INCOME TAX BENEFITS AVAILABLE TO THE MINING INDUSTRY: A COMPARISON BETWEEN SOUTH AFRICA AND AUSTRALIA

by

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ABSTRACT

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The mining industry plays a vital role in the South African economy as well as supporting various sectors of the economy, for example the transport services, consulting and financial services, steel and material inputs, and electricity and water usage. The future success of the mining industry requires certainty on numerous regulatory issues, one of which is taxation. In this study the income tax benefits available to the South African mining sector were compared to those offered to the mining industry in Australia, which has the third largest mining sector in the world, in order to determine which of the two systems is more advantageous.

The history of mining and the current taxation legislation applicable to the mining sector in South Africa was briefly discussed and analysed to provide an understanding of this industry. Australia recently introduced new taxation legislation and incentive scheme for the mining sector, namely the Exploration Development Incentive, effective from 1 July 2014. This was explained and analysed.

The comparison of the tax benefits between the two countries led to the conclusion that South Africa offers better income tax benefits in respect of corporate income tax rate, prospecting, research and development, tax incentives and interest. Australian mining companies are better off with regard to capital expenditure, capital gains tax and mining rehabilitation. The income tax benefits received by both countries in respect of depreciation, royalties and tax losses are very similar. From this comparison it seems evident that while both countries offer substantial tax benefits to the mining industry, the South African mining industry currently enjoys an advantageous situation.

KEY WORDS:

Mining sector

Tax benefit

Tax incentives

South Africa

Australia

ABSTRAK

INKOMSTEBELASTINGVOORDELE BESKIKBAAR IN DIE MYNWESE: 'n VERGELYKING TUSSEN SUID-AFRIKA EN AUSTRALIë

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Die Suid-Afrikaanse mynbedryf speel 'n uiters belangrike rol in die land se ekonomie, sowel as die ondersteuning van verskeie ander sektore van die ekonomie, byvoorbeeld vervoerdienste, konsultasie- en finansiële dienste, staal- en materiaalinsette en elektrisiteit- en waterverbruik. Ten einde die toekomstige sukses van die mynbedryf te verseker, is dit noodsaaklik dat daar sekerheid moet wees aangaande wetlike aangeleenthede, soos belasting. In hierdie studie is die inkomstebelastingsvoordele wat aan die Suid-Afrikaanse mynbedryf gebied word vergelyk met dié wat beskikbaar is vir die mynbedryf in Australië, wat die derde grootste mynbousektor in die wêreld het. Die doel van dié vergelyking was om vas te stel watter van dié twee lande se belastingstelsel is vir die mynbedryf die voordeligste.

Die geskiedenis en huidige belastingwetgewing van toepassing op mynbou in Suid-Afrika is kortliks bespreek en geanaliseer om die sektor te verduidelik. Australië het onlangs 'n nuwe belastingstelsel en aansporingsskema (die Exploration Development Incentive) vir mynwese bekendgestel wat op 1 Julie 2014 geïmplementeer is. Hierdie skema is verduidelik en geanaliseer.

Die vergelyking van die belastingvoordele in die twee lande het tot die gevolgtrekking gelei dat Suid-Afrika beter belastingvoordele bied ten opsigte van korporatiewe inkomstebelastingkoers, prospektering, navorsing en ontwikkeling, en belastingaansporings en rente. Daarteenoor is Australiese mynmaatskappye beter daaraan toe met betrekking tot kapitaalbesteding, kapitaalwinsbelasting en mynrehabilitasie. Die inkomstebelastingvoordele wat deur albei lande gebied word ten opsigte van waardevermindering, tantieme en belastingsverliese, stem ooreen. Uit die

vergelyking blyk dit dat alhoewel albei dié lande belastingvoordele aan die mynbedryf bied, die Suid-Afrikaanse mynbedryf tans voordeliger belastingvoordele geniet.

SLEUTELWOORDE:

Mynwese

Belastingvoordeel

Belastingaansporing

Suid-Afrika

Australië

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

'Our wellbeing as a nation depends on the success of our mining industry, which runs not only deep in our soil, but in the heritage and hearts of our people' (Saloojee, 2013).

Mining supports various sectors of the economy, for instance transport services, consulting and financial services, steel and material inputs, electricity usage and water usage, therefore the mining industry plays a vital role in the South African economy (Department of Environmental Affairs, Department of Mineral Resources, Chamber of Mining, Biodiversity Forum and South African National Biodiversity Institute, 2013). In 2012, the mining sector generated 16.7%, i.e. almost one fifth, of the country's economic activity. The direct contribution of the industry is effectively 8.3%, but this figure is doubled by the contributions of mining supplier industries and industries that use mining outputs. In 2012 the South African mining sector created 1 365 892 jobs, of which 524 632 were created by the mining sector directly and 841 260 by secondary industries (Chamber of Mines of South Africa, 2012).

The future success of the mining industry requires certainty on numerous regulatory issues, one of which is taxation. The question that is raised is whether the Government derives appropriate economic benefit from the taxation of mining companies. In order to maximise the economic benefit, the Government is re-evaluating the current mining royalties [taxation] regime. This re-evaluation is a cause for concern for mining companies and investors alike, since the mining industry has been under severe pressure as a result

of difficult economic circumstances. It is necessary to give assurances to investors that the South African economic environment is stable, that there is tax certainty and that the tax they are liable for is fair (Saloojee, 2013).

1.2 PROBLEM STATEMENT

The mining industry has played a significant role in attracting foreign investments and creating leading global enterprises. It is the economic sector that is most critically observed (Hans Seidel Foundation, 2013).

Since the global financial crisis in 2008, South Africa's primary economy has undergone major turmoil. If one takes into account the violence in the mining sector (34 mine-workers were shot by police at Marikana in 2012), the threats to nationalise mines and the ongoing strikes, the picture that is being painted is not a positive one (Hans Seidel Foundation, 2013).

The South African mining industry is the fifth largest mining industry in the world (Chamber of Mines, 2012:12) and this country is still considered to be 'the country with the world's largest mineral endowment' (Carroll, 2012). Citibank estimated that the remaining mineral endowment in South Africa is worth US $2.5 trillion, which means that large quantities are still available for extraction (Carroll, 2012).

Any discussion of the mining industry that focuses on the negative aspects is likely to draw the attention away from what South Africa has to offer. It is therefore necessary to consider ways in which current income tax benefits for the mining industry can be enhanced in order to encourage new mining projects.

The South African mining sector is comparable to that of Australia, which has the third largest mining sector (Mining Australia, 2013). Australia recently introduced a new system of taxation and tax incentives for the mining sector, namely the Exploration Development Incentive, which took effect on 1 July 2014 (Australian Government: Australian Taxation Office, 2014c). It would be worthwhile to compare the treatment of the mining industries with regard to taxation in these two countries.

An extensive database search undertaken for this study indicated that no formal research regarding the new system in Australia and the tax incentives available to the mining sector has yet been undertaken. This study therefore aims to compare this new system and the tax benefits offered to the Australian mining industry to what is currently available in South Africa.

1.3 STATEMENT OF PURPOSE

When one looks at newspaper headlines such as '*South African mining still troubled and uncompetitive: Analysts cite regulatory uncertainty, labour unrests*' (*International Business Times,* 2014) and '*South Africa Strikes Stroke Investor Fears* (Money Beat, 2013), the future of the South African mining sector does not look good.

According to Fred McMahon, a researcher with Canada's Fraser Institute, who spoke at a mining conference held in Johannesburg on 27 August 2013, South Africa was placed 64th out of 96 jurisdictions for mining competitiveness. This means that South Africa is in the bottom third of jurisdictions for global mining competitiveness on the Policy Potential Index (PPI), which is a ten-place drop since 2012 (Fraser Institute, 2014:14).

In their annual report, Survey of Mining Companies 2012/2013*,* the Fraser Institute focuses on the attractiveness of a country to major international mining companies. The factors that are considered when rating the over 700 mining companies are, for example, regulatory uncertainty, corporate tax rates and labour unrests (*International Business Times*, 2014). The outcome of this report clearly indicated that, if South Africa wants to compete with the international mining industry, those are the factors in respect of which drastic changes need to be made.

Owing to the negativity surrounding the South African mining industry, other avenues must be explored to make the mining environment in South Africa more attractive. The purpose of this study is to focus on the income tax benefits available to mining companies. The study will also emphasise the vital role played by the mining industry in this country, and the fact that South Africa will not be able to function without it.

The income tax benefits offered to the mining industry locally will be compared to those available in Australia. The tax systems of the two countries will be compared in order to determine which system is more developed or advantageous.

This study is important as it will make a unique contribution to the development of a forward-looking taxation policy, specifically for the mining industry, by identifying and investigating differences in the income tax benefits available to the mining sectors in South Africa and Australia.

The suggested improvements, as identified through the comparison, could be used by the legislator to develop current legislation in order to assist government in achieving its mining-sector goals. The findings should also assist taxpayers in determining the nature of the available tax benefits, should they wish to invest in the South African mining sector.

1.4 RESEARCH OBJECTIVES

The study will be guided by the following research objectives:

- To critically evaluate the income tax benefits available in the South African and Australian mining sectors respectively.
- To compare income tax benefits available to the South African and Australian mining industries in order to expose any differences, draw relevant conclusions and make recommendations.

1.5 DELIMITATIONS AND ASSUMPTIONS

The delimitations and assumptions of the study are discussed below:

1.5.1 DELIMITATIONS

The study has several delimitations in respect of its context, constructs and theoretical perspectives. First, it will be limited to a discussion of the income tax benefits available to mining companies and investors only. The study will not consider the specifics of policy design, but will rather focus on the concepts of income tax benefits available in the mining industry and will exclude the discussion of any potential additional tax regimes imposed by the relevant legislative authorities. This study will focus on identifying the differences between South African and Australian income tax benefits. The viability of the Australian income tax benefits and governmental policies identified will be addressed in the South African context. Actual financial statements will not be compared and included in this study as the purpose here is only to compare the different income tax benefits.

In terms of sales and employment, the mining industry's four main mineral commodities have been the platinum group metals (PGMs), gold, coal and iron ore (Hans Seidel Foundation, 2013). Even though South Africa mines numerous minerals like coal, copper, diamonds and gold, this study will focus only on iron ore (Lowtax Global Tax & Business Portal, 2013). Australia also mines iron ore and is in fact the second-largest producer of iron ore in the world (MBendi, 2014).

1.5.2 ASSUMPTIONS

The following assumptions applied to the study:

- A pure literature review is an appropriate means for investigating the topic.
- Tax incentives assist in stimulating investment in the mining industry.
- Australian tax incentives and governmental policies identified are viable in a South African context.
- The comparison is in accordance with the generally accepted rules for calculating income tax in terms of the Income Tax Act No 58 of 1962 and the Australian corporate income tax laws in terms of the Income Tax Assessment Act of 1997.

1.6 DEFINITION OF KEY TERMS AND ABBREVIATIONS

The following key terms were used in the study:

Arm's length: 'Transactions between affiliated firms which are made purely on a commercial basis, both firms trying to maximise their advantage, and neither firm accommodating or favouring the other in any way' (*BusinessDictionary.com*, nd)

Brownfield investments: 'Expansions or upgrades of existing industrial projects' (Department of Trade and Industry, 2013)

Expenditure: 'Payment of cash or cash-equivalent for goods or services, or a charge against available funds in settlement of an obligation as evidence by an invoice, receipt, voucher, or other such document' (*BusinessDictionary.com*, nd)

Greenfield Investments: 'New industrial projects that utilise only new and unused manufacturing assets' (Department of Trade and Industry, 2013)

Incentive: 'Inducement or supplemental reward that serves as a motivational device for a desired action or behaviour' (*BusinessDictionary.com*, nd)

Mineral: 'Any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process, and includes sand, stone, rock, gravel, clay, soil and any mineral occurring in residue stockpiles or in residue deposits, but excludes water, other than water taken from land or sea for the extraction of any mineral from such water, petroleum or peat' (Section 1 of the Mineral and Petroleum Resource Development Act (MPRDA) (2002))

Mining operations and mining: This includes 'every method or process by which any mineral is won from the soil or from any substance or constituent thereof' (Section 1 of the Income Tax Act (58/1962) (hereafter referred to as the Act))

Research and development (R&D): 'Systematic activity combining both basic and applied research, and aimed at discovering solutions to problems or creating new goods and knowledge' (*BusinessDictionary.com*, nd)

The abbreviations used in this study are listed in Table 1 below.

Table 1: Abbreviations used in this document

Abbreviation	Meaning
ABET	Adult Basic Education and Training
AMEC	Association of Mining and Exploration Companies
CAPEX	Capital expenditure
CGT	Capital gains tax
DMP	Department of Mines and Petroleum
DTI	Department of Trade and Industry
EIS	Exploration Incentive Scheme
EDI	Exploration Development Incentive
ESKOM	Electricity Supply Corporation
GDP	Gross domestic product
HDSA	Historically Disadvantaged South African
IDZ	Industrial Development Zone
ISCOR	Iron and Steel Corporation
JSE	Johannesburg Stock Exchange
MPRDA	Mineral and Petroleum Resource Development Act
MRRT	Mining Resource Rent Tax
MTEF	Medium-term Expenditure Framework
PGMs	Platinum Group Metals
PPI	Policy Potential Index
R&D	Research and development
SARS	South African Revenue Service
Sasol	South African Coal, Oil and Gas Corporation
WIP	Work in progress

1.7 RESEARCH METHODOLOGY

This is a non-empirical study based on a review of existing literature. Saunders, Lewis and Thornhill (2009:595) define a literature review as a 'detailed and justified analysis and commentary of the merits and faults of the literature within a chosen area, which demonstrates familiarity with what is already known about the research topic'.

Current legislation regarding income tax benefits available to the mining industries in South Africa and Australia respectively will be critically evaluated and compared. A comparative analysis will then be undertaken in order to highlight any differences between the tax legislation in the two countries concerned, as well as benefits offered and limitations imposed. Specific reference will be made to the geographic locations of South Africa and Australia.

Finally, the findings will be summarised in the conclusion, and possible improvements to the legislation will be identified. These possible improvements could be used by the legislator to improve current legislation in order to assist the government in achieving its mining-sector goals.

1.8 SUMMARY OF CHAPTERS

This study comprises six chapters. Chapter 1 is the introduction, which contains the definitions of key terms used, a discussion of delimitations and assumptions, as well as an explanation of the research methodology. In Chapter 2 the importance of the mining is discussed and an overview is given of the history of mining in Australia and South Africa. Emphasis is placed on the importance of the mining sector in South Africa. Chapter 3 contains an overview of income tax benefits in the mining industry in South Africa, and in Chapter 4 the income tax benefits in the mining industry in Australia will be placed under the spotlight. In Chapter 5 the tax benefits offered to the mining industries in South Africa and Australia respectively are compared. Chapter 6, the final Chapter, will contain a discussion of the conclusions arrived at based on the research, as well as recommendations for future research.

CHAPTER 2

THE IMPORTANCE OF THE MINING SECTOR

INTRODUCTION

In Chapter 1, mining in South Africa was briefly discussed to provide a general understanding of the current importance of this industry to South Africa. Reference was also made to mining in Australia.

AN OVERVIEW OF THE HISTORY OF MINING IN SOUTH AFRICA

'Historically, South Africa's mining industry has been at the heart of the economy's development – given the country's competitive position as one of the most naturally resource-rich nations in the world' (Hans Seidel Foundation, 2013:1).

Western mining practices were first applied in 1852, in the copper mines at Springbok in the Northern Cape (Pogue, 2000:2). For the past 150 years, mining has been taking place in South Africa on an immense scale. The discovery of large diamonds in the Northern Cape led to the diamond rush in 1869 (Pogue, 2000:2). Over the next two decades the diamond-mining sector bloomed and continued as an active industry (Curtis, 2009:4).

Another mineral of note is gold. Mining for this precious metal commenced in the 1870s, but it was only after the discovery of gold in the Witwatersrand area in the 1880s that the gold-mining sector became firmly established. Thousands of foreigners descended on the region and triggered the gold rush. By the end of the nineteenth century, South Africa's gold value output exceeded $40 million (Curtis, 2009:4).

The gold mining on the Witwatersrand created direct and indirect demands in the South African economy, for example the need to expand large-scale coal mining (Pogue, 2000:2). General economic development was created by the building of infrastructure (roads and rail networks) to provide passage for the large mining equipment to and from the mines (Pogue, 2000:2).

In 1906 the gold mines were electrified and the demand for coal escalated. When the Electricity Supply Corporation (ESKOM) was established in 1922, there was a further increase in the demand for coal (Pogue, 2000:4).

The Iron and Steel Corporation (ISCOR), another sector that was interlinked with the coal resources, was established in 1929. In 1950 South Africa experienced fuel shortages and was under pressure to produce its own fuel. This led to the establishment of the South African Coal, Oil and Gas Corporation (Sasol) by the government (Pogue, 2000:4).

Although initially the major mineral industries in South Africa were the diamond-, coal- and gold-mining industries, mineral operations continued to increase and diversify. Some of the other minerals being mined are nickel, iron ore, copper, chrome ore and manganese ore. Currently South Africa is mostly self-sufficient as far as mineral resources are concerned (Pogue, 2000:4).

Definitions in the Geoscience Act (100/1993) were used to develop the first mining legislation that focused on taxation, which led to the promulgation of the Mineral and Petroleum Resource Development Act (28/2002). Prior to that, provisions concerning mining tax were addressed only in the Income Tax Act (58/1962). These two Acts are still in force today (Department: Mineral Resources, 2014).

AN OVERVIEW OF THE HISTORY OF MINING IN AUSTRALIA

Minerals have played an important role in Australia's development and culture, and from the early days following European settlement at Sydney Cove, minerals were produced in large quantities (Australian Government, 2012). In Newcastle in New South Wales, coal was discovered within 10 years of the arrival of the first fleet in 1788. The areas near Newcastle provided fuel, which was used for cooking and heating, and also for powering steam locomotives (Australia Mining History Association, 2002).

The first metal mined in Australia was lead, which was first extracted at Glen Osmond in South Australia in 1841. The mining of copper at Burra and Kapunda followed soon

afterwards. The young colony started to export agricultural products, and in the 1850s the value of copper and lead exports from South Australia exceeded that of wool and wheat exports. When copper was also discovered at Moonta and Kadina in 1861, skilled Cornish miners with appropriate knowledge of mining technology moved to those mines (Australia Mining History Association, 2002).

In 1823, gold was discovered in New South Wales by a public official named James McBrien. The Gold Rush took place in the 1850s and soon the Australian colonies became famous for their mining industries. By the 1850s approximately 40% of the gold produced in the world came from Australia (Australia Government, 2012).

Tin was discovered in the 1870s at Mt Biscoff in Tasmania and subsequently Australia became an important producer of tin. The first large mines were erected in the late twentieth century. Copper and gold was found at Mt Morgan near Rockhampton in Queensland; silver, lead and zinc at Broken Hill in New South Wales; gold at Coolgardie and Kalgoorlie in Western Australia, and iron ore at Iron Knob and Iron Baron in South Australia (Australian Government, 2012).

Despite the steady rise in the value of mineral production, mining activities began to decline in the early twentieth century (Australian Mining History Association, 2002). In the 1960s, the public believed that Australia's iron ore reserves were insufficient to cater for the domestic demand. Discoveries of 'new' metals, such as bauxite (the source of aluminium), nickel, tungsten, rutile (the source of titanium), uranium, oil and natural gas followed a renewal of interest in Australia's mineral resources. The production of other minerals also increased and Australia became a major exporter of raw materials, particularly to Japan and Europe (Australian Government, 2012).

THE IMPORTANCE OF THE CURRENT MINING SECTOR IN SOUTH AFRICA

Over the past 140 years the contribution made to the development of the South African economy by the mining sector has been significant and has led to this country becoming the most industrialised country in Africa (Chamber of Mines of South Africa, 2012:2).

The mining sector has contributed just over R2.1 trillion to the country's Gross Domestic Product (GDP) and R2.16 trillion to its export earnings in the past decade (Chamber of Mines of South Africa, 2012:2).

The mining sector continued to be a significant player on the Johannesburg Stock Exchange (JSE) and, at the end of 2012, accounted for 24.7% (R1.8 trillion) of the All-Share Index and 24.4% (R1.9 trillion) of the equities market capitalisation (Chamber of Mines, 2012:2).

In terms of both direct and indirect tax contributions, the mining sector makes a substantial contribution to the government and society in inter alia the following ways (the figures quoted are those for 2012):

- Direct corporate tax: In 2012, the mining sector's contribution was R21.4 billion, which represented 14.1% of the total corporate taxes paid in South Africa and was almost double the sector's share of GDP.
- Indirect taxes: The sector helped to contribute R1.1 billion in terms of the special levy on electricity and approximately R900 million in terms of the one per cent national skills development levy.
- The extraction of minerals: Through the mineral royalty system, royalties to the amount of R5.6 billion were paid to the government.
- Employees' personal income tax: A total amount of R9.5 billion was paid to the government in the form of taxes levied on the R93.6 billion paid in salaries and wages in 2012 (Chamber of Mines of South Africa, 2013:3).

The significant contribution made by the mining industry becomes very clear if one looks at the rest of the economy and tax contributions that are indirectly linked to the mining sector and compares the amount of tax collected by the government to the overall contribution of mining and its related activities (Chamber of Mines of South Africa, 2013:3).

After depreciation and impairments, the industry recorded a total income of R497.1 billion and a total expenditure of R488 billion in 2012. Of that expenditure, an estimated 80% was consumed in South Africa.

These statistics illustrate why mining has such a significant impact on the South African economy, and how the money generated by the mining industry is circulated through the rest of the economy and impacts many other sectors, such as housing and financial services (Chamber of Mines of South Africa, 2013:2).

Mining also contributes to a large extent to infrastructure investment in South Africa. According to Treasury's 2013 Budget Review, the government planned to spend approximately R845 billion on capital projects over the three-year period from 2012 to 2014 (Chamber of Mines of South Africa, 2013:3).

The mining industry provides in 72% of South Africa's primary energy needs. During the above-mentioned period, Eskom planned to spend R296 billion, mostly on new power stations and the improvement of network and distribution infrastructure. Transnet is expected to spend R101 billion during the Medium-term Expenditure Framework (MTEF) period, with investments focusing on the freight rail network, large-capacity upgrades on iron ore and coal export lines, the acquisition of modern rolling stock and the refurbishing of existing infrastructure in an attempt to boost general freight and mining exports. The South African public is generally unaware of the fact that the costs of the Transnet Rail Freight and Eskom upgrades will be covered by user fees levied on the mining companies over the next 10 to 20 years (Chamber of Mines of South Africa, 2013:3).

The capital and operating costs will ultimately have to be recovered in full from users, and since mining accounts for 50% of the business conducted by Transnet Rail Freight, more than half of the expected capital cost will eventually have to be recouped from the mining sector (Chamber of Mines of South Africa, 2013:3).

Since mining and smelting account for nearly 40% of Eskom's business, the same cost recovery mechanism will be applied in the mining sector. In effect, the mining companies are therefore most likely to pay an amount in the region of R50 billion towards Transnet Rail Freight's capital costs and R100 billion towards Eskom's planned capacity expansions (Chamber of Mines of South Africa, 2013:3).

The mining industry makes a substantial contribution to society in the form of, among other things, community, enterprise and skills development. The Chamber of Mines of South Africa (2013:3) listed the top ten mining producers in South Africa as follows:

- Anglo American SA
- AngloGold Ashanti
- African Rainbow Minerals
- BPH Billiton
- Glencore Xstrata
- Gold Fields
- Harmony Gold
- Impala Platinum
- Lonmin Platinum
- Sasol Mining

Note the following important facts relating to the mining industry:

- In 2012, approximately R2.4 billion was spent on community development.
- During the same year, an amount of approximately R2 billion was spent on human resource development and R330.5 million was awarded to individuals in the form of scholarships and bursaries, which included 5 168 bursaries awarded to non-employees.
- The amount spent on learnership programmes amounted to R4.9 billion and a further R1.7 billion was spent on Adult Basic Education and Training (ABET).
- Artisan training and other training initiatives were also undertaken at a cost of R7.4 billion.
- The mining industry provides a significant healthcare base and provides medical care to mine employees and their families (Chamber of Mines of South Africa, 2013:4).

The mining industry makes a significant, albeit often unrecognised contribution to capital investment by state-owned enterprises, and therefore to fixed investment and the growth of productive fixed capital stock (Chamber of Mines of South Africa, 2013:4).

If one looks at mining and its linkages to, and induced impact on many other sectors of the economy, it becomes clear that this industry is a key investor in the South African

economy. Mining accounts directly for 12% of the total investment in the economy (both public and private) and for 19% of the total private-sector investment. If one considers the indirect multipliers and induced effects, it becomes evident that mining contributes approximately 25% of the total fixed investment (Chamber of Mines of South Africa, 2013:4).

2.5 CONCLUSION

In summary, Chapter 2 briefly outlined the history of mining in South Africa and Australia and provided a general understanding of the immense importance of the South African mining sector. The income tax benefits available to mines in the two countries will be discussed in detail in Chapters 3 and 4.

CHAPTER 3

AN ANALYSIS OF INCOME TAX BENEFITS FOR MINES IN SOUTH AFRICA

INTRODUCTION

In line with the research objectives outlined in Chapter 1, this chapter provides a detailed analysis of the income tax benefits available to the mining sector in South Africa. The analysis will clearly outline the income tax benefits currently available to the mining industry in South Africa, which will subsequently be compared to the income tax benefits available to the Australian mining industry.

3.1.1 Stages in the life of a mine

From a discussion with Mr J Kotze (3 August 2014), an Associate Director of Klynveld Peat Marwick Goerdeler (KPMG), it became clear that it is important to understand the different internationally accepted stages of mining in order to be able to take the applicable taxation aspects into account.

The stages in the life of a mine can be summarised as follows (Deloitte, 2010:15).

1. Prospecting
2. Preliminary operations
3. Pre-production
4. Production
5. Non-production
6. Post-termination

The cost implications of any mining activity are usually very high, but tax incentives can help lighten the tax burden. To illustrate the types of cost that can or may be incurred in each of the stages of a mining operation, KPMG (2009:17) and Price Waterhouse Cooper (PwC) (2009:34) provide the following examples:

1. Prospecting
    - Surveys
    - Boreholes
    - Trenches
    - Pits
    - Other prospecting work preliminary to the establishment of a mine
2. Preliminary operations
3. Pre-production
    - Development
    - General administration
    - Management
    - Interest on loans utilised for mining purposes
4. Production
    - Royalties
    - Insurance
    - Environmental contributions
        - Ongoing rehabilitation
        - Contributions to qualifying environmental bodies
5. Non-production
6. Post-termination
    - Rehabilitation of mining site
    - Anti-pollution measures
    - Demolition of buildings

The costs that are incurred by mines, as well as the applicable deductions and allowances, will be discussed in detail at a later stage. The above-mentioned stages merely serve to give the reader some idea of the bigger picture.

3.1.2 Specific sections relating to mining

According to KPMG (2009), it is important to note that that the general rules of taxation for 'regular' companies should be exactly applied in the case of mining companies (KPMG, 2009). In addition to the normal rules of taxation, there are some additional allowances that apply specifically to mining companies (KPMG, 2009).

The sections in the Act that relate to mining are listed below and will be discussed in detail later:

- Section 1 – Interpretations
- Section 10(1)(cP) – Exemption of section 37A entities
- Section 15(a) – Deductions from income derived from mining operations
  Amount to be ascertained under the provisions of section 36 (KPMG, 2009).
- Section 15(b) – Exploration expenditure
  Applies only to prospecting in South Africa (KPMG, 2009)
  Any expenditure allowed as a deduction under section 15(b) may not be included in the CAPEX determined in section 36(11) (KPMG, 2009).
- Section 20 – Assessed losses
- Section 22 – Trading stock
- Section 36 – Calculation of redemption allowance and unredeemed balance of capital expenditure in connection with mining operations
- Section 37 – Calculation of capital expenditure on sale, transfer, lease or cession of mining property
- Section 37A – Closure rehabilitation of company or trust

3.1.3 Definition of mining operations and mining

Mining operations and mining, as defined in Section 1 of the Act, 'include every method or process by which any mineral is won from the soil or from any substance or constituent thereof'.

To understand the meaning of 'mining income', the definition of the word 'mineral' needs to be considered. According to Section 1 of the MPRDA, a mineral is 'any substance,

whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water, and which was formed by or subjected to a geological process. These substances include sand, stone, rock, gravel, clay, soil and any mineral occurring in residue stockpiles or in residue deposits, but excludes water, other than water taken from land or sea for the extraction of any mineral from such water, petroleum or peat'.

MINING VS MANUFACTURING

Mining is followed by a production process that is considered to be manufacturing.
This study will focus on the mining of iron ore. Iscor is an example of a company that mines iron ore and manufactures steel.

It is important to determine at which point mining stops and manufacturing begins. Different sections will apply to mining and manufacturing. Section 36, for instance, relates to CAPEX, while section 12C deals with the depreciation of manufacturing assets (KPMG, 2009). A substantial difference can be observed in the timing of the deduction for depreciation. The above-mentioned sections will be discussed below.

Section 1 states that the definition of mining income includes the winning of a mineral. When, for instance, iron ore is transformed into iron, it is considered as part of mining as the smelting process is included in the definition. The process during which iron is transformed into steel is regarded as manufacturing (KPMG, 2009).

CURRENT TAX BENEFITS APPLICABLE TO THE MINING INDUSTRY

The following tax benefits are applicable to the mining industry in South Africa:

3.3.1 Corporate income tax rate

The taxable income from mining operations will be taxed at a corporate tax rate of 28%, as applicable to other companies. However, in the case of companies that mine gold, special rates, calculated by using a special formula, apply (SARS, 2013:42).

3.3.2 Prospecting

According to section 15(b) of the Act, the expenditure incurred by the taxpayer in the year of assessment in respect of prospecting procedures and operations, together with expenditure that is incidental to the prospecting operations, is deductible from the income received from mining operations. The expenditure that was incurred must have been incurred in South Africa. Therefore the taxpayer has to first derive income from mining operations in order to be able to qualify for the deduction (De Koker & Williams, 2014).

3.3.3 Capital expenditure (CAPEX) – section 36

CAPEX that is incurred can be allowed as a deduction from taxable income derived from mining operations. CAPEX will include expenditure on shaft sinking, mining equipment, development and general administration before the commencement of production or during a period of non-production (SARS, 2013:42). Section 36(7C) of the Income Tax Act stipulates that, subject to the provisions of sections 36(7E), 36(7F) and 36(7G), the amounts to be deducted from the working of any producing mine under section 15(a) shall be the amount of CAPEX incurred. According to Deloitte (2010:23), CAPEX excludes land, mining rights, prospecting rights and goodwill.

The CAPEX deduction incurred at a specific mine is restricted to the taxable income of that particular mine. Any excess or unredeemed CAPEX will be carried forward to the next tax year and can be carried forward and used only for that specific mine (SARS, 2013:42). According to Deloitte (2010:24), if the mines are contiguous, they will be treated as one in calculating the redemption of CAPEX (section 36(11)). The CAPEX ring fence is calculated after taking into account assessed loss in accordance with section 20.

When any asset that is subject to full or partial redemption is sold, there will be a recoupment of CAPEX as the full proceeds reduce the CAPEX (if the CAPEX balance is less than the full proceeds, then the excess is taken to taxable mining income as an excess recoupment). The 100% recoupment will be a special inclusion in terms of par (j) of the definition of gross income (Deloitte, 2010:31).

According to KPMG (2009), qualifying capital expenditure will also include:

- Low-cost employee housing
- Infrastructure for residential areas
- Hospitals
- Schools
- Shops
- Recreational buildings
- Railway lines for mineral transport

The above-mentioned capital expenditure is deemed payable over 10 years (KPMG, 2009).

New and unused residential houses (not low-cost houses) are deemed to be payable over 20 years and employee motor vehicles are deemed payable over five years. If the life of the mine is expected to be shorter than the above-mentioned periods, the Commissioner may reduce the instalments periods (KPMG, 2009).

Expenses incurred in acquiring a mining right in terms MPRDA will be dealt with as stipulated in section 36(11)(e). The expenses should be divided by the number of years for which the taxpayer has obtained the right. An example of this would be the upliftment of the community (KPMG, 2009).

Non-deductible capital expenditure includes:

- Cost of land
- Acquisition of mining and mineral rights
- Servitudes and surface rights
- Any form of depletion allowance in respect of these assets (PwC, 2009:25).

Non-mining income, e.g. rental, interest or other trading activities, cannot be used to set off CAPEX, which can only be set off against taxable income derived from mining operations (SARS, 2013:42).

According to SARS (2013:43), a taxpayer who commenced mining operations at a new mine after 14 March 1990 may deduct the unredeemed or excess portion of CAPEX from

the total taxable income derived from the mining of other mines operated by that taxpayer. This may not exceed more than 25% of the total taxable income derived from the taxpayer's other mines.

3.3.4 Depreciation

If the capital assets are not used in the mining process, but in the process of manufacturing, section 12C will be applicable with regard to depreciation.

In terms of section 12C, a 20% allowance will be granted on the cost of machinery or plants used in the manufacturing or similar process, or for improvements. Regarding new and unused machinery, the allowance will be 40% in the first year brought into use and 20% in each of the following three years. The cost that will be depreciated is the lesser of two costs, i.e. either the actual cost or the cost of an arm's-length transaction at the time of acquisition (SARS, 2013:28).

According to section 13quin of the Act, commercial buildings and their improvements depreciate at a rate of 5% per year if they are brought into use new and unused. The depreciable cost of the building is the lesser of the actual cost or the cost of an arm's-length transaction at the time the building was acquired.
Where the taxpayer did not construct that part of the building himself,

- 55% of the acquisition price will be deemed to be the cost incurred for that part of the building, and
- 30% of the acquisition price will be deemed to be the cost incurred for the improvements, in terms of section 13quin of the Act.

Section 13 of the Act states that industrial buildings or buildings used in the process of manufacturing will be awarded an allowance of 2%. The 2% allowance increases to 5% if the construction of that building commenced on or after 1 January 1989.

3.3.5 Capital gains tax (CGT)

Capital gains tax (CGT) became effective from 1 October 2001 and applies to assets disposed of by a taxpayer on or after that date (SARS, 2013:46).

The provisions that regulate CGT are contained in the Eighth Schedule of the Act. In terms of section 26A of the Act, a taxable capital gain should be included in taxable income. No annual exclusion of capital gains is available to companies (par 5 of the Eight Schedule to the Act).
The rate at which the net capital gain will be included in a company's taxable income is 66.66% (par 10 of the Eighth Schedule of the Act). This amount is then subject to the company tax rate of 28%.
Capital losses may only be set off against capital gains. If the capital loss is not set off in a specific year of assessment, it can be carried forward to the next year (SARS, 2013:46).

3.3.6 Environmental rehabilitation

Provisions are made for rehabilitation expenses that are allowed as deductions for income tax purposes (SARS, 2013:43).

In terms of section 41 of the MPRDA, financial rehabilitation provisions are required by law for all mines. These provisions can be provided via any of four methods, i.e.

- cash deposits;
- guarantees;
- insurance; and
- approved trust funds (WWF-SA, 2012).

Section 37A of the Act specifically regulates mining rehabilitation funds. The funds are created for the sole purpose of rehabilitating the mining areas by using their property or funds. A tax deduction is granted in terms of payments made to these specific funds (SAICA, 2012).

There are strict rules in respect of rehabilitation funds and the assets contained in the funds may be used for prescribed rehabilitation purposes only (SAICA, 2012).

According to Mr J Kotze (2014), some mining companies prefer to make use of 'mining rehabilitation guarantees' supplied by companies like Gaurdrisk.

Section 37B, which was introduced in 2007, deals with two types of environmental expenditure:

1. Environmental treatment and recycling assets
   Assets that fall in this category will be depreciated by 40% in the first year after they were brought into use and by 20% in each of the following three years.
2. Environmental waste disposal asset
   Assets that fall in this category will be depreciated by 5% in each year of assessment (Deloitte, 2011:35).

The effectiveness of the rehabilitation of mines will depend on the financial provisions that should be in place to deal with rehabilitation and closure (WWF-SA, 2012).

3.3.7 Royalties

In the past, mineral and petroleum resources were privately owned. However, under specific circumstances where mining activities took place on state-owned land, consideration had to be paid over to the state for the extraction of the minerals and resources (SARS, 2013:78).

According to section 3(2)(b) of the MPRDA, the state, as the custodian of South Africa's mineral and petroleum resources, may determine and levy any fee or consideration payable. In the case of any exploration of mineral and petroleum resources within South Africa, the MPRDA will require a payment of consideration to the state in the form of a royalty. This royalty will be payable through SARS (SARS, 2013:79).

3.3.8 Incentives

No specific tax incentive relating to the mining industry is available in South Africa. However, as discussed below, section 12I does provide for industrial projects.

Section 12I

Section 12I of the Act deals with industrial projects and if a mining project makes a significant contribution to the Industrial Policy Programme of South Africa, it may qualify for a tax incentive. According to the Standard Industrial Classification of all Economic Activities (fifth edition) some types of mining and quarrying may not qualify (Department of Trade and Industry, 2013).

In an interview conducted with him, Mr J Kotze (2014) mentioned that he was not aware of any mining company using this tax incentive. He stated that if a company meets the criteria to qualify for the incentive, there is no reason why it should not benefit from it.

Section 12I of the Act is a tax incentive formulated to promote industrial projects in South Africa through foreign or local investments. Under this tax incentive, additional tax deductions of R20 billion have been specifically allocated to large industrial projects (Deloitte and Department of Trade and Industry, 2013:215).

In South Africa capital allowances for the manufacturing of assets are available in terms of sections 12C, 13 or 13quin. These sections are relevant only in the case of machinery brought into use for the first time by the taxpayer and they have to be used in South Africa. To qualify for the deduction, the assets must be used in the process of manufacturing and the cost of the construction or renovation of buildings must comply with certain conditions (Deloitte and Department of Trade and Industry, 2013:215).

If a project qualifies for the tax incentive, it will be awarded the status of ‘Preferred’ or ‘Qualifying’ or ‘Normal’, depending on the number to points earned in various categories. The classification of the project (Greenfields or Brownfields) will allocate a certain score to the criteria being used (Engelbrecht & Newman, 2013).

Brownfield investments can be defined as ’expansions or upgrades of existing industrial projects’, and Greenfield investments as ’new industrial projects that utilise only new and unused manufacturing assets’ (Department of Trade and Industry, 2013).

It is very important to differentiate between the two projects. The amount of points will decide if the project will have ‘Preferred’, ‘Qualifying’ or ‘Normal’ status. The status of the project, combined whether it is a Greenfields or Brownfields type of project, will indicated the value of the incentive.

Table 2 illustrates the total amount of points that will be allocated to the different criteria regarding the Greenfields and Brownfields projects.

Table 2: Points awarded for Greenfields and Brownfields projects

Criterion	Greenfields maximum points	Brownfields maximum points
Innovation	1	1
Energy efficiency	2	2
Business linkages	1	1
SMME procurement	1	2
Located in IDZ	1	0
Employment creation	2	2
Training of employees	2	2
Maximum points	10	10

Source: Engelbrecht & Newman (2013)

This provision will give an additional allowance on top of the allowances already received by the taxpayer.

Preferred-status project

An additional deduction of 55% of the cost of the new and unused qualifying asset can be claimed. This can be increased to 100% if the project is in an industrial development zone (IDZ). The total is limited to R900 million on a Greenfields project and R550 million on a Brownfields project.

A Qualifying- or Normal-status project

An additional deduction of 35% of the cost of the new and unused qualifying asset can be claimed. This can be increased to 75% in the case of IDZ project. The total is limited to R550 million on a Greenfield project and R350 million on a Brownfield project Binder Dijke Otte (BDO) (2014:57b).

To qualify for this incentive, the minimum investment for a Greenfields project is R200 million, and for a Brownfields project it will be the higher of R30 million or 25% of the value of manufacturing assets used for the project (Deloitte and Department of Trade and Industry, 2013:216).

Research and development

Section 11D deals with deductions for scientific or technological research and development (R&D). The programme is called a tax incentive scheme (SARS, 2009).

Expenditure that is actually incurred by a taxpayer is allowed as a deduction under section 11D. That expenditure must have been for the purpose of R&D and must have been incurred directly in South Africa (SARS, 2009).

Two types of deduction are available under section 11D, namely:

1. A 150% deduction of expenditure incurred for the purpose of R&D (section 11D(1)) (R&D expenditure on or after 1 January 2014)

   The following allowance is available in respect of R&D expenditure on or after 1 October 2012:

   A 100% deduction of the expenditure is allowed if the expenditure was directly for the purpose of R&D and was incurred in the production of income (SARS, 2013:34). In

addition to the 100% deduction, an additional 50% deduction will be granted if the R&D was approved by the Minister of Science and Technology (SARS, 2013:34). Where the R&D project is funded by a third person, only one person is allowed to claim the 50% deduction. The party responsible for the research methodology will qualify for the deduction (SARS, 2013:34).

2. Accelerated depreciation deduction

   Deductions of 50% in the first year, 30% in the second year and 20% in the third year are allowed (section 11D(2)). According to Interpretation Note 50, published by SARS (2009), a taxpayer is entitled to the incentive if he/she:

   - is carrying on a trade;
     - has actually incurred the expenses;
     - has directly undertaken the activities in South Africa; and
     - the activities were intended specifically for the purpose of R&D.

The purpose of R&D:

- 'is of a scientific or technological nature;
- is intended to be used by the taxpayer in the production of income; or
- is discovered or developed by the taxpayer for purposes of deriving income' (SARS, 2013:35).

Where a building is being used for R&D purposes, the cost of that building will also be reduced. The deduction will be 5% of the cost of the building if the building or part thereof is new and unused (SARS, 2013:35).

Since 1 January 2014, only one entity is allowed to claim the 150% deduction in the case of an R&D project funded by a third entity. The party responsible for the research methodology will qualify for the deduction (SARS, 2013:35).

3.3.9 Tax losses

Section 20 deals with assessed losses and can be summarised as follows:

- A non-mining assessed loss can be set off against mining income.
- A mining assessed loss can be set off against non-mining income.
- Mining CAPEX can never be set off against non-mining income (Deloitte, 2011:33).

3.3.10 Interest relating to mining income

Since the Act does not contain a specific definition for 'mining income' and does not specify what interest may be deducted from such income, examples from court cases should be used. In *Western Platinum Ltd v C:SARS*, 2004 (67 SATC 1) the court held that for income to constitute 'mining income', its source must be minerals taken from the earth, and that 'income derived from mining operations' refers to income derived from the business of extracting minerals from the soil. However, an intermediate investment of such income by putting it to work as capital generally breaks the requisite direct connection. Thus, interest derived by a mining company from a cash management scheme involving moneys placed on overnight call is not mining income. The same applies to interest earned on foreign bank accounts (De Koker & Williams, 2014).

In *Western Platinum Ltd v C: SARS* it was held that under specific circumstances interest may be characterised as 'income derived by the mining operation', so that it can be deducted from 'mining income':

- Interest received from cash management system
- Interest on escrow (trust) accounts
- Interest earned on money lent on fixed deposit
- Interest earned on late payment by customers
- Interest earned it terms of the General Export Scheme; and
- Interest earned on refunds by the Commissioner of tax or mineral rental in terms of section 88(1) of the Income Tax Act.

According to PwC (2009:34), interest and finance charges received prior to the commencement of production will be capitalised. Thereafter, it will be deductible as a

working cost. Interest on loans utilised for mining purposes is deductible from mining income.

CONCLUSION

In summary, income tax benefits available to taxpayers in South Africa in respect of the mining sector include corporate income tax; prospecting; CAPEX; depreciation; CGT; environmental rehabilitation; royalties; research and development incentives; section 12I; tax losses; and interest.

The aforementioned income tax incentives were analysed in order to obtain clarity with regard to income tax benefits currently available to the mining industry in South Africa. A detailed analysis of the income tax benefits available to the mining sector in Australia will be follow in Chapter 4.

CHAPTER 4

AN ANALYSIS OF CURRENT INCOME TAX BENEFITS FOR THE MINING SECTOR IN AUSTRALIA

INTRODUCTION

This chapter contains a detailed analysis of the income tax benefits available to the mining sector in Australia.

Australia is one of the world's most mineral-rich countries and the second largest producer of iron ore (MBendi, 2014). The country has the potential to remain amongst the leaders in this field as new deposits are being discovered and developed as the demand for mineral products grows (Australian Government, 2012).

TAX BENEFITS CURRENTLY APPLICABLE TO THE MINING INDUSTRY

The following tax benefits are applicable to the mining industry in Australia:

4.2.1 Corporate income tax rate

The corporate tax rate of Australia is a flat rate of 30% and it is applied at the federal level (PwC, 2012:16).

4.2.2 Prospecting

Special allowances and contracts are in place for mining companies. If the criteria set out in the Australian Taxation Act are satisfied, the miners are allowed to deduct expenditure incurred in respect of exploration or prospecting. An immediate deduction is also available for the cost of the asset, for example a mining right, first used in exploration and prospecting, but only under limited circumstances (PwC, 2012:16).

4.2.3 Capital expenditure (CAPEX)

Some kinds of mining capital expenditure, such as transport, infrastructure, housing and other mine development expenditure may be eligible for write-off at an accelerated diminishing value rate of 200% over the life of a project (PwC, 2012:16).

4.2.4 Depreciation

In the case of ore assets, the rate of depreciation is calculated over the lifetime of the mine. The Commissioner's Ruling outlines the effective lives of depreciable assets. Industry-specific assets have a specific recommended effective life (PwC, 2012:16).

Land is not a depreciable asset, therefore improvements that can be identified as being separate from land are depreciated over their effective life (PwC, 2012:16). Buildings are depreciated at an annual rate of 2.5%, and plant, machinery and trailing lines at 5.0% (PwC, 2012:16).

Work or construction in progress is depreciated over the life of the mine. Expenditure capitalised to work in progress cannot be depreciated until after the asset has been installed and is ready for use. However, if the asset is first used for exploration or prospecting, the entire cost of the asset will be written off for tax as incurred, subject to the miner meeting certain conditions as set out in the Taxation Act (PwC, 2012:16).

4.2.5 Capital gains tax (CGT)

Capital gains form part of income tax, i.e. it is not considered a separate tax. A discount of 33.33% is allowed for complying superannuation entities. Depreciable assets will only attract CGT if they are used for non-taxable purposes. Capital losses can be carried forward and used to off-set against capital gains (Australian Government: Australian Taxation Office, 2014a).

4.2.6 Environmental rehabilitation

An immediate deduction is available on capital expenditure that does not form part of the cost of a depreciating asset and is incurred in respect of:

- Exploration or prospecting for minerals, which include petroleum or quarry materials. The cost incurred must be for obtainable activities that involve the production of assessable income.
- Rehabilitation of mining or quarrying sites (Australian Government: Australian Taxation Office, 2014b)

A recoupment may be included in the assessable income. If the capital expenditure incurred arose from a non-arm's-length transaction and the market value of the expenditure is higher, the expenditure will be taken into account at market value (Australian Government: Australian Taxation Office, 2014b).

4.2.7 Royalties

The two types of royalty that will be discussed are mining royalties and mineral resource rent tax.

Mining royalty

Where certain minerals are mined in a specific state, a mining royalty is payable to the government of that state. Generally the applicable mining royalty will either be a set amount or fixed percentage of the volume of minerals extracted, or the realised value of minerals mined (PwC, 2012:16).

Mineral resource rent tax (MRRT)

MRRT is a tax levied on certain profits gained from the extraction of coal and iron ore. Entities that have an entitlement to, or may explore for coal and iron ore to be extracted in Australia, may be affected by MRRT (Australian Government: Australian Taxation Office, 2014d).

MRRT applies to the following taxable resources:

- Iron ore
- Coal
- Anything produced by the in situ consumption of coal or iron ore
- Coal seam gas extracted as a necessary incident of coal mining or from a proposed coal mine (Australian Government: Australian Taxation Office, 2014d).

From 1 July 2012 to 1 July 2014 MRRT applied to all new and existing coal or iron ore ventures in Australia. The Australian Government announced that this section has been repealed from 1 July 2014 (Australian Government: Australian Taxation Office, 2014d).

The effective MRRT rate is 22.5%, which is the nominal rate of 30% less an extraction factor of 7.5%. This extraction factor recognises the specialist skills required to extract the resource and take it to the valuation point (Australian Government: Australian Taxation Office, 2014d). Mining profit for MRRT is equal to mining revenues less mining expenditure, and for tax purposes any MRRT paid is deductible from income (PwC, 2012:16).

4.2.8 Incentives

At the Association of Mining and Exploration Companies (Amec) Convention held in Crown Perth on 2 July 2014, the Australian Minister of Industry, Ian Macfarlane, said: '… we need a strong junior sector to search for the next generation of Australia's mineral deposits, but junior exploration companies find it increasingly difficult to attract capital via capital markets …" (*Mining Weekly*, 2014).

To assist the junior explorers with regard to Greenfields mineral exploration, the Exploration Development Incentive (EDI) will help raise capital from private-sector investors through a refundable tax offset for Australian resident shareholders (*Mining Weekly*, 2014).

Exploration Development Incentive (EIS)

EIS is a State Government initiative that aims to encourage exploration in Western Australia for the long-term sustainability of the State's resource sector. The State hopes that this will reinforce the image of Western Australia as an attractive destination to invest in mineral and energy exploration (Government of Western Australia and Department of Mines and Petroleum, 2013).

The EIS proposal was announced by the former government in the 2013-14 Budget published on 14 May 2013. The Treasurer's media release of 6 November 2013 announced that the Government would proceed with this incentive. This EIS will have the following financial impact on revenue on the Australian government, according to the Tax and Superannuation Laws Amendment Bill - Explanatory Memorandum (3/2014):

- 2014-15 - $500 million
- 2015-16 - $350 million
- 2016-17 - $250 million
- 2017-18 - $250 million

The EIS will allow investors of eligible exploration companies to deduct a proportion of the expenditure of mining explorations and tax losses if they occurred in the same year. This will provide shareholders with exploration credits and an entitlement to a refundable tax offset (Deloitte, 2014). This scheme will be limited to companies with no taxable income, but will most likely target small exploration companies (Coalition, 2013). The explorers will be able to carry forward the losses, or have the option to distribute the credits to shareholders (BDO, 2014a).

For a mining company, the scheme is capped at $100 million over the following three years. In 2014-15, exploration credits will be capped at $25 million in respect of exploration expenditure; $35 million for exploration expenditure incurred in 2015-16; and $40 million for exploration expenditure incurred in 2016-17. To ensure that the cap is not breached, a modulation process will be used (Australian Government: Australian Taxation Office, 2014c).

The scheme was implemented on 1 July 2014 and it will start with investments made from then onwards. This initiative, funded by Royalties for Regions, will lead to new mineral discoveries because of the stimulation of resource exploration in the private sector. The focus of the EIS will be mainly on the under-explored Greenfield regions (Government of Western Australia & Department of Mines and Petroleum, 2013).

The Government of Western Australia & Department of Mines and Petroleum (2013) state that new discoveries in the Greenfields regions will lead to employment opportunities and will increase the State's geological and resource database. The provision by the Government of new, high-quality geosciences information in Greenfields areas will increase resource exploration expenditure, which is one of the objectives of the EIS.

The EIS will be managed by the Department of Mines and Petroleum (DMP), the State agency that leads the future development in the resource industry. They collaborated with the Department of Local Government and Regional Development to formulate the EIS (Government of Western Australia and Department of Mines and Petroleum, 2013).

The focus will be on the immediate deduction of exploration expenditure to increase genuine exploration activity (Australian Government: Australian Taxation Office, 2014c). Initially the Exploration Development Incentive (EDI) will be limited to the exploration of minerals, therefore petroleum and geothermal exploration expenditure will not be eligible for the incentive (BDO, 2014a).

According to the Tax and Superannuation Laws Amendment Bill (3/2014), the costs relating to the acquisition of mining rights and mining information, first used for exploration, will be deductible over 15 years or over the effective life of the right or information, whichever comes first.

The exploration costs will no longer be an immediate deduction, except in limiting circumstances:

- The cost of mining rights and mining information acquired from an Australian government authority (Commonwealth, State or Territory government body) – this remains the same as stipulated in the Act;

- the cost of geological, geophysical or similar information acquired from specific providers – this remains the same as stipulated in the Act; and
    - the cost of newly created mining information – this remains as stipulated in the Act (Subsection 40-80(1) of Tax and Superannuation Laws Amendment Bill (3/2014).

All other mining rights and mining information costs that would currently benefit from the immediate deductions that are excluded by the operation of this measure will be depreciated over 15 years or over the effective life of the rights or information. This will come into play from the initial utilisation of the rights or information (Tax and Superannuation Laws Amendment Bill - Explanatory Memorandum (3/2014)).

The taxpayer can choose to immediately deduct any remaining undepreciated value of the related mining rights and mining information, where exploration on a particular tenement ceases. If the taxpayer then recommences exploration on the tenement, he will be subject to a clawback of what would have been the residual value of the mining rights or mining information had he not chosen an immediate deduction (Tax and Superannuation Laws Amendment Bill - Explanatory Memorandum (3/2014).

The taxpayer has to meet the full qualifying criteria in subsection 40-80(1) to determine whether he will qualify for the immediate deduction according to the Tax and Superannuation Laws Amendment Bill - Explanatory Memorandum (3/2014).

Regarding the qualifying criteria, the taxpayer must satisfy one of the following three tests (Subsection 40-80(1) (IAA) :

- the taxpayer carried on general mining operations, petroleum mining operations or quarrying operations;
- it would be reasonable to conclude that the taxpayer proposed to carry on such operations; or
- the taxpayer carried on a business of, or a business that included, exploration or prospecting for minerals (including petroleum) or quarry materials obtainable by such operations and the expenditure was necessarily incurred in carrying on that business (Tax and Superannuation Laws Amendment Bill - Explanatory Memorandum (3/2014)).

Research and development

The Australian R&D incentive provides a tax offset for eligible activities (Australian Government: Australian Taxation Office, 2012).

To be eligible for the incentive, the taxpayer must be an R&D entity engaging in eligible activities. The entity's notional R&D deduction must be at least $20 000 (Australian Government: Australian Taxation Office, 2012).

The incentive has two core components:

- A 45% refundable tax offset (equivalent to a 150% deduction)
  Eligible entities must have an aggregate turnover of less than $20 million per annum, provided they are not controlled by an entity that has been exempted from tax.
- A 40% non-refundable tax offset (equivalent to a 133% deduction) for all other eligible entities.

Entities may carry the unused offset amounts forward to future income years (Australian Government: Australian Taxation Office, 2012).

According to Deloitte (2011), up to 50% of the cost of the R&D activity may be conducted offshore.

4.2.9 Tax losses

Restrictions of both a capital and a revenue nature are in place for the use of tax losses. Capital losses may be used only to offset capital gains, whereas revenue losses can be used to offset taxable income. The use of both revenue and capital losses is subject to integrity measures in the form of loss recoupment tests. If the tests are satisfactory, the loss may be carried forward indefinitely (PwC, 2012:16).

CONCLUSION

Chapter 4 provided an analysis of the income tax benefits available to taxpayers in the Australian mining sector. The analysis included the following income tax benefits:

Corporate income tax rate; prospecting; CAPEX; depreciation; CGT; environmental rehabilitation; royalties; research and development incentive; EDI; and tax losses.

In Chapter 5 the income tax benefits outlined in Chapters 3 and 4 will be compared in order to highlight differences and specific benefits.

CHAPTER 5

COMPARISON OF INCOME TAX BENEFITS CURRENTLY AVAILABLE TO THE SOUTH AFRICAN AND AUSTRALIAN MINING SECTORS

INTRODUCTION

This chapter provides a detailed comparison of the income tax benefits available to the mining sectors in South Africa and Australia as identified in Chapters 3 and 4 respectively.

5.2 DETAILED COMPARISON

In Table 3, the summarised income tax benefits available to the mining sector in South Africa, as identified in Chapter 3, are compared to the income tax benefits available to the Australian mining sector, as identified in Chapter 4.

Table 3: Comparison of income tax benefits currently available to the South African and Australian mining sectors

Tax benefit	South Africa	Australia
Corporate income tax rate	Annual rate of 28%	Annual rate of 30%
Prospecting	Expenditure incurred in respect of prospecting procedures is 100% deductible from income received from mining operations.	A 100% deduction is available with regard to the cost of an asset initially used for exploration and prospecting, but only under limiting circumstances.
CAPEX	CAPEX that is incurred will be allowed as a deduction against income received from mining	Specific mining capital expenditure, such as expenditure on transport,

	operations. The CAPEX deduction is restricted to a specific mine.	infrastructure, housing and other mine development expenditure may be eligible for write-off at an accelerated diminishing value rate of 200% over the life of a project.
Depreciation	<u>Manufacturing assets</u> Allowance of 20% for five years if asset is new and unused The allowance will increase to 40% in the first year brought into use and then change 20% in the following three years. <u>Commercial buildings</u> Allowance of 5% per year (new and unused) <u>Industrial buildings</u> (Used in the manufacturing process) Allowance of 2% per year	<u>Ore assets</u> Depreciated over the life of the mine <u>All buildings</u> Allowance of 2.5% per year <u>Plant, machinery and trailing lines</u> Allowance of 5% per year <u>Work in progress</u> Depreciated over the life of the mine
CGT	Capital gains form part of income tax and are not considered a separate tax. Net capital gains are included at a rate of 66.6% in taxable income. Capital losses may be used as an offset against capital gain and may be carried forward if not used.	Capital gains form part of income tax and are not considered a separate tax. A discount of 33.33% is available for superannuation entities. Depreciable assets will only attract CGT if they are used for non-taxable purposes. Capital losses can be carried

		forward and used as an offset against capital gains.
Environmental rehabilitation	Payments made to mining rehabilitation funds tax deductible. <u>Environmental expenditure</u> For environmental treatment and the recycling of assets, an allowance of 40% is granted in the first year after being brought into use. This decreases to 20% in each of the next three years. An environmental waste disposal asset allowance of 5% per year	A 100% deduction is available on capital expenditure that does not form part of the cost of a depreciating asset and is incurred on rehabilitation of mining or quarrying sites.
Royalties	Royalties are payable on the extraction of iron ore.	Royalties are payable on the extraction of iron ore. The MRRT was repealed on 1 July 2014.
Research and development incentive	A 150% deduction of expenditure for R&D purposes is allowed in respect of expenditure incurred on or after 1 January 2014. Accelerated depreciation is 50% in the first year, 30% in the second and 20% in the third year.	A 45% refundable tax offset (i.e. a 150% deduction) is allowed if the annual turnover of the entity is less than $20 million. A 40% non-refundable tax offset (133% deduction) is allowed for all other eligible entities.

Incentives	**Section 12I incentive**	**Exploration Development Incentive (EDI)**
	<u>Preferred-status projects</u> An additional 55% of the cost of the new and unused qualifying asset. This can be increased to 100% if the project is in an industrial development zone (IDZ). Limit R900 million on a Greenfield project R550 million on a Brownfield project <u>Qualifying or Normal-status projects</u> An additional 35% of the cost of the new and unused qualifying asset. Which can be increased to 75% if the project is in an industrial development zone (IDZ). Limit R550 million on Greenfields projects R350 million on Brownfield projects	The expenditure incurred should be in terms of Greenfields exploration expenditure. Exploration credits will be capped at $100 million in respect of exploration expenditure: • $25 million in 2014-15 • $35 million in 2015-16 • $40 million for 2016-17. The exploration costs will no longer be an immediate deduction, except in limiting circumstances: The cost of mining rights and mining information acquired from an Australian government authority (Commonwealth, State or Territory government body) – this remains the same as what it was in the Act. The cost of geological, geophysical or similar information acquired from specific providers remains as stipulated in the Act, and so does the cost of newly created mining information.

		All other mining rights and mining information costs that would currently benefit from the immediate deductions that are excluded by the operation of this measure will be depreciated over 15 years or over the effective life of the rights or information.
Tax losses	An assessed non-mining loss can be set off against mining income. A assessed mining loss can be set off against non-mining income. Mining CAPEX can never be set off against non-mining income.	Revenue losses can be used to offset taxable income.
Interest	Interest may be characterised as income derived from mining operations under these circumstances: • Interest received from cash management system • Interest on escrow (trust) accounts • Interest earned on money lent on fixed deposit • Interest earned on late payment by customers • Interest earned it terms of the	No specific interest is addressed regarding mining operations

	General Export Scheme • Interest earned on refunds by the commissioner of tax or mineral rental in terms of section 88(1) of the Income Tax Act	

Based on the contents of Table 3, the following were identified:

- In South Africa the corporate income tax rate is 28%, whereas in Australia it is 30%. South Africa offers the better tax benefit.
- In the case of prospecting expenditure, South Africa and Australia both offer a 100% deduction. In South Africa the deduction will be allowed as soon as income is received from mining operations; in Australia will only be allowed under limiting circumstances. The best tax benefit will be received in South Africa.
- In South Africa CAPEX that is incurred will be allowed as a deduction against income derived from mining operations, in other words, a 100% deduction. However, the deduction is restricted to a specific mine. In Australia certain CAPEX may be eligible for accelerated write-off at a rate of 200%. The best tax benefit will be received in Australia.
- Depreciation is dealt with under a few categories in both countries. In South Africa manufacturing assets are depreciated over five years at a rate of 20% per year. If the assets are new and unused, the allowance will increase to 40% in the first year and 20% in the next three years. In Australia ore assets are depreciated over the life of the mine. The better tax benefit will be received in South Africa.
- In South Africa buildings are split into two categories. The annual allowance for commercial buildings is 5%, while for industrial buildings it is 2%. In Australia all buildings are depreciated at a rate of 2.5% per year. With regard to commercial buildings, South Africa offers the best tax benefit, whereas the benefit offered for industrial buildings is better in Australia.
- In Australia WIP is depreciated over the life of the mine. Since South Africa does not depreciate WIP, Australians clearly receive the best tax benefit.

- Capital losses are treated the same in both countries. In South Africa capital gains will be included at a rate of 66.66% in the taxable income of companies. In Australia a discount percentage of 33.33% is available for superannuation entities. A comparison between the different treatments shows that the corporate income tax rate applicable in South Africa and the rate applicable in Australia will have the same net effect. However, in Australia depreciable assets will only attract CGT if they are used for non-taxable purposes. Therefore the best tax benefit will be received in Australia.
- Payments made to mining rehabilitation funds, which are very restrictive, are 100% deductible from tax in South Africa. Environmental treatment and the recycling of assets receive an allowance of 40% in the first year and 20% in each of the following three years. Environmental waste disposal assets receive an allowance of 5% per year. In Australia, a 100% deduction is available on capital expenditure incurred to rehabilitate mining or quarrying sites. The best tax benefit will be received in Australia.
- Royalties on the extraction of iron ore are payable in both countries. The MRRT has been repealed in Australia, so neither country is better off regarding this tax benefit.
- Australia and South Africa offer similar research and development incentives for R&D purposes. In South Africa a 150% deduction is available in the case of R&D expenditure incurred on or after 1 January 2014. An accelerated depreciation allowance of 50% in the first year, 30% in the second and 20% in the third year is also available for assets used specifically for R&D purposes. Australia offers a 133% deduction or a 40% non-refundable tax offset for entities with an annual turnover of more than $20 million. The best tax benefit will be received in South Africa.
- In South Africa a section 12I incentive is available for industrial projects. The projects are split into two categories, which may include Greenfields and Brownfields projects. The first category is for ‘Preferred-status projects’. In the case of projects with this status, an additional 55% allowance on the cost of new and unused assets may be claimed. This can be increased to 100% if the project is in an IDZ. The second category is for ‘Qualifying or Normal-status projects’, in which case an additional 35% allowance on the cost of the new and unused assets may be claimed. This could be increased to 75% if the project is in an IDZ. Certain limitations are in place, per category, on Greenfields and Brownfields projects. Australia offers an Exploration

Development Incentive. The exploration incurred can only be for Greenfields exploration. The scheme will be capped at $100 million per mine over three years ($25 million in the first year, $35 in the second and $40 million in the third year). The best tax benefit will therefore be received in South Africa.

- Regarding tax losses, capital losses can only be used to offset capital gains in each of the two countries. In Australia, revenue losses can be used to offset taxable income. In South Africa the specifications regarding mining losses are more detailed. A non-mining assessed loss can be set off against mining income. A mining assessed loss can be set off against non-mining income. Mining CAPEX can never be set off against non-mining income. The benefit received in the two countries will be the same.
- In South Africa, under certain circumstances, interest may be characterised as income derived from mining operations. In Australia, no specific interest is addressed regarding mining operations. The best tax benefit will be received in South Africa.

CONCLUSION

Chapter 5 provided a comparative analysis of the income tax benefits offered to the mining industries in South Africa and Australia in order to determine which of the two countries offer the most advantageous tax benefits. The conclusions reached will be discussed below.

South Africa offers the best income tax benefits in the following instances:

- Corporate income tax rate – the income tax rate is lower in South Africa.
- Prospecting – South Africa allows a 100% deduction, while in Australia a deduction is only allowed under limiting circumstances.
- R&D – South Africa offers a 150% incentive, compared to the 133% incentive available in Australia. South Africa also offers an accelerated depreciation on R&D assets.
- Incentives – South Africa offers incentives for both Greenfields and Brownfields expenditure, while Australia takes only Greenfields expenditure into account.
- Interest – South Africa specifically addresses interest derived from mining operations.

Australia will receive the best income tax benefit in the following instances:

- CAPEX – Australians are entitled to a 200% deduction, compared to the 100% deduction offered in South Africa. South Africans can only utilise the deduction when income is derived from mining operations.
- CGT – Australia is in the better position as there is no CGT on depreciable assets used for taxable purposes. The rate at which the net capital gain is included in taxable income is the same in both countries.
- Mining rehabilitation – Australia has a 100% deduction available for capital expenditure incurred for rehabilitation. In South Africa the money used for rehabilitation must be paid into funds, which are very restrictive. The deduction is available only if the money is paid over to a fund.

The same income tax benefit will be received by both countries in the following instances:

- Depreciation – South Africa depreciates manufacturing assets over three to five years and Australia over the life of the mine. Australia depreciates all buildings at the same rate of 2.5%, which means that the allowance on industrial buildings is more advantageous than that offered in South Africa, which applies a rate of 2%. However, South Africa offers the better benefit where commercial buildings are concerned as it applies a rate of 5%. Australia depreciates WIP, but South Africa does not.
- Royalties – both countries have the same treatment regarding royalties.
- Tax losses – both countries offer the same treatment, but South Africa is more specific.

Based on the comparison performed above, it is evident that both countries have a lot to offer regarding income tax benefits available to the mining industry. It is apparent that the income tax benefits in South Africa exceed the income tax benefits currently available in Australia. This chapter also highlighted the fact that there is a lot to be learnt from Australia regarding their treatment of CAPEX, CGT and mining rehabilitation. The final chapter will offer concluding remarks and recommendations for possible future research.

CHAPTER 6

CONCLUSION

INTRODUCTION

The aim of this chapter is to assess the findings of the study in the light of the research objectives outlined in Chapter 1, which defined the purpose of this study.

ADDRESSING THE RESEARCH OBJECTIVES

The achievement of the research objectives as set out in Chapter 1:

To critically evaluate the income tax benefits available in the South African and Australian mining industries respectively.

Chapter 2 promoted a general understanding of the importance of the mining sector and provided an overview of the history of mining in South Africa and Australia. A critical analysis of income tax benefits available to mines in South Africa was provided in Chapter 3, which was followed in Chapter 4 by a critical analysis of the income tax benefits currently available to taxpayers in Australia.

In summary, this analysis included the following income tax benefits: corporate income tax rate; prospecting; CAPEX; depreciation; CGT; environmental rehabilitation; royalties; research and development incentive; EDI, section 12I, tax losses and interest.

To compare income tax benefits available to the South African and Australian mining industries in order to expose any differences, draw relevant conclusions and make recommendations.

A detailed comparison between the current income tax benefits available to the mining industries in South Africa and Australia was made in Chapter 5. Based on this comparison, the differences between the income tax benefits available in South Africa and those provided in Australia were highlighted. Recommendations will be made later in this chapter.

To summarise the findings of the comparison, it was concluded that the South African mining industry enjoys the best income tax benefits with regard to the corporate income tax rate, prospecting, R&D, incentives and interest, whereas the tax benefits offered in Australia are better in respect of CAPEX, CGT and mining rehabilitation. The income tax benefits awarded to mining companies in respect of depreciation, royalties and tax losses are the same.

FINAL CONCLUSION

This study found that the mining industries in South Africa and Australia currently enjoy several tax benefits. First, it should be noted that even though South Africa is considered to be a developing country, a comparison between the tax benefits offered locally and those offered to the mining industry in Australia, a developed country, showed that South Africa was in the lead. Credit should therefore be given where it is due. Usually perceptions regarding the South African mining industry are mostly negative. It is easily forgotten that the tax legislation in South Africa rates very highly compared to that of the rest of the world. This was once again proved by the outcome of this study.

Based on the comparison in Chapter 5, it was determined that the income tax benefits offered to the mining industry by the South African Revenue Service (SARS) are more advantageous than those currently available in Australia. The fact was also highlighted that the tax treatment received by mines in the two countries is similar. However, South Africa can learn a great deal from Australia regarding their treatment of CAPEX, CGT and mining rehabilitation.

All the objectives of this study were addressed and the outcome was successfully determined. The aim, which was to determine how the income tax benefits currently

available to the local mining industry compare with income tax benefits available in Australia, was achieved.

RECOMMENDATIONS

South Africa is at the forefront in respect of the corporate tax rate and income tax benefits that relate to prospecting, R&D, incentives and interest. There is a strong similarity between the way in which tax losses, royalties and depreciation are treated in South Africa and Australia.

A recommendation could be made that South Africa should consider how Australia deals with CGT. The effect of the rate at which net capital gains are included in taxable income is the same in the two countries, but the fact that depreciable assets that are used for taxable purposes do not attract CGT is definitely advantageous for the Australian mining industry. With regard to CAPEX, the 200% deduction that Australian mines receive on CAPEX is twice the deduction allowed in South Africa. Since in the mining industry CAPEX is usually astronomical, this benefit can make a huge difference.

Another major hurdle to be overcome in South Africa is labour relations. If government can succeed in designing a policy or incentive to mediate labour relations, investors will have a much more positive view of the South African mining sector.

Since South African tax legislation is fairly complex, it is important to keep taxation as simple and fair as possible. This might have a positive effect on tax compliance by the mining sector.

FUTURE RESEARCH

The comparison that was drawn in Chapter 5 was fairly simple. Future research could include a case study dealing with actual financial statements to quantify the difference between the ways in which the South African and Australian mining industries are being taxed.

This study focussed on income tax benefits only. Future research could investigate all the different taxes that have an impact on mining operations.

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