harmony Freegold case are sections 36(7E) and (7F).

Section 36(7E) limits the maximum capital redemption for all mines in aggregate to the taxable income of all mines in aggregate as calculated before the capital redemption but after the set-off of any balance of assessed loss brought forward from the previous year (qualified definition of taxable income). The assessed losses from other trades are not taken into account in this calculation (see subchapter 3.5).

Section 36(7F) on the other hand limits the maximum capital redemption per mine to the taxable income (as qualified) per mine. Therefore, none of the operating results of other mines may be taken into account in calculating the capital redemption per mine in terms of section 36(7F) (see subchapter 3.5).

### **5.3.3 Research objective 3: Compare the order of the utilisation of assessed losses between the judgment and the current legislation in order to determine whether amendments should be made to the current legislation in order to support the judgment.**

The third research objective of this study was to compare the order of the utilisation of assessed losses between the judgment and the current legislation to determine whether amendments should be made to the current legislation in order to support the judgment. This research objective was addressed in Chapter 4 of this study.

In terms of the provisions of the Act, the loss incurred by the St Helena mine constituted an operating loss of a unit of one mining trade as envisaged in section 11(a). Therefore, the approach adopted by Armgold/Harmony Freegold in calculating its taxable income by treating the loss as an assessed loss from a trade as envisaged by section 20(1)(b), was not in accordance with the provisions of the Act.

Armgold/Harmony Freegold furthermore did not take into account the provisions of section 36(7E), which provides for the maximum amount of the capital redemption in aggregate for all mines.

SARS, in its calculation of the capital redemption per mine in terms of section 36(7F), apportioned the loss of the St Helena mine between the profitable Freegold and Joel mines. This contradicts the provisions of section 36(7F), which provides that the capital redemption per mine is limited to the taxable income per mine.

Leach, JA in his calculation of the capital redemption per section 36(7F), took only the loss from the St Helena mine into account against the remaining profits of the Freegold and Joel mines, which is in accordance with the provisions of section 36(7F). The order in which the loss is applied in calculating taxable income per trade is not of any significance as was analysed in subchapter 3.2, paragraphs 10 and 11.

Accordingly, no changes are required to be made to the current legislation contained in the Act in order to support the judgment.

#### **5.4 CONTRIBUTION OF THE STUDY AND RECOMMENDATION FOR FUTURE RESEARCH**

The information pertaining to matters relating specifically to the taxation of mining companies is limited. This is mainly due to the following reasons:

- with a few exceptions, mining tax is not an area of focus in the curriculum of either graduate or post-graduate taxation studies at academic institutions as it is considered to be a specialist taxation area. The amount of academic research in respect of matters specific to mining tax is therefore extremely limited (Van Blerck, 1992);
- the first and also last published text devoted exclusively to mining tax in South Africa, is *Mining Tax in South Africa* (Van Blerck, 1992). Van Blerck states that “[t]he area of mining tax is of great importance in South Africa and it is a matter for concern that there is widespread ignorance of the relevant principles, and amongst some of those who have some knowledge of the area a degree of misunderstanding often exists”;

- the provisions relating specifically to the taxation of mining companies are relatively new in comparison to the general provisions of the Act. Section 36(7F) was only introduced in 1984 (see subchapter 3.4.1). There is accordingly limited court precedence on matters relating specifically to mining taxation.

The lack of information on the subject matter has made the subject a very interesting, albeit challenging, topic to research.

The analysis done in this study provides clarity to mining companies, SARS, tax consultants and academics on the rationale of the judgment in the Armgold/Harmony Freegold case.

The analysis of the provisions of the Act furthermore provides clarity on the approach that should be adopted by mining companies in calculating their taxable income following the Armgold/Harmony Freegold judgment.

Future research on matters related to mining tax is recommended as mining companies lack updated guidance on how to approach their tax calculations based on the outcome of new court precedence. It is furthermore recommended that the wording of the provisions in the Act pertaining to mining companies be reviewed, in order to provide more clarity.

## **5.5 CONCLUDING REMARKS**

The Armgold/Harmony Freegold judgment by Leach, JA was analysed in detail in this study. This was compared with a detailed analysis of the current provisions of the Act. Based on this comparison, it was found that the approach adopted by Leach, JA in utilising the St Helena mine's loss in calculating Armgold/Harmony Freegold's taxable income and capital redemption was in accordance with the current legislation contained in the Act. Accordingly, no amendments are required to be made to the Act in order to support the judgment.

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