

**AN ANALYSIS OF THE TAX IMPLICATIONS OF
ORE STOCKPILING IN THE MINING INDUSTRY**

Mini dissertation by

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GLOSSARY OF TERMS

Commissioner of the South African Revenue Service	CSARS
Generally Accepted Accounting Practice	GAAP
International Accounting Standard	IAS
International Financial Reporting Statement	IFRS
Income Tax Act 58 of 1962	ITA
Income Tax Court	ITC
Interpretation Note	IN
Practice Note	PN
Section	s
South African Mineral Resource Committee	SAMREC
South African Code for the Reporting of Mineral Asset Valuation	SAMVAL
South African Revenue Service	SARS
South African Tax Court	SATC

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ENGLISH SUMMARY

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by

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The purpose of this study was to examine whether unmined ore stockpiles fall within the ambit of the definition of trading stock in section 1 of the Income Tax Act (58/1962) and therefore needs to be considered for the purposes of section 22 in the determination of taxable income. Furthermore the judgement in **Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR** (1996:55) would be analysed to determine whether a distinction could be made between the stockpiled material held in that case as opposed to unmined ore.

The research object would be determined by analysing the nature of ore stockpiles, the accounting treatment ore stockpiles and its effect on the tax treatment as well as the taxation of stockpiles in terms of case law.

As to the first part, a distinction in the legal sense was examined between movable and immovable property. It was concluded that stockpiles could by its nature in certain circumstances, be considered immovable property even though they became movable by its separation from the soil. Intention was furthermore identified as one of the most important criteria in a three tier test for the determination of the legal nature of stockpiles.

As to its tax nature, it was concluded that even though case law suggests that the intention to realise through mining activities could make such stockpiles floating capital, it was submitted that intention remains the conclusive criteria and therefore

only once an intention exist, to utilise mining property in a mining process that is a scheme of profit making, does the intention change and does the fixed capital (both immovable property and movable stockpiles) become floating capital.

In the second chapter an analysis was done of the financial reporting requirements for stockpiles and whether the accounting treatment thereof would influence the tax treatment. It was concluded that the accounting treatment would influence the tax treatment as the definition of trading stock in section 1 of the ITA (58/1962) is actually an extension of the normal grammatical meaning, the latter for which the accounting treatment is critical. In terms of IAS1 it was found that an essential criterion for a current asset was that it must be expected to be realised in the 12 months after the reporting date. It was found that even though mined ore and crushed ore could be seen as work in progress and thus inventories, such ore still had to comply with the requirements of IAS1 and IAS2 to be classified as inventory. The valuation of the ore would be in terms of IAS2 if at historical cost and in terms of SANREC if at net realisable value. It was concluded that stockpiles that did not meet the trading stock criteria due to various uncertain circumstances could be disclosed as non-current assets at historical cost, but not in terms of IAS16. However, if no reasonable expectation of future benefits existed, then no disclosure would be required.

In examining the taxation of stockpiles the definition of trading stock was analysed. It was concluded that to the extent that the normal grammatical meaning did not apply, the extension to the definition still had to be considered. It was held that the extension to the definition had two parts of which the first required that the object must be acquired, produced or manufactured for the purpose of use in a manufacturing process, irrespective of whether the object was saleable in its current condition. The second part required no intention but was an objective enquiry of whether a saleable object was disposed of and which the proceeds would be revenue in nature

It was also found that a distinction between a mining process and a manufacturing process exists in the South African tax law and that objects intended for use in the different processes could be treated differently from a tax perspective. Finally the analysis of the **Richards Bay case** (1996:55) revealed that even though the court

considered that stockpiles are raw materials or work-in-progress, it was the taxpayer's admission of a manufacturing process and his lack of distinction of the mining process that was critical in the decision against him. The court accepted the taxpayer's contentions and withheld opinion on these two critical matters.

It was concluded that stockpiles of unmined ore did not constitute trading stock in the extended definition and only under very specific circumstances could it be considered trading stock under the normal grammatical meaning when inferred from accounting disclosure and valuation requirements.

AFRIKAANSE OPSOMMING

‘N ONTLEEDING VAN DIE BELASTING GEVOLGE VAN ERTS OPEENHOPING IN DIE MYNBEDRYF

deur

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Die doel van die navorsing was om ondersoek in te stel of ongemynde ertshope voldoen aan die definisie van handelsvoorraad in artikel 1 van die Inkomstebelastingwet (58/1962) en derhalwe in ag geneem moet word vir die doeleindes van artikel 22 om soedoende belasbare inkomste te bepaal. Die uitspraak van **Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR** (1996:55) is ondersoek om te bepaal of daar ‘n onderskeid getref kon word tussen ongemynde erts en die opgehoopde material beskryf in die hofspraak.

Die navorsingsdoelstelling sou bepaal word deur die aard van ertshope te ontleed, die rekenkundige hanteering te ondersoek asook laasgenoemde se uitwerking op die belasting gevolge, ingevolge regspraak te ontleed.

In die eerste gedeelte is die regsonderskeid tussen roerend en onroerende eiendom bepaal. Die gevolgtrekking was dat ertshope onder seker omstandighede wel onroerende goed kon wees, al word hulle roerende goed deurdat dit van die grond geskei is. Bedoeling is as die belangrikste eienskap geïdentifiseer in ‘n drie vlak toets om die aard van goed te bepaal.

In verband met die belastingaard van die ertshope is bevind dat ongeag die feit dat sekere regspraak sou aanleiding gee dat die ertshope bedryfskapitaal is, is dit aangevoer dat die bedoeling van die belastingbetaler konkreet is. Derhalwe sou dit vaste bates (beide onroende goed en ertshope) bly tot die bedoeling van die

belastingbetaler verander om die goed in 'n skema van winsbejag te gebruik, waarna dit bedryfsbates word.

In die tweede hoofstuk is die rekeningkundige verslagdoeningsvereistes van ertshope ontleed en of dit die belasting hanteering sou beïnvloed. Die gevolgtrekking was dat die rekeningkunde wel die belasting hanteering beïnvloed omdat die definisie van handelsvoorraad in artikel 1 van die Inkomstebelastingwet (58/1962) eintlik net die normale grammatiese woord uitbrei. Laasgenoemde word volgens die rekeningkundige vereistes bepaal. Ingevolge die vereistes van IAS1 is bepaal dat 'n belangrike eienskap van bedryfsbates is dat daar ten minste 'n verwagting moet wees om dit te realiseer binne twaalf maande na die verslagdoenings datum. Dit is bevind dat ongeag die feit dat erts wel handelsvoorraad kon wees, moes dit steeds aan die vereistes van IAS1 en IAS2 voldoen om as handelsvoorraad geopenbaar te word. Die waarde van die voorraad moes ingevolge IAS2 bepaal word as dit teen historiesekoste getoon was en ingevolge SAMREC as dit teen netto realiseerbare waarde getoon is. Ertshope wat nie aan die handelsvoorraad vereistes voldoen het nie moet geopenbaar word as vaste bates teen historiese koste, maar nie ingevolge IAS16 nie. Waar geen redelike vooruitsigte vir toekomstige ekonomiese voordele bestaan het in verband met die ertshope, moes geen openbaarmaking geskied.

Om die belasting hanteering van ertshope te bepaal is die definisie van handelsvoorraad ontleed. Dit is bevind dat wanneer die normale grammatiese betekenis van die woord nie van toepassing is nie, moes die uitbreiding op die definisie steeds in ag geneem word. Dit is bevind dat die uitbreiding op die definisie uit twee dele bestaan waarvolgens die eerste deel vereis dat vir die doeleindes van vervaardiging of verkoop iets geproduseer, vervaardig of gekoop is. Dit geld ongeag of die belastingbetaler bedoel het om die goed te verkoop en dit maak ook nie saak dat die goed nie verkoopbaar is in hul huidige toestand nie. Die tweede deel vereis geen bedoeling nie, maar is 'n objektiewe toets of iets wat verkoopbaar was daadwerklik verkoop is en dat die opbrengs belasbaar sou wees as inkomste.

Dit is ook bevind dat 'n onderskeid tussen 'n mynbouproses en 'n vervaardigingsproses in die Suid Afrikanse belastingreg bestaan en dat afhangend van watter proses geld, iets verkillend vir belastingdoeleindes hanteer kon word. Die

ontleding van die **Richards Bay saak** (1996:55) het getoon dat ongeag die feit dat die hof erts as rou material of werk-in-proses geag het, was dit die belastingbetaler se erkening van die feit dat hy met 'n vervaardigingsproses te make het en dat hy geen onderskeid vir 'n mynproses gemaak het, dat die hof 'n ongunstige beslissing gemaak het. Die hof het op hierdie twee belangrike punte sonder verdere ondersoek die belastingbetaler se vertoë aanvaar.

Die slotsom was dat ongemynde ertshope nie handelsvoorraad ingevolge die uitgebreide definisie is nie. Slegs onder spesifieke omstandighede kon dit as handelsvoorraad onder die normale grammatiese betekenis beskou word mits daar aan die rekeningkundige vereistes voldoen word vir sodanige openbaarmaking.

CHAPTER 1

INTRODUCTION AND BACKGROUND

1.1 BACKGROUND TO THE RESEARCH

Due to the natural abundance of minerals in South Africa, especially gold and platinum, mining constitutes a large part of the economy with mining contributing 32 percent of exports in the last decade (Department of Minerals and Energy, 2007:5). Intense mining in South Africa started in the latter part of the 19th century (Department of Minerals and Energy, 2005:3) and continues to this day. A direct result of mining and the mining process is the creation of stockpiled material either in the form of waste or unmined ore. Soaring metal and mineral prices have changed even discarded dumps into viable stockpiles of material to be remined (Jacobson, 2007).

Mining as opposed to any other trade or business form e.g. manufacturing may be distinguishable from such other business and trades in that the operation constitutes the removal of a natural occurring mineral or compound from the soil or ore without such mineral being produced or acquired. This distinction was surmised in **ITC 1455** (51 SATC 111:119-120) as follows:

“These two instances differ from the present instance in that those cases one mines for gold and diamond. The gold and diamond is already in the earth. One merely isolates it. In the case of iron production the iron is not in the ore. Iron oxide is. The iron is produced by an industrial process and not a mining process.”

This distinction is also made in section 1 of the Income Tax Act (58/1962) (hereafter “ITA”) by the inclusion of a specific definition and taxing provisions specifically dealing with mining. The complex process of mining operations includes by definition in the ITA (58/1962) every method or process by which any mineral is won from the soil or from any substance or constituent thereof.

The winning of the mineral itself may however only be the last process of mining activities and in many instances mines stockpile ore or soil, which has been excavated at one site and winning of the mineral on another site so that the mining process can be completed.

Section 22 of the ITA (58/1962) requires that opening stock of all businesses carrying on a trade (other than farming) be included in taxable income and closing stock be deducted. "Trading stock" is defined in section 1 of the ITA (58/1962) to include:

- “(a) anything
 - (i) produced, manufactured, constructed, assembled, purchased or in any manner acquired by a tax payer for the purpose of manufacture, sale or exchange by him or on his behalf; or
 - (ii) The proceeds of which will form part of his gross income;
- or
- (b) any consumable stores and spare parts”

Traditionally ore and soil stockpiles which have been created over many years have not been treated by either SARS or the mining industry as trading stock for tax purposes. However, subsequent to the judgement in **Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR** (1996:55) SARS has now begun to perceive stockpiles of unmined ore and soil as trading stock to the potential hardship of the mining industry. In that case it was held that stockpiles of material created in course of operations carried on for extracting and exploiting minerals from sand dunes constituted trading stock even though the stockpiles were not saleable or not intended for sale in its then state. The court further held that the stockpiles were capable of valuation as work-in-progress and fell within definition of trading stock which had to be included in taxable income in terms of section 22 of the ITA (58/1962).

1.2 RESEARCH OBJECT

The research object is to determine whether stockpiles of unmined ore should constitute trading stock as defined in the ITA (58/1962) and whether the nature of such things can be distinguished from the stockpiled material in **Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR** (1996:55). Furthermore it will be determined if the physical nature of that which is being stockpiled influences the classification of such subject matter for tax purposes.

1.3 RESEARCH METHOD

The research object will be determined by analysing, with reference to case law, when mining operations start or cease and when minerals will be mined or deemed to have been mined for the purposes of the ITA (58/1962). Furthermore the definition of trading stock in section 1 of the ITA (58/1962) will be analysed to determine whether processed or unprocessed stockpiles should fall within the ambit of this definition with specific reference to the decision in **Richards Bay Iron & Titanium (Pty) Ltd and Another v CIR** (1996:55). Where South African law does not address a specific matter reference will be made to foreign case law as guidance to the interpretation or application of a principle or provision in a South African context.

CHAPTER 2

NATURE OF STOCKPILES

2.1 INTRODUCTION

The movable or immovable nature of stockpiles is important to the subject matter as it may affect the tax treatment thereof. Should the stockpile form part of the immovable property it is upon, it cannot be held to be something separate or an intention heralded for it being separate from that of the immovable property it attaches upon.

Thus the legal nature of a stockpile will be examined with reference to case law to determine whether it correlates to the tax nature thereof. The word “stockpile” is defined in the Merriam Webster Online Dictionary (2008) as:

“A storage pile; a gradually accumulated reserve of something”.

The word stockpile is commonly used for an accumulated reserve of something still to be used whereas mine dumps are usually an accumulation of something already used. The expressions “stockpile” or “mine dump” will be used as a collective description for piled or heaped rock or soil, separated from the earth, but not yet mined or piled and heaped mined rock. The latter is commonly referred to as tailings or waste. The reason for the inclusion of the latter is that a “mine dump” can also become stockpile by the mere change in the intention of its use such as mine dumps that are to be remined or disposed of for this purpose.

2.2 LEGAL NATURE

At common law minerals remain part of the immovable property until they are severed from the ground, then they become movables (**Trojan Exploration Company (Pty) Ltd and Another v Rustenburg Platinum Mines Ltd** (1996:126)). However, in legal terms a stockpile or mine dump can either be immovable or movable tangible property. In **Macdonald Ltd Appellants v Radin NO and the**

Potchefstroom Dairies & Industries Co Ltd (1915:466) the court sets out the three imperative criteria for determining whether something constitutes an immovable or not, namely the nature of the object, the degree and manner of the annexation and the intention of the person annexing the object.

An object which was once movable can also become immovable by complying with these criteria and *visa versa* (**Macdonald supra** (1915:459)). The intention of the person annexing the object was found to be the most important of the three criteria. Thus, was the person intending to annex it temporarily or permanently (**Macdonald supra** (1915:476-477))? This approach was approved in **Konstanz Properties (Edms) Bpk v Wm Spilhaus & Kie (WP) Bpk** (1996:225) where the court examined the intention criteria based on three approaches, namely the traditional approach where intention was only applicable if the nature and manner of attachment was ambiguous, the new approach where the *ipse dixit* of the person was conclusive as to the intention and the approach formulated by court in **Sumatie Edms (Bpk) v Venter en Andere NNO** (1990:171) whereby the purpose of the attachment must be determined from the intention and nature of the attachment or failing, on a balance of probabilities.

The court in **Konstanz supra** (1996:224) as *obiter dictum* notes that it may be necessary to examine whose intention is actually of importance, *inter alia* the owner of the movable object, the person who attaches the object or the owner of the immovable property. However it would not be necessary, for the purposes of proving intention to attach something permanently, that the person intended to attach it indefinitely (**Standard-Vacuum Refining Co of SA (Pty) Ltd v Durban City Council** (1961:679)).

In **Simmer and Jack Mines Ltd v GF Industrial Property Co (Pty) Ltd and Others** (1978:445-446) the court dealing expressly with the nature of mine dumps applies the principles in **Standard-Vacuum supra** (1961:669) regarding the intention criterion. The court found that even though a mine dump could be an immovable, the applicant could not prove that the intention was to permanently attach the dump to the property and thus the mine dump constituted movable property.

Commentators have criticised the **Simmer and Jack** case (Franklin, B.L.S. & Kaplan, M. (1982:53)) in that the court failed to apply the three tier test, focusing just on intention and they conclude that mine dumps could thus, based on the particular facts, be movable or immovable property.

The introduction of the Mineral and Petroleum Resources Development Act (28/2002) may however negate to a large extent any intention to permanently affix a mine dump, especially tailings. In terms of section 39 and 42, stockpiles and residue deposits must be rehabilitated in terms of a rehabilitation management plan.

It is submitted that where the removal of the mine dump is required at a specific period in time by the rehabilitation management plan, either pre or post mining, this would be *prima facie* indicative that the mine dump constituted a movable. In this instance no intention could legally be held to permanently annex the dump to the soil. In contrast, the requirement of the mere levelling of the mine dump as part of the rehabilitation process could serve as indication that intention of permanent annexure is present, provided all the requirements of the three tier test are met.

2.3 TAX NATURE

2.3.1 Capital versus revenue

The ITA (58/1962) distinguishes between two different types of transactions, namely those of revenue or capital nature (section 1 “gross income” & Schedule 8) and an object can accordingly be categorised as falling within one of these categories.

In **Matla Coal Ltd v CIR** (1987:227) the court held that all property, including mineral and mining rights, can be held as trading stock or fixed capital assets. The taxation of amounts in these two categories is also dealt with differently as the one attracts normal taxation as gross income and the other capital gains tax. In **New State Areas Ltd v Commissioner for Inland Revenue** (1946:627) the court clarifies this distinction as follows (own emphasis):

“The conclusion to be drawn from all of these cases seems to be that the true nature of each transaction must be enquired into in order to determine whether the expenditure attached to it is capital or revenue expenditure. Its true nature is a matter of fact and the purpose of the expenditure is an important factor; if it is incurred for the purpose of acquiring a capital asset for the business, it is capital expenditure, even if it is paid in annual instalments; if, on the other hand, it is in truth no more than part of the cost incidental to the performance of the income-producing operations, as distinguished from the equipment of the income-producing machine, then it is revenue expenditure, even if it is paid in a lump sum.’

In **Elandsheuwel Farming (Edms) Bpk v SBI** (1978:181-182) the court states that there are three main tests commonly applied in the determination of the distinction between capital and revenue namely, the intention at acquisition and sale, the nature of agreement i.e. scheme of profit making or realisation of an asset and whether it constituted fixed or floating capital, as the latter would be taxable.

2.3.2 Intention

In the determination of this distinction the South African courts have identified intention, the same important criterion heralded for the determination of the immovable nature of an object, as also being critical to the examination of whether an object will be classified as capital or revenue in nature (**ITC 1462** (1988:172); **ITC 1659** (1998:239)). However intention is not conclusive and consideration must be given to all the factors (**CIR v Stott** (1928:264); **CIR v Richmond Estates (Pty) Ltd** (1956:365)).

In **CIR v Lydenburg Platinum Ltd** (1929:147) the court in trying to determine the tax nature of farms originally purchased for the purpose of platinum mining but later sold, held that the intention of the taxpayer had also been to make a profit, either through mining or sale and thus by selling was conducting a scheme of profit making. The taxpayer initially intended to mine the farms but was later informed that due to the presence of underground water the working capital requirement would be increased

significantly, which made the mining of the farms less favourable to the taxpayer. The court stated that it was not necessary to determine which of the profit realising alternatives the directors intended (**Lydenburg *supra*** at 147).

Even though the court did not expressly focus on the intention of the taxpayer as conclusive it is submitted that this is exactly what it did and thus on the facts inferred the taxpayer to have had alternative intentions.

The South African courts have in various instances (**Overseas Trust Corporation Ltd v CIR** (1926:456-457); **LHC Corporation of SA (Pty) Ltd v CIR** (1950:133); **SIR v The Trust Bank of Africa Ltd** (1975:104–105) held that where alternative intentions exist, namely of resale or to produce income and the asset is eventually sold, the proceeds are revenue in nature, irrespective of which one occurred.

2.4 CONCLUSION

A three tier test remains the legal test for determining whether a stockpile would be considered movable or immovable. Facts for each particular case would have to be ascertained and the three criteria applied. Based on the authorities cited, intention remains an imperative part of the test even though not the only one. The determination of the intention of the permanent annexing or not of the object should be conducted on the various factors, including the *ipse dixit* of the annexor.

In conclusion, stockpiles of pre-mined ore would not constitute an immovable as the intention of the miner would always be to still mine the stockpile of ore by its physical removal and insertion into the mining process. The legal nature of post-mined stockpiles or tailings are however less evident and the nature should be determined on a case by case basis. It is however submitted that where the rehabilitation management plan specifically requires the removal of the stockpile no such intention of permanent affixing can be contended and the stockpile will be movable in nature.

As to the tax nature, a mine acquires immovable property to realise through a scheme of profit making through its mining activities. However, it is submitted that where the immovable property is to be subjected to mining activities it cannot be

considered floating capital or trading stock and thus the intention of the taxpayer would be to hold it as a fixed asset. In certain circumstances the same intention can be had for unmined stockpiles where the intention is to hold the stockpiles for a considerable period in circumstances where the expectation of its commercial viability is in doubt.

However, as can be seen from the authorities cited (**Lydenburg Platinum *supra*** (1929:147)) the realisation of a fixed asset through mining activities constitutes a scheme of profit making and the property becomes floating capital. It is submitted that only once the intention exists to insert the immovable property or parts thereof into the mining process does the fixed property or the parts inserted (such as stockpiles) convert in nature to floating capital.

This submission is based on the fact that all property can be held as either fixed or floating (e.g. as inventory), even property which by its nature would seem to be normally used in the course of a scheme of profit making (**Matla Coal Ltd v CIR** (1987:227)).

CHAPTER 3

FINANCIAL REPORTING OF STOCKPILES

3.1 INTRODUCTION

An important aspect of stockpiles and mine dumps is how they are accounted for in the financial records of a business. The physical size, value of and cost to date incurred in the creation of stockpiles usually makes it a material item for accounting purposes. South Africa subscribes to the accounting prescriptions of the published statements of generally accepted accounting practice (“hereafter GAAP”) as issued by the International Accounting Standards Committee (“IASC”) in the form of International Accounting Statements (“hereafter IAS”).

This body has since been replaced by the International Accounting Standards Board (“IASB”) which issues their accounting statements in the form of International Financial Reporting Statements (“hereafter IFRS”) (Vorster, Koornhof, Oberholster & Koppeskaar, 2004:5-7).

The prescriptive nature of the accounting statements in terms of GAAP may indicate or clarify whether the intention of the taxpayer contributed to the manner in which the stockpiles were accounted for within the financial records. This chapter will also examine the relevance of the accounting treatment in the determination of the tax treatment and disclosure, by establishing the reporting requirements for accounting and tax.

3.2 EFFECTS OF FINANCIAL DISCLOSURE ON THE TAX TREATMENT

GAAP as a requirement is prevalent throughout the ITA (58/1962) (section 1 proviso (g) of “dividend”, section 23H, section 24J(1) proviso (a) of “alternative method”, 11B(1), 22(3)(b), 24I(1) “ruling exchange rate”). However mismatches do occur and for this the ITA specifically contemplates the provisions of the ITA (58/1962) to supersede GAAP, such as in section 80M(1)(c) where tax avoidance is addressed by

requiring reporting where a tax benefit occurs in terms of the ITA (58/1962), even if a tax benefit is not obtained in terms of GAAP.

The duality of the application of accounting principles for tax is also prevalent in our common law. In **ITC 1634** (1997:235) it was held that a taxpayer who had included credit amounts as accounting profit for extinction of debt, even though no legal extinction took place, was liable to tax on the amounts. In **Joffe & Co Ltd v Commissioner for Inland Revenue** (1946:165) the court makes the following statement (own emphasis):

“The Court is only concerned with deductions permissible according to the language of the Income Tax Act and not debits made in a taxpayer’s books of account for deduction even though considered proper from an accountant’s point of view.”

In **Commissioner for Inland Revenue v Felix Schuh Ltd SA (Pty) Ltd** (1994:329) the court quotes with approval the following from an unreported case (On appeal cited as **Plate Glass and Shatterprufe Industries Finance Co (Pty) Ltd v Secretary for Inland Revenue** 1979 (3) SA 1124 (T), 41 SATC 103) (own emphasis):

“While it is no doubt in accordance with the principles of sound accountancy to make some provision in the balance sheet for such an eventuality and to reflect the extent of the appellant’s liability in respect of the loan at the current rate of exchange, a loss, reflected in the balance sheet for this purpose, would not, in my view, constitute a loss actually incurred, as envisaged in section 11(a) of the Act.”

The court then concludes with the following on this matter (own emphasis):

“As has frequently been pointed out, the Court is concerned with the deductions permitted in terms of the Act and not with debits or other

provisions made in a taxpayer's accounts, even though these may be regarded as prudent and proper from an accounting point of view.

In **Sub-Nigel Ltd v CIR** (1948:389) the court, dealing with deductions, stated that it is not concerned with deductions which may be considered proper from an accountant's point of view or from the point of view of a prudent trader, but merely with the deductions which are permissible according to the language of the ITA (58/1962).

Thus it is clear that even though the ITA (58/1962) requires the application of GAAP in certain instances, accounting principles do not necessarily apply in all instances in determining the tax reporting for a particular subject matter and the interpretation of the wording of the ITA (58/1962), even if the taxpayer correctly applied them. It is imperative that the provisions of the ITA (58/1962) are carefully perused to determine whether it concurs with reporting requirement for accounting purposes.

The nuances of the application of when accounting principles should apply was clarified in **Richards Bay supra** (1996:67-68) where the court held that unlike in the United Kingdom, the ITA (58/1962) does not provide for the assessment of tax on the profits or gains of business. Consequently some accounting principles and practices which have been held to be appropriate in the ascertainment of a taxpayer's profit may have no application because the provisions of the ITA (58/1962) specifically guides as to what constitutes assessable income and as to the items that shall be allowed as deductions from that income.

It was held that trading stock was one such provision. However the definition of "trading stock" was an interpretation and not an exclusive definition (the definition is only an extension of the ordinary word, similar to "mining"). It requires that effect be given to the ordinary word and thus as was in that case the commercial meaning of the expression. This superseding of the provisions of the ITA (58/1962) principle applies notwithstanding that in part it is a meaning which may have derived from or may have been influenced by accounting principle or practice. However in **Richards Bay supra** (1996:75) the court in its determination of the grammatical or commercial

meaning of trading stock accepted that acceptable accounting practice reflected such meaning.

Thus accounting principle is of importance in the interpretation of the provisions of the ITA (58/1962) where guidance of the provisions specifically includes the accounting principles or indirectly includes them by use in interpreting the ordinary or commercial meaning of a charging provision or word. To this extent the accounting principles regarding trading stock will be discussed to clarify when an object will constitute trading stock or inventories as guidance in interpreting the ordinary meaning of the word. The valuation of inventories will also be examined as section 22(3)(a) of the ITA (58/1962) requires specific valuation in terms of GAAP.

3.3 FINANCIAL REPORTING OF STOCKPILES

The nature of stockpiles or mine dumps can vary as indicated and may be dependent on the intention of the taxpayer. Therefore it will be examined whether for accounting purposes, the duplicity remains, by discussing the possibility of stockpiles as being either inventories or as non-current assets in terms of the relevant accounting statements applicable in South Africa.

The Framework for the Preparation and Presentation of Financial Statements (Tweedie et al, 2008:12) state that the purpose of financial statements are to provide information about the financial position, performance and changes in financial position of an entity that is useful to many different users in making economic decisions.

In South Africa, mines follow the South African Code for the Reporting of Exploration Results, Mineral Resources and Mineral Reserves (“hereafter SAMREC Code”)(South African Mineral Resource Committee (2007:4)) for the public reporting of their mining activities. Thus reference will be made to the financial reporting requirements in terms of this code as well.

IAS1 (Tweedie et al, 2008:IAS1-60) requires that an entity disclose current assets such as inventories (Tweedie et al, 2008:IAS1-68) separately from non-current

assets such as immovable property. An entity must classify an asset as a current asset if (Tweedie et al, 2008:IAS1-66):

- it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
- it holds the asset primarily for the purpose of trading;
- it expects to realise the asset within twelve months after the reporting period; or
- the asset is cash or a cash equivalent (as defined in IAS7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

All other assets must be classified as non-current assets. Thus it will be examined whether stockpiles can fall within both categories namely current or non-current as inventories or fixed property.

3.3.1 Stockpiles as inventory

The accounting identification of an asset is set out in principle in the Framework (Tweedie et al, 2008:53-54) as:

“An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources....”

“The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to

reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.”

Thus by the sale of the subject matter future economic benefits and cash flows may flow to a person. Inventories are defined as assets (Tweedie et al, 2008:IAS2:6):

- held for sale in the ordinary course of business;
- in the process of production for such sale; or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Whether unmined ore stockpiles fall within this definition is debatable as the ore is not held for sale but to be mined, neither in a production process nor as materials in such production process. Thus the conclusion should be that ore can never be trading stock for accounting purposes, only the separated minerals which are assets held for sale. It is uncertain whether the “production process” for accounting purposes attaches a wider connotation than its ITA (58/1962) counterpart as the latter equates to manufacturing where something different to the initial material must be produced (**ITC 1247** (1975:31)) and in mining a person only isolates the material, it does not produce it or use it in a production process (**ITC 1455** (1989:120)).

However PricewaterhouseCoopers (PricewaterhouseCoopers, 2007:48) are of the opinion that inventories in the mining industry include run of mine ore, work-in-progress (e.g. crushed ore) and finished goods (e.g. minerals) and it will for the purposes of the rest of the chapter be assumed that this interpretation and application is correct.

Based on this premise, ore should be recognised as inventory as soon as it is extracted, the reliable assessment of mineral content is possible and the cost of production can easily be determined. Work-in-progress such as stockpiles should be recognised as soon as the mineral content and the cost of production can reliably be determined ((PricewaterhouseCoopers, 2007:48).

However where an entity decides to defer the processing of stockpiles for many years e.g. when prices decline and low grade stock deferred, then the stockpiles are only recognised when it is expected that future economic benefits will flow as IAS1.60 (Tweedie et al, 2008:IAS1-60) requires that the asset must be realised within 12 months to constitute a current asset and thus inventories.

Inventories should be valued at either cost or net realisable value (Tweedie et al, 2008:IAS2-9). IAS2, which deals specifically with inventories, however specifically excludes from its application minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries ((Tweedie et al, 2008:IAS2-3a). Thus where net realisable value is used to account for inventories the SAMREC code should be used.

3.3.1.1 Inventories at historical cost

The cost of inventories should be determined with reference to the purchase costs, conversion costs and other costs incurred in bringing the inventories to its present location and condition (Tweedie et al, 2008:IAS2-10).

Thus in the mining industry the cost of separating the ore from the soil and transporting it to the stockpile and well as any costs incurred in reducing the size of ore for manageable transport to the stockpile would constitute such a cost.

However if it cannot be determined if future economic benefits will flow the stockpile is not recognised and extracting costs are reported as waste removal cost (PricewaterhouseCoopers, 2007:48). Where the future economic benefits are determined but deferred for more than twelve months after the reporting date the stockpiles will be reclassified as non-current assets (Tweedie et al, 2008:IAS1-60). Inventory valued at cost should be recorded on the first-in-first-out basis (Tweedie et al, 2008 IAS2-25) or weighted average method, but once a specific method is used it must be used consistently for inventory of a similar nature.

3.3.1.2 Inventories at net realisable value

The SAMREC code (2007:1) distinguishes between two concepts of mineral assets for financial reporting purposes namely, mineral resources and mineral reserves.

“Mineral resources” are defined as (SAMREC (2007:21)):

“ is a concentration or occurrence of material of economic interest in or on the earths crust in such form, quantity and quality that there are reasonable and realistic prospects for eventual economic extraction.”

“Mineral resources” thus refer to concentrations, including dumps and tailings, which have a reasonable expectation of being extracted but after an extended period e.g. 30-50 years (SAMREC (2007:21)).

The measurement of the resource is determined when the tonnage, density, shape, physical characteristics, grade and mineral content can be estimated with a high degree of confidence (SAMREC (2007:25)). The value will also be adjusted according to the degree of confidence with which these factors can be determined (SAMREC (2007:26)).

“Mineral reserves” are defined as (SAMREC (2007:32)):

“is the economically mineable material derived from a Measured or indicated Mineral Resource or both.

Similar valuation criterions apply to mineral reserves as applies to mineral resources. Furthermore the value of both is adjusted according to the level of certainty with which the value criterion was determined (SAMREC (2007:35)). A direct relationship exists between mineral resources and mineral reserves whereby the former, as mineralisation estimates, are converted into the latter, as mineable production. Thus where stockpiles of mineral reserves become sub-economic they may be reclassified as mineral resources until such time as they are economically viable. If no reasonable prospects for economic extraction exist then the material cannot be

classified as either mineral resources or mineral reserves and would not form part of inventories (SAMREC (2007:40); Tweedie et al, 2008:IAS2-60)).

The value of the subject matter is determined in accordance with the provisions of the South African Code for the Reporting of Mineral Asset Valuation (“hereafter SAMVAL code”)(SAMVAL (2008:1)). The SAMVAL code provides for three generally accepted valuation methods namely (SAMVAL (2008:21)):

Cash flow approach

The value is equal to the present value of the future cash flows over the useful life of the mineral asset.

Market Approach

The value represents the price obtainable in an arms length transaction.

Cost Approach

The value is based on the historical and future actual costs incurred on the mineral asset.

It is submitted that if the last mentioned valuation method is elected, the valuation principles in IAS2 should be followed as only the other two methods represent calculation of net realisable value. The use of the SAMREC and SAMVAL codes are just for valuation purposes and not for the determination whether such material constitutes inventories. Whether the subject matter constitutes inventories shall be determined from the provisions of IAS2. Thus from the provisions of IAS2 it can be deduced that mineral resources will never constitute inventories as the economic benefits will not be realised within the following 12 months (Tweedie et al, 2008:IAS1-66). Similarly mineral reserves will only constitute inventories to the extent that they conform to this requirement.

3.3.2 Stockpiles as non-current assets

The reporting of stockpiles as inventory is dependent of whether the mineral content and cost of production is known, whether it is determined that the future economic benefits can be realised or whether it will be realised in the near future (PricewaterhouseCoopers, 2007:48; SAMREC (2007:40); Tweedie et al, 2008:IAS1-66) . Should any of these conditions not be met the stockpiles cannot be recognised as inventories.

Thus if the material does not constitute current assets as inventories, then how should it be disclosed? Two circumstances can be determined namely, where the stockpiles have no reasonable expectation for future economic benefits and secondly where the stockpiles do have a reasonable expectation for future economic benefits but such benefits will only realise in the long term. Where no reasonable expectation of future economic benefits exists, the mineral asset should be impaired as examined in the section that follows. Stockpiles that do have determined future economic benefits but have not been evaluated in terms of mineral content or cost of production should be disclosed as a non-current mineral asset.

IAS16 (Tweedie et al, 2008:IAS16-3(d)) specifically excludes mineral reserves from its scope of application but does include property, plant or equipment used in developing mineral reserves. Thus a void exists as to the specific guidance of disclosing mineral reserves which have reasonable expectations of future economic benefits but do not constitute inventories. PricewaterhouseCoopers (PricewaterhouseCoopers 2007:26) confirms this and notes that the IASB is considering the accounting treatment for mineral reserves as part of its Extractive Activities project of which a draft is due for release at the end of 2008 (IASB:2008).

Accordingly, mineral reserves should be disclosed under the minimum disclosure requirements of IAS1 (Tweedie et al, 2008:IAS1) which is usually at historical cost and must at least disclose the major assumptions and sources of estimation uncertainty such as (PricewaterhouseCoopers 2008:27):

- The methodology used and major assumptions for mineral reserve estimates

- The sensitivity of carrying amounts of assets and liabilities to mineral reserves estimates used
- The range of possible outcomes in the following financial year of the affected assets and liabilities
- An explanation of the changes made to past mineral reserve estimates and key assumptions

3.3.3 Impairment of stockpiles

Impairment occurs in terms of IAS36 (Tweedie et al, 2008:IAS36-8) when the carrying amount exceeds the recoverable amount. Common indicators of impairment include (PricewaterhouseCoopers 2007:38):

- Significant decline in market value
- Significant decline in expected future prices
- Significant decline in foreign exchange rates
- Significant increase in production costs
- Large cost overrun on capital project
- Significant decline in mineral content of ore reserve (e.g. leaching or lower ore grade)
- Significant adverse changes in government regulations and statutes (e.g. tax rate increases)

Thus where ore stockpiles are affected by the above mentioned factors they should be impaired to reflect the reduced net realisable value. Where the above factors cause the future economic benefits to be doubtful the costs incurred should be expensed as wastage (PricewaterhouseCoopers, 2007:48).

3.3 CONCLUSION

The accounting determination of the nature of stockpiles is relevant to the ultimate tax treatment thereof due to the definition of trading stock in section 1 of the ITA (58/1962) not being an exclusive definition but an extension of the normal

grammatical meaning. Therefore where an evaluation of ore stockpiles are done for financial reporting it should be done in such manner that a reasonable determination was made on the given facts. It is submitted that the accounting definition may *per se* exclude stockpiles in the mining process in the ordinary grammatical sense.

However, it would seem that in commerce a distinction between production in the making of something new and isolating something in a mining process, as applied in tax law, is not used and therefore production may include a mining process. Where the future economic benefits of the ore stockpile has been determined but not the extent of the future economic benefits, it is submitted that it may favour the taxpayer to account for the stockpile at net realisable value which has been adjusted for the lower confidence in the measurement criterion in instances where cost of creating the stockpile is high. This submission is made on the basis that mining is cost intensive and thus the historical cost incurred in creating the stockpile may exceed the adjusted net realisable value.

Furthermore, the stockpile should only be accounted for to the extent that it will be utilised in the mining process within 12 months after reporting date. Stockpiles that have no reasonable expectation of future economic benefits should be impaired. Stockpiles created that have not yet been accounted for as assets and have no reasonable expectation of future economic benefits should be expensed as wastage. In conclusion, where mineral reserves such as stockpiles do not qualify as inventory they should be disclosed as non-current assets within the framework of IAS1 until such time as more guidance is afforded to the accounting disclosure by the IASB.

CHAPTER 4

TAXATION OF STOCKPILES

4.1 INTRODUCTION

The examination of ore stockpiles for accounting purposes emphasises the enormous task of classifying and reporting such stockpiles in the financial records. The accounting determinations were examined and were found to be relevant for tax purposes in interpreting the normal grammatical meaning.

However, the determination of a mineral asset as trading stock for the purposes of section 22 of the ITA (58/1962) has to be done according to the letter of the law and the weighting given to the accounting disclosure in such determination should be adjusted according to what is being examined in terms of provisions of the ITA (58/1962).

Therefore an analysis of the extension of the definition of trading stock in section 1 of the ITA (58/1962) must be conducted to determine whether a specific stockpile would constitute trading stock or not in relation to a mining process. It will also be examined whether the content of the stockpile and the process in which it will be used affects its tax nature for the purposes of section 1 and 22 of the ITA (58/1962).

4.2 TRADING STOCK FOR TAX PURPOSES

The extension to the definition of trading stock can be divided conceptually into three parts:

- Anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by the taxpayer for the purpose of manufacture, sale or exchange by himself or on his behalf;
- The proceeds from the disposal of which forms or will form part of his gross income;

- Any consumable stores and spare parts acquired by him to be used or consumed in his trade.

The third part dealing with consumable store or spare parts is excluded from the scope of the research and therefore does not form part of the analysis.

In **CSARS v AA The Motorist Publications (Pty) Ltd** (2001:331) it was held that trading stock could only constitute a thing that formed part of the finished product or was consumed in the manufacturing of the product such as a catalyst. However things which were used in the process of manufacture but did not form part of the manufacturing process such as saw blade to cut wood did not constitute trading stock under the first part of the definition. To address the various parts of the definition they will be examined separately.

4.2.1 Action and purpose of the subject matter

The first part of the definition places emphasis on the purpose for which the subject matter was produced, manufactured, purchased or in any other manner acquired. The specified purposes are limited to manufacturing, sale or exchange by the taxpayer. The clause “for purposes of manufacture” was interpreted in **Richards Bay supra** (1996:75) to mean “for use in manufacture” in context of the definition of trading stock in section 1 of the ITA (58/1962). The fact that it is capable of being sold in its current state or that it may not have an ascertainable monetary value is not what brings the subject matter within the scope of the definition. It is its intended use for either manufacturing or sale that brings it within the ambit of the definition (**Richards Bay supra** (1996:59)).

The Legislature has deliberately extended the ambit of trading stock to include things that the taxpayer has no intention of disposing of separately, but intends to use solely for the purpose of manufacturing something in which he trades (**Richards Bay supra** (1996:73)). In **De Beers Holdings v Commissioner for Inland Revenue** (1986:256) the court states that the definition was intended to be exhaustive.

As to the meaning of “process of manufacture” in **SIR v Safranmark** (1982:238) the court approves the following dictum (own emphasis):

“That the ordinary connotation of the term “process of manufacture” is an action or series of actions directed to the production of an object or thing which is different from the materials or components which went into its making, appears to have been generally accepted. The emphasis has been laid on the difference between the original material and the finished product.”

The court furthermore states at 248:

“The conclusion to be drawn from the above is that not only did each of the ingredients cease to retain its individual qualities but upon completion of the process a different compound substance having a special quality as such, viz edibility and special taste, has been produced...”

It is submitted that the essence of a mining process is the extraction and winning of minerals and not the producing of a substance that is different to the original. The unmined ore is not manufactured or produced but is mined. Secondly, to the extent that it is acquired, it is done so not for the purposes of manufacturing, but for the purpose of mining. Each “ingredient” in the ore retains its individual qualities and no different compound substance is produced in the mining process.

It is submitted that the stockpiling of unmined ore and the process in obtaining such ore cannot constitute a manufacturing process or be for the purposes of manufacture. Thus unmined ore cannot fall within the ambit of the first proviso of trading stock in section 1 of the ITA (58/1962).

4.2.2 Inclusion of proceeds from disposal

The second part of the definition of trading stock infers no purpose requirement and has an objective requirement that the proceeds from the sale of the subject matter must be included in gross income (**Richards Bay *supra*** (1996:72))

In **De Beers Holdings *supra*** (1986:256) the following statement is made by the court (own emphasis):

“Mr Welsh argued that category (b) related to, or at any rate included, things the proceeds of which would form part of the taxpayer’s gross income if he were to dispose of them, notwithstanding the fact that he had no intention of disposing of them at the time of acquisition or at any other time during the relevant tax year, ie postulating a notional disposal of things not to be disposed of. To my mind, the argument is unsound.”

In **Richards Bay *supra*** (1996:72) the following is stated in reference to the above:

“The second part makes no direct reference to any purpose which the taxpayer must have had at the time of acquisition; it postulates an objective assessment, namely whether, if the thing under consideration was disposed of, the proceeds would form part of his gross income.”

Thus the courts prescribe an objective test as to whether a thing was disposed of or not and nothing can be inferred as to if it would be sold. In relation to unmined ore, stockpiles that are created through a mining process are not for sale but to be further mined to extract the mineral content. However, even if any intention of sale existed (e.g. decide to sell stockpile to another mining company), the provision only applies once the sale occurs and is not triggered by the intention to sell. Furthermore, the proceeds must be revenue in nature. In the analysis of the capital or revenue nature of stockpiles it was concluded that the sale of the stockpile would not always be revenue in nature as it could constitute the realisation of an asset (**Natal Estates Ltd v SIR** (1975:199)). Furthermore, in contradiction to the **Lydenburg case** (1929:147) the Supreme Court of Appeal has found that not every receipt or accrual arising from sale and designedly sought for, in view to making a profit, is revenue in nature (**Samril Investments (Pty) Ltd v CSARS** (2003:68)).

The second part also has a final requirement, namely that the object must be in a saleable condition. In **ITC 1662** (1999:361) it was held that this is an essential requirement of the second part that the object must be in a saleable condition (even though it is not a requirement for the first part). Whether an unmined stockpile constitutes a saleable thing will depend on the facts. However it is submitted that as the value of the stockpile is contained in the mineral content thereof, the latter which can only be estimated, the stockpile does not constitute a saleable thing in many instances.

In conclusion, whether a stockpile is saleable or not is however not relevant and the taxing provisions will only apply in terms of the authorities cited once the unmined ore stockpile is actually sold. Furthermore, a stockpile will still have to meet the revenue criteria as discussed because should it constitute an asset of capital nature, such as an undetermined mineral reserve, the proceeds will not constitute gross income and thus also fall outside the ambit of the second part.

4.2.3 Accounting for the value of trading stock

In conjunction with this definition section 22(2) of the ITA (58/1962) requires that in the determination of a taxpayers income from the carrying on of a trade, cognisance must be taken of the value of the trading stock held at the beginning of the year constituting stock held at the end of the preceding year and the cost of stock acquired after the preceding year.

The purpose of section 22 of the ITA (58/1962) is that in the determination of taxable income of a taxpayer, the value of the trading stock at hand at the beginning and end of the year of assessment must be taken into account. The value of the closing stock should be added to taxable income and the value of the opening stock should be deducted. This approach corresponds with GAAP (De Koker, 2008:8.111). The reason why the value of the trading stock must be taken into consideration is that in terms of section 11(a) and 23(f) of the ITA (58/1962) the cost of the earlier purchases may be taken into account as a deduction, even when the stock is not disposed of during the specific year of assessment. The operation of section 22 and its use as a timing provision to prevent a taxpayer from claiming a deduction for unsold stock

without taking into consideration the stock carried forward from a previous year is explained in detail by the court in **Richards Bay *supra*** (1996:316).

Section 22 provides that what must be taken into account as part of the taxpayer's taxable income is the value of the trading stock which has not been disposed of at year end. The value is referred to in section 22(1)(a) to be the cost price thereof. The cost price in terms of section 22(3)(a) comprises the cost incurred by the taxpayer plus any further costs incurred by the taxpayer in getting such trading stock into its existing condition and location and any other costs in terms of GAAP.

4.3 RICHARDS BAY CASE

Richards Bay *supra* (1996:55) is of critical importance as the *locus classicus* in determining the current legal position in terms of the taxation of stockpiles as trading stock and thus requires closer analysis.

The facts of the case were that the appellant taxpayer, Richards Bay Iron & Titanium (Pty) Ltd, beneficiated minerals from sand dunes off Richards Bay. The process involved creating self contained water ponds in the dunes and turning the sand and water into a slump. The slump was removed by suction and then the heavy mineral concentrate was removed from the sand by the use of a gravity separation process. In the course of these operations various stockpiles were created, some constituting the heavy metal concentrate and some constituting the separated individual minerals within the concentrate.

The purpose of the stockpiles was to ensure that enough concentrate was available for the plant to operate continuously. In the financial records of the taxpayer for the purposes of determining its taxable income the taxpayer excluded some of the stockpiles as trading stock (thus no opening or closing stock adjustments were made in terms of section 22 of the ITA (58/1962)) but claimed the costs incurred in creating the stockpiles as a deductible expense.

The Commissioner of the South African Revenue Services ("hereafter CSARS") issued an additional assessment to the taxpayer on the basis that he had neglected

to account for the financial benefit of the stockpiles as work-in-progress in terms of section 22 of the ITA (58/1962).

The taxpayer appealed the finding of the CSARS on four grounds namely:

- The definition of trading stock does not include things which have no separate identity and value as a saleable article, especially in manufacturing.
- Some of the stockpiles were not saleable in its current form and thus had no market value as they just represented a continuous process of production or manufacture.
- The legislator could not have intended that the stockpiles within the continuous process of manufacture or production, that still required further processing, should be assigned an artificial value at the end of the year of assessment.
- If the legislature had intended that anything in the process of manufacture should be trading stock it would have stated so.

On the first ground the court found against the appellant on the grounds that the term “trading stock” as used in the ITA (58/1962) has been purposefully extended by the legislature. It would include objects that are not saleable in its current condition as that is not a requirement of the provisions of the ITA (58/1962). The appellants second ground was also rejected as the court found that it is an accepted practice to value work-in-progress and that the valuation method is prescribed as the expense incurred or historical cost. The court also found against the taxpayer on the third and fourth ground by stating that the distinction between saleable and non-saleable objects has not been made by the legislator. Thus the court concludes that the stockpiles did constitute trading stock as work-in-progress.

What is important in the context of the current examination is actually not the findings on the grounds of appeal but the comments made by the court regarding what the taxpayer did not argue (**Richards Bay *supra*** (1996:75). The first “erroneous” statement was that no distinction was argued by counsel for the appellant regarding the fact that the stockpiles were actually mined and not produced or manufactured. The second was that the taxpayer consented to that, not only did the processes as

described constituted a process of manufacture, as they had produced or manufactured the stockpiles, but that the purpose of the stockpiles produced were for use in a manufacturing process. In both these matters the court withholds judgement and accepts that they are correct in law as the appellant consented thereto. The court merely bars the appellant from raising these arguments on appeal as they did not form part of the initial grounds of appeal.

From the authorities cited it has been concluded that in determining whether stockpiles are trading stock, it is imperative to determine whether the subject matter was produced in a mining or manufacturing process. Furthermore the purpose of the subject matter is also important, thus will it be used in a manufacturing or mining process. Only if manufacturing is the acquisition process and the purpose will it constitute trading stock. It must therefore be concluded that **Richards Bay *supra*** (1996:55) does not assist in providing a clear line of thought in determining whether stockpiles should be trading stock. It merely clarifies certain general concepts of work-in-progress and makes assumptions on the actual legal nature of the processes involved and its specific purposes as revealed in the facts.

It is submitted that by addressing the arguments of the nature of the process of acquisition and the purpose of the subject matter, a different conclusion could be made regarding whether stockpiles constitute trading stock. However, this distinction would not have assisted the taxpayer as even though it might be questionable how the court came to its decision, it is submitted that it correctly decided that the mineral concentrate as raw material constituted trading stock. Had a mining process been argued, it would have concluded with the winning of the mineral concentrate.

Another distinction made indirectly by the court was in fact regarding what would be the trading stock. In the description of the appellants process (**Richards Bay *supra*** (1996:61) the court distinguishes different phases, namely the creation of the slump consisting of sand and minerals (similar to ore), the removal of the minerals in totality and lastly the separation of the minerals into various constituents. The court found the stockpiles of mineral concentrate to be trading stock and not the slump created by the taxpayer. This is an important distinction as the slump is quite similar to ore, namely consisting of sand / rock and minerals. It was thus found that the minerals,

excluding the sand, constituted the raw material for trading stock purposes and not the minerals inclusive of the sand / rock. However this distinction would not have assisted the appellant as the court correctly identified the mineral concentrate as raw material but does provide a distinction for mines stockpiling mineral rich ore.

4.4 DISTINGUISHING DIFFERENT PROCESSES

The above authority indicates that the purpose of the process does affect whether the subject matter will constitute trading stock or not. Should the purpose be for mining, it will be excluded and if it is for manufacturing it will be included within the ambit of the definition of trading stock. Van Blerck (1990:20-14) also identifies this conundrum by conceding that minerals form part of trading stock in a mine but states that it is unclear at which stage minerals have been sufficiently mined to constitute trading stock. It is thus imperative to distinguish these processes from one another as both can be prevalent within the same business, such as where a raw material is mined and later refined or smeltered into an alloy.

4.4.1 “Mining process”

The ITA clearly distinguishes between various processes including that of mining and manufacturing. “Mining operations” and “mining” are defined in section 1 of the ITA (58/1962) to include every method or process by which a mineral is won from the soil or from any substance or constituent thereof.

In **Western Platinum Limited v Commissioner for South African Revenue Service** (2004:612) the court states that the fiscus favours miners and farmers and that class privileges exist in this respect. This privileged dispensation is not available to manufacturers. In **ITC 1455** (1989:119) the court clearly rejects any notion that subject matter that is mined is manufactured and states that the process of crushing rock and leaching gold from it is a process that involves in nature the mining of gold and cannot be perceived as the manufacturing of gold.

A taxpayer's activities can qualify as mining operations if it either complies with the general meaning of the word or the extended meaning (**COT v Nyasaland Quarries and Mining Co Ltd (High Court of Nyasaland (1961:592)**).

In **Lord Provost and Magistrates of Glasgow v Farie (1888:677)** the court states that although the original meaning of the word "mine" might be restricted to subterranean excavation, it appears to be beyond question that for a very long period, that has ceased to be its exclusive meaning and that the word has been used in ordinary language to signify, either the mineral substances which are excavated or mined, or the excavations, whether subterranean or not, from which metallic ores and fossil substances are dug out.

From the general meaning it is clear that mining encompasses the extraction of minerals from the earth or rock not only subterranean but also above ground such as in stockpiles.

In **Parker v FCT (1953:494)** the court confirms that "mining operations" embraces not only the extraction of minerals from the soil but all process pertaining to mining. It is submitted that this would include the displacement of the mineral rich soil to a place to extract the mineral itself.

In **FCT v The Broken Hill Company (Pty) Ltd (1996:4031)** the court in confirming the decision of the court *aquo* of the definition of "mining", expressly excludes the contention that the subsequent treatment of minerals to extract a specific mineral is mining operations (the latter contention also supported by **Richards Bay supra (1969:311)**). It should be noted that the extended meaning of "mining" and "mining operations" in section 1 of the ITA (58/1962) has exactly the same definition as that heralded in **Parker supra**.

The court in **Broken Hill supra (1969:4031)** goes on to clarify this similar meaning by stating that:

“...to separate what it is sought from to obtain by mining from that which is mined e.g. gold from quartz or tin from sluicing, is part of the mining operations.”

It is submitted that the mining process only ends once the minerals are extracted from the rock or ore, but includes all process preceding such final extraction of the minerals. Therefore separation into various mineral constituents or applying chemical processes (manufacturing) follows the mining process.

It is clear that the mining process incorporates both the activities where a mineral is won from the soil or any substance of such soil; the latter would include rock, and includes the preceding extraction of the soil or any such substance of the soil itself.

That both these two tiers constitute the mining process can be inferred in **Richards Bay *supra* (1996:61&76)** where the court held that the mineral concentrate which had been extracted and mined from the soil of the sand dunes was what constituted the raw materials for the manufacturing process.

In that instance the process entailed firstly the displacement of the mineral rich dune sand by using water to form sand slurry. The slurry was then mined to remove the mineral concentrate. Lastly the mineral concentrate was separated into its various mineral constituents.

It should be noted that the court in **Richards Bay *supra* (1996:55)** did not find that the sand dune sludge (mixture of soil and water) which was created to effectively remove the soil from one place to another was what constituted trading stock, but that the stockpiles of mineral concentrate, subsequent to being mined, constituted trading stock.

Thus a stockpile of minerals would constitute trading stock, whether they have been separated from each other or not. It is submitted that when the subject matter that is used in the mining process is not a mineral in itself, its stockpiling would not constitute trading stock as it is still in a process of mining. Only once it is a mineral does the mining process end and can it enter a manufacturing process or other

process. The existence of this distinction is clear from the dictum in **Richards Bay *supra*** (1996:75) where the court states that the proposition exists that the stockpiles were not “produced” or “manufactured” within the meaning of the definition of trading stock but were “mined” within the meaning of the definition of “mining”. However as noted by the court no finding was made on this distinction as the taxpayer did not pursue argument on the matter.

4.4.2 “Mineral”

Van Blerck (1990:7-11) is of the opinion that the dominant question to determine if mining occurs is what is a mineral? An answer in the negative to the subject matter as a mineral usually leads to finding against the processes being mining operations. The above authority confirms that crucial in the determination of the commencement or conclusion of the mining process is whether a mineral has already been extracted from the soil. Thus it is important to determine what constitutes a mineral for the purposes of identifying a mining process.

“Mineral” is not defined in the ITA (58:1962) but is defined in the Merriam Webster Online Dictionary as (own emphasis):

“a solid homogeneous crystalline chemical element or compound that results from the inorganic processes of nature”

In **Falcon Investments Ltd v CD of Birnam (Suburban) (Pty) Ltd & others** (1973:400) the court states that there is no general definition for the word “mineral” and therefore it must be given the meaning according to the intention it was used. As to a definition for the purposes of the ITA (58/1962) and an intention of the legislator, the following definition of a “mineral” was quoted with approval in **COT v Nyasaland Quarries and Mining Co Ltd** (1961:584)(own emphasis):

“If I were rash enough to venture a definition of “mineral” I should say that it is any substance that can be got from within the surface of the earth which possesses a value in use, apart from its mere

possession of the bulk and weight which makes it occupy so much of the earth's crust.....

..Such materials have not a value in use apart from their bulk and weight, and they are only used as being capable of forming a portion of the earth's crust in a new position. On the other hand, everything that has an individual value in use appears to me to be fairly called a mineral."

As to whether the rock or ore itself is a mineral separate from its content no definite guidance is to be had from case law. In the first instance, conflicting judgements exist. It has been found that rock does constitute a mineral (**ITC 909** (1960:101)) and it does not (**Bozzone & others v SIR** (1975:579)). Secondly in most instances the rock in those cases was the ultimate product sought, thus the mining process had been completed.

In light of the authorities cited in respect of the interpretation of the word "mining" it is submitted that an interpretation that ore itself is the mineral (separate from the content thereof) and thus that the mining process ends after its extraction would be in conflict with the findings of the authority cited. It is submitted that the interpretative extension to the normal meaning of the word mining as contained in section 1 of the ITA (58/1962) should be interpreted in such a manner that the ore cannot constitute a mineral separate from its content.

Thus only if the ore itself is the end product being mined (such as coal) should the ore constitute a mineral. Therefore the mineral content inside the ore should be the focus of the interpretation which would eliminate the conflict in interpretation between mineral and mining. The mining of the ore is thus still in a process of mining as it is in a process of extracting a mineral within such ore. Only once the mineral content has been extracted from the ore is the mining process complete.

4.4.3 “Manufacturing process”

In the preceding examination of the “mining process” it was found that the conclusion of the mining process is critical in the determination of whether the subject matter mined will constitute trading stock or not. The converse is also true that the identification of the beginning of a subsequent manufacturing process in which the subject matter is used, infers the former.

Thus it will be examined what constitutes a “manufacturing process” and when does it commence, as an alternative method to determining the end of a mining process.

The “manufacturing process” must be distinguished from other processes for the purposes of the ITA (58/1962) (**Formscaff Investments (Pty) Ltd v CIR** (1993:251)) to give effect to the intention of the legislature and the specific provisions of the ITA (58/1962) in that specific context (**COT v Processing Enterprises (Pvt) Ltd** (1975:111)). It is submitted that the various processes are mutually exclusive and therefore even though multiple processes can exist in a single business process, a specific thing will be subject to only one process at any given point in time.

In **Formscaff supra** (1993:257) the court rejects the contention heralded in **ITC 1247**, 38 SATC 27 at 33 that processes could be contemporaneous by giving preference to the judgement of the court aquo whereby it was found that during the stage whereby material came into existence it is possible that a process of manufacture may exist, but this stage is completed before the construction stage begins and therefore no manufacturing takes place while the process of construction is in progress.

The taxpayer does not need to be engaged in the production of the final product to be engaged in the process of manufacture (**SIR v Hersamer (Pty) Ltd** (1967:59)). Similarly a finished product would constitute anything which is of use to someone (**Hersamer supra** (1967:59)).

In **SIR v Safranmark (Pty) Ltd** (1982:240) the court summarises the term “process of manufacture” as follows (own emphasis):

“Denotes an action or series of actions directed to the production of an object or thing which is essentially different from the materials or components which went into its making.

The requirement of “essential difference” necessarily imports an element of degree; and there are no fixed criteria — nor is there any precise universal test — whereby it can be determined whether or not a change in the materials or components wrought by the process, be it as to the nature, form, shape or utility of the materials or components, has brought about an essential difference. This must be decided on the individual facts of each case.

When deciding whether a particular activity does or does not fall within the ambit of a “process of manufacture” the ordinary, natural meaning of that phrase in the English language must not be lost sight of. And in this connection analogies can be misleading. Thus to analyse and extract from a process or operation which indubitably amounts to a process of manufacture general criteria or attributes and to conclude that another process to which the same general criteria apply or which exhibits similar general attributes is, therefore, also a process of manufacture may lead to results not intended by the legislature, particularly where it would be inaccurate or unrealistic in normal parlance to describe the latter process as a process of manufacture.”

The requirement of “essential difference” between what is manufactured and from what it is manufactured has thus been heralded as the critical distinction (**Safranmark *supra*** (1982:246)). The “essential difference” may be colour, shape, chemical composition or any other quality (**FCT v Softex Industries (Pty) Ltd** (2001:4187) citing with approval the dictum in **MP Metals (Pty) Ltd v FCT** (1967) 117 CLR 631 at 638)).

In **FCT v Hammersly Iron (Pty) Ltd** (1980:4519) the Australian court discusses whether stockpiling of iron ore and then “blending” the ore could be considered as the “treatment” of such soil (thus manufacturing) as opposed to the mere storage thereof.

The court held that the subjection of something to an action or agent to effect a change in form, nature or condition with a realistic purpose constituted a “treatment” as envisaged in that definition of “aids to manufacture”.

However the processing of iron ore is different to the mining of other minerals and thus the statement above should be viewed with caution in respect to other mining activities. In **ITC 1455** (1989:120) the court states that the production of iron is different to the mining of gold and diamonds as iron is not mined but iron oxide, thus the mining process ends with the extraction of the iron oxide and therefore the subsequent blending process to make iron is a manufacturing process.

As to the commencement of a “process of manufacture”, in **SIR v Cape Lime Company Ltd** (1967:144) it was held that the insertion of the raw material into the manufacturing process constituted the beginning of the process (in that instance the dumping of lime rock into crushers formed part of the process of manufacture). In **ITC 1591** (1993:221) it was also held that the processing of cattle at an abattoir started when the cattle arrived at the abattoir.

The acts for the preparation of the raw material (**Norton Harvesters (Pty) Ltd v FCT** (1974:4080) approved on appeal in 74 ATC 4380) or obtaining of the raw material (**Cape Lime supra** (1967:142) does however not form part of the manufacturing process. It is submitted that this would include obtaining the raw material from the ore, namely the mineral itself, through a process of mining. This contention is supported by the statements of the court in **Cape Lime supra** (1967:142) that the extraction of the raw material from the rock is a process too far separated to constitute part of the process of manufacturing and thus distinguished between the acts of acquiring the raw material and those beginning the process of manufacture.

4.5 CONCLUSION

The extended definition of trading stock in section 1 of the ITA (58/1962) can be logically divided into three parts of which only two are relevant to the research as consumables stores are excluded.

The first part of the definition is divided into two tiers for which the first requires that something must be produced, manufactured or acquired. Secondly, it must be produced, manufactured or acquired for a specific purpose, namely for the purpose of manufacture or sale. If such intention is present, then it is irrelevant that the goods are not in a saleable condition as it would still fall within the ambit of the first part of the definition.

The second part of the definition has no purpose requirement and constitutes a factual investigation as to whether something which is saleable, has actually been sold and that the proceeds would constitute gross income in terms of section 1 of the ITA (58/1962) of section 8(4)(a) as a recoupment.

On analysis of the **Richards Bay** case it was concluded that not only does the distinction as stated above exist, but that a distinction between a mining and manufacturing process may be critical in the determination of an object as trading stock. This distinction for the purposes of taxation was supported in the case law cited in the analysis of a “mining process”. “Mining”, similarly to “trading stock” in section 1 of the ITA (58/1962) is not a pure definition but an extension of the normal grammatical meaning. It is concluded that mining would include any process for the winning of mineral and that such process concludes once the mineral is won from the soil.

As to what constitutes a “mineral” it was concluded that conflicting authority exists to this extent that may or may not include unmined ore stockpiles. However it was submitted that enough authority and distinction exists to conclude that only the minerals inside the soil held value separate from mere bulk or weight unless the ore itself was the subject of that to be sold (e.g. coal). In the latter instance it is concluded that the process of mining has then concluded once the ore had been one.

As an alternative to establishing the existence of a mining process or the end of the mining process, manufacturing as a separate process was analysed. It is concluded that a manufacturing process requires that a raw material be subjected or inserted into the mining process and that the resultant object would then have an essential difference compared to the initial raw material. The winning of minerals from soil was compared to the manufacturing of ore (e.g. iron ore) by treatment of the raw material (e.g. iron oxide) to create a material (e.g. iron ore) which is essentially different to the raw material. It was held to be different processes whereby the former could not be concluded to be manufacturing.

In conclusion, subject matter that is still in the mining process cannot be trading stock. Only once the mining process is completed, either by a change in intention (e.g. to sell in a scheme of profit making) or actual completion by the winning of the mineral, can the subject matter constitute trading stock in terms of the extended definition of trading stock in section 1 of the ITA (58/1962).

CHAPTER 5

CONCLUSION

The research object was to examine whether ore stockpiles of unmined ore, which is a common occurrence in the mining industry, should be taken into consideration in the determination of taxable income as prescribed by section 22 of the ITA (58/1962).

The research object was specifically limited to unmined ore stockpiles for which a taxpayer had the intention to conduct mining activities on and to separate the mineral content from the rock. It did not include tailings or mine dumps except to the extent that the intention was to mine those tailings or mine dumps as stockpiles in the mining process.

From the authorities cited it can be concluded that to determine whether stockpiles should be accounted for it must be determined what constitutes trading stock as defined in section 1 of the ITA (58/1962). To this extent the trading stock definition in the ITA (58/1962) is an extension and not a definition in the strict sense. Therefore to fall outside the definition, stockpiles have to be measured against both the normal grammatical meaning of the word “trading stock” as well as the extension to the definition.

The extension of the definition must be determined by the letter of the law. Furthermore in **Richards Bay *supra*** (1996:67-68) the court held that an appropriate criteria for the normal grammatical meaning of trading stock is generally acceptable accounting practice. Thus the definition of trading stock was firstly examined according to its accounting treatment and secondly according to the extension of the definition of trading stock in section 1 of the ITA(58/1962)

On examination of the accounting statements it is evident that assets, to be classified as trading stock, have to be evaluated in terms of and comply with both IAS1 and IAS2 to disclose it as such in the financial records. One of the main criteria for a current asset in terms of the statements is that it must be used or disposed of within 12 months.

Furthermore IAS2 requires in its definition of inventories that the asset must be held for the purpose of sale in the ordinary course of business, in the process of production for such sale or in the form of materials to be consumed in the production process. It is submitted that unmined ore stockpiles do not meet any of the criteria. Stockpiles are not held for sale but for the purpose of being mined. Secondly it is not an asset in a process of production as minerals are not produced, they are merely isolated from rock. They are also not consumed in the production process as both the separated rock and minerals exist after the mining process is complete. The conclusion therefore should be that stockpiles cannot form part of inventories and that only the mined minerals which are held for sale can constitute inventories.

However PricewaterhouseCoopers (2007:48) were of the opinion that stockpiles could form part of trading stock. Based therefore on the assumption that stockpiles could comply with the definition of inventories in IAS2 it is concluded that stockpiles will however only be considered trading stock once the mineral content has been assessed and the cost of production has been determined. Thus stockpiles which have been created to ensure continuity of the mining process without assessment of both these criteria should not be disclosed as inventory and will therefore fall outside the normal grammatical meaning. These stockpiles must then be disclosed as non-current assets but only if they do have a reasonable expectation of future economic benefits. Otherwise they are excluded.

The extended definition of trading stock as contained in section 1 of the ITA (58/1962) was held from the authorities cited to contain two parts or criterions. The first part required the existence of a certain purpose, namely manufacturing. The second part had no purpose requirement and was a factual investigation of the facts. It is concluded that ore stockpiles cannot be acquired, manufactured or produced for the purpose of manufacturing or sale. They are merely created from the immovable property for the purpose of being mined and therefore fall outside the ambit of the first part. As to the second part of the extension it is concluded that stockpiled ore is not in a saleable condition and is also not meant for sale. Thus ore stockpiles would fall outside the scope of this provision. It is debatable whether the sale of the whole stockpile would constitute profit by sale or the mere realisation of an asset (**Natal**

Estates Ltd v SIR (1975:199) as the intention with which the asset was held is critical. This is however outside the scope of the research. Furthermore, not every receipt or accrual arising from sale and designly sought for, in view to making a profit, is revenue in nature (**Samril Investments (Pty) Ltd v CSARS** (2003:68)).

In the analyses of the **Richards Bay case** (1996:55) it was found that the court by its *dictums* supported the distinction between assets intended for use in a manufacturing process as opposed to a mining process. It furthermore also seems plausible that these distinctions do affect the nature of stockpiles for tax purposes as contended. Unfortunately the taxpayer did not argue these points and the court reserved its comment as to the legal point of view of stockpiles when these points are considered.

In conclusion it is submitted that ore stockpiles do not constitute inventory. Only if a wider definition of the accounting principles is accepted would they constitute inventories but only to the extent that the measurement is defined and the stockpile will be mined within twelve months from the reporting date.

As for the extended definition, it is submitted that unmined ore stockpiles can not form part trading stock and that only the mined minerals, which indicate the conclusion of the mining process, can constitute trading stock. The latter applies irrespective of whether the minerals have been separated or processed as long as they have been mined by being isolated from the ore bearing rock.

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