AN EVALUATION OF SELECTED CHANGES PROPOSED IN RESPECT OF THE SOUTH AFRICAN MINING TAX REGIME

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ABSTRACT

The South African mining tax regime is a fairly mature legislative framework. The legislator has made numerous changes to the legislation in order to respond to the trends of the industry. This framework has arguably been behind the substantial contribution of the mining industry to the South African economy. Recent trends have seen numerous jurisdictions especially in the African continent changing and in some instances completely replacing their entire framework with new legislation. South Africa has recently come under pressure to make substantial changes to its mining tax framework in a manner that mere legislative amendment might not suffice. This follows the recommendations of inter alia the ruling party, African National Congress which proposes changes to the mining tax regime. Due to the fact that the proposed changes could have a significant impact on the mining industry as well as South Africa as a mining nation, the state has established the Davis Tax Committee to investigate the viability of the proposed changes as well as the advantages and disadvantages thereof. The Davis Tax Committee has made interim recommendations which at most are in favour of retaining the status quo and making minor changes to the current mining tax framework. Prior to making an evaluation of the recommendations made by the Davis Tax Committee it is necessary to lay the basis of the recommendations which includes giving an overview of the current mining tax regime as it is and thereafter discussing the calls for change in the said regime. The purpose of conducting this study and evaluation is to make recommendations in response to the calls for regime change as well as the Davis tax Committee's recommendations in respect of the proposed change.

KEYWORDS

Mining tax regime;

Mining tax instruments;

Tax design;

Tax structure;

Tax incentives;

Regime change;

Capture of revenue;

Mining income tax;

Mining royalties; and

Taxation of mines.

CHAPTER 1: INTRODUCTION

1.1. Research statement (problem)

For one of the largest mineral producers in Africa and the world, South Africa receives relatively diminutive revenue returns from its mineral endowments. The *Income Tax Act (ITA)*[1] and the *Mineral and Petroleum Resources Royalty Act (MPRRA)*[2] being the main regulatory instruments that establish the basis for revenue collection in the South African mining industry, the question to be answered is whether these statutes provide effective instruments to afford South Africa a fair share of its mineral wealth. In other words, the problem that I seek to resolve through this study is that the current tax regime is argued to be failing to capture sufficient rents due to *inter alia* its excessive generosity and narrow tax base.

Many fingers are however pointed at the Multinational Enterprises (MNEs) as the main cause of revenue losses in the mining industry and calls for better transfer pricing instruments are made. This work however focuses on the calls for change of selected tax instruments or provisions and does not look into the transfer pricing issues. Through this work I seek to determine and identify the short-comings of the *ITA* as well as the *MPRRA* in as far as their purpose to capture revenue on as wide a tax base is concerned.

1.2. Assumptions

a) The South African fiscal regime is not an effective instrument for revenue collection in the mining industry.

b) The South African fiscal regime incentives are too generous.

c) New tax instruments are necessary to capture a greater share of mining proceeds.

[1] Income Tax *Act* 58 of 1962.
[2] *Mineral and Petroleum Resources Royalty Act* 28 of 2008.

1.3. Research questions

a) To what extent is the South African Fiscal Regime an effective instrument for revenue collection in the mining industry?

b) Are the South African tax instruments too generous to the mining industry?

c) Is it necessary to introduce new instruments to capture a greater share of mining proceeds?

1.4 Overview/Background

In this document I will look into the South African tax legal framework to determine its suitability or efficiency as an instrument for effective tax collection in the mining industry as in December 2016. There have been calls for the revision of the South African tax framework owing to arguments that the current tax model does not collect taxes effectively in the mining industry. The latter is argued to be allowing the mining houses especially the multinationals to take all the benefit of the South African mineral wealth to their home countries without leaving much for South Africa to show.[3]

From the title of this work one will note that my intention is not to look at the tax regime on its own as an island without taking into consideration some pressing issues which have a direct and/or indirect impact on the taxability of the mining industry in South Africa. In this regard factors or circumstances that contribute to reduced revenues will be considered in order to determine if the tax regime is solely to blame or there are circumstances that are so stark that the need to change the tax regime may not be there.

I will start by exploring the tax structure and provisions as they are. In this regard I will look at the South African corporate tax in general where after I will look at how it differs from the corporate tax in the mining industry as well as the gold mining

[3] ANC, “Maximising the Developmental Impact of the People’s Mineral Assets: State Intervention in the Minerals Sector”, Policy Discussion Document (March 2012): Pretoria. Available online: http://anc.org.za/docs/discus/2012/sims.pdf. Last Accessed on 03/10/2016”.

industry in particular. For now it suffices to note that the mining industry is generally taxed at the same rate as other industries however with different treatment when it comes to tax incentives which are especially applicable to mining companies acquiring income from mining operations.

The *ITA* defines what is regarded as "mining"[4] and what is regarded as "mining operations".[5] The specific definition of these terms is meant to ring-fence certain tax incentives for the exclusive benefit of mining companies. However not all income that accrues to mining companies is subject to the latter special treatment. Income that is generated by mining companies whilst conducting activities other than what is considered "mining operations" is taxed in the same manner as income generated by non-mining companies.

It suffices at this stage to note further that the *ITA* provides for a separate tax formula which applies only to gold-mining companies in respect of income acquired through "mining for gold"[6]. The *ITA* provides a tax formula to determine the rate of tax for gold mines in respect of income accruing from mining operations.

I will proceed to look into the royalties that are taxed in terms of the *MPRRA*. The *MPRRA* makes provision for tax formula which varies depending on the extent to which minerals are refined.[7] In an attempt to promote local beneficiation of minerals, the *MPRRA* imposes a higher cap on the royalty rate leviable on unrefined mineral transfers as compared to refined minerals.[8] However, irrespective of the beneficiation of a given mineral the *MPRRA* imposes a minimum royalty rate of 0.5% on all mineral transfers.[9]

[4] *Section 1 of Income Tax Act* 58 of 1962.
[5] *Ibid.*
[6] *Section 1 of Income Tax Act* 58 of 1962.
[7] *Ibid.*
[8] *Ibid.*
[9] *Ibid.*

After looking into the corporate taxes and royalties applicable to mining companies, sufficient background would be laid down for one to venture into the calls for a review of the latter taxes. It is notable however that the latter taxes are not the only taxes that are taxable in respect of mining companies but they are the main taxes which form the main tax base in the mining industry. In this regard it is therefore noteworthy that certain withholding taxes are leviable on mining companies although not necessarily limited to the mining industry.

In respect of the calls for review of the tax legislation in particular respect of the taxation of mining companies I will discuss the *State Intervention in the Minerals Sector (SIMS) Report*[10] which was issued by the African National Congress ("the ANC") in 2012. This report was issued to discuss *inter alia* the possibilities of revising the existing tax framework in the mining sector with the aim of increasing revenues accumulated from the mining industry. The report discusses various types of taxes commonly levied in the mining industry and various tax regimes which support these various taxes. The report also discussed the feasibility of applying some of these taxes and/or regimes in the South African mining industry. It further explains the challenges that could be faced in the South African context if certain changes are made.

With the above in mind the Minister of Finance appointed the Davis Tax Committee ("the DTC") to conduct further research and submit recommendations in respect of the possibility of revision of the South African mining tax regime as well as the viability thereof. The DTC approached the International Monetary Fund ("the IMF") to assist it in its investigation and the IMF compiled a report with its findings and recommendations to the DTC.[11] In light hereof I will therefore discuss the findings and recommendations of the IMF.

[10] ANC (2012) above.
[11] IMF, 'South Africa, Technical Assistance Report – Fiscal Regimes for Mining and Petroleum: Opportunities and Challenges' (September 2015): Washington, D.C. Available online: http://www.taxcom.org.za/docs/20150909%20Final%20IMF%20SA%20Mining%20report%20-%20consolidated.pdf. Last Accessed on 03/10/2016.

After receiving the report from the IMF and making its own research, the DTC released an interim report on mining in which it makes recommendations of potential changes.[12] In its report the DTC comments on the IMF's findings and recommendations and makes counter recommendations where it sees fit to do so. Seeing that there are certain crucial aspects in which the *DTC report* and the *IMF report* make differing recommendations in respect of the potential changes to the mining tax regime, it is necessary to discuss both documents.

In light of the current mining tax regime, the *SIMS report*, the *IMF report* and the *DTC report* I will proceed to make evaluations on what all these parties have recommended. In order to make fair evaluations it will be necessary to take into consideration surrounding circumstances which influence profitability of the South African mining industry. The profitability of the mining industry has a direct impact on the income tax collectable from the mining companies and therefore has a great impact on the question of necessity of revision of the existing tax regime. In this regard it is notable that the existing tax regime might not be the issue but the surrounding circumstances which make it seem no longer effective to collect taxes.

In these reports as well in the evaluation to follow, I will discuss the details of the South African tax regime including the incentives provided by the *Act*, how these incentives may still be necessary or no longer necessary and thus no longer serving their purpose leading to loss of revenue instead. The incentives to be discussed include sideways relief, capex deduction as well as other deductions and allowances. Moreover, the reports discuss some definitional issues and these will also be addressed in the evaluation where after recommendations will be made in the following chapter.

[12] DTC, 'First Report on Mining: For the Minister of Finance' (December 2014): Pretoria. Available online: http://www.taxcom.org.za/docs/20151201%20DTC%20First%20Interim%20Report%20on%20Mining%20(hard-rock).pdf. Last Accessed on 03/10/2016.

I will further evaluate the South African mining tax regime against the general principles of taxation to determine if it meets the standards thereof. I will further comment on the recommendations of made on the *SIMS* Report as wells the *IMF* and *DTC reports* respectively. It is notable that these reports are all discussed in chapter 3 and that that chapter takes a narrative approach. The *IMF report* takes a more detailed technical approach to the review of the South African mining tax regime and for this reason a more detailed discussion of the *IMF report* is held in the abovementioned chapter.

It is also notable that a bulk of this work is based on legislation as well as the aforementioned reports. Other literature will however be considered which is relevant in responding to the said reports. It is notable that the reports are fairly new and not much literature has been published in direct response to the reports and therefore my observations, analysis and opinion with the help of the available literature will form the bulk of the evaluation to follow the discussion of the reports.

1.5. Motivation

South Africa is estimated to have the world's fifth largest mining sector in terms of its gross domestic product (GDP) value.[13] The value of South Africa's total reserves is estimated at R20.3 trillion ($2.5 trillion); some of the most valuable reserves in the world[14] despite some of the deposits thereof nearing depletion. This being the case, the mining sector accounts for about a third of the Johannesburg Stock Exchange's market capitalisation.[15]

[13] Kearney, L. 'Mining and Minerals in South Africa' (8 August 2012), *SouthAfrica.info*. Available online: http://www.southafrica.info/business/economy/sectors/mining.htm#.V6G669J9600. Last Accessed on 3/08/2016.
[14] *Ibid*. South Africa's manganese and platinum group metals are the largest in the world. South Africa is endowed with some of the largest gold, chromite ore and vanadium reserves in the world - Kearney, L. (2012) above. See also Smit, C. 'The Role of Mining in the South African Economy', *KPMG South Africa*. Available online: https://www.sablog.kpmg.co.za/2013/12/role-mining-south-african-economy/. Last Accessed on 3/08/2016.
[15] *Ibid*.

With the above in mind, South Africa however sits with a quandary on how it should extract the most of revenue from these wealth deposits in light of various surrounding circumstances and emerging developments that counter this aspiration. The counter forces that challenge the South African mining fiscal regime drafters include declining mineral prices, decreased mineral demand and the abovementioned deposits that are nearing depletion.[16]

The Mining industry is currently on a down cycle with escalating operation costs and declining commodity prices.[17] This unfortunately does not sit well with many mineral dependent countries as they do not have the luxury of riding off the downward cycle without much if any revenue from the mining industry. Although South Africa is not heavily dependent on the mining revenue the industry's contribution is still of a considerable amount to state revenue.[18]

It is notable that the mining industry's contribution to state revenue has declined from about 29% as it was in 1981 to about 2.5% in the 2013/14 fiscal year.[19] Although taxation on its own is not considered one of the greatest challenges of the South African mining industry, the abovementioned surrounding circumstances greatly influence the taxability of the industry and thus influences tax policy and regulatory decisions or at least should.[20]

Among the surrounding circumstances which influence the taxation of mining companies is the depletion of known reserves which has become stark in some

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[16] Cohen, M. and Burkhardt, P. 'South Africa Faces Tax Dilemma as Mining Industry Costs Soar' (6 February 2013), *Bloomberg*. Available online: http://www.bloomberg.com/news/articles/2013-02-05/south-africa-faces-tax-dilemma-as-mining-industry-costs-soar. Last Accessed on 15/08/2016.

[17] *Ibid*.

[18] Daniel, P. et al, 'Fiscal Regimes for Mining and Petroleum: Opportunities and Challenges' (September 2015), Technical Assistance Report: South Africa, *IMF Country Report* No. 15/244. Available online: http://www.taxcom.org.za/docs/20150909%20Final%20IMF%20SA%20Mining%20report%20-%20consolidated.pdf. Last Accessed on 15/08/2016.

[19] *Ibid*.

[20] *Ibid*.

sections of the industry.[21] Mining costs have also surged in the past couple of years following numerous strikes which led to unplanned wage increases of up to 22%.[22] The recent electricity tariff hikes have majorly contributed to the increased cost of mining in South Africa[23] and as such have a direct bearing on the operation costs of mining companies in determining their taxable income.

In light of the changed mining environment, South Africa currently seeks to review its mining fiscal regime in a manner that will achieve higher revenue collection from profitable operations and equitable contributions from other operations. The government seeks to develop its tax base through an attractive tax environment which would essentially attract new investments.[24]

Looking at the above contributory factors which affect the mining industry and the revenue thereof one tends to wonder whether the South African fiscal regime is ineffective and therefore needs to be reviewed in order to achieve the tax targets aspired for by government or government needs to address the surrounding circumstances which hinder the industry from generating the taxable income that would enable government to reap the desired taxes.

1.6. Aims and/or goals

The objective behind this study is to advise on how to prevent as much revenue loss as possible whilst capturing as much state revenues as possible. This I seek to achieve through determining the necessary changes that need to be made to the current mining regime if any. I seek further to advise on the legal framework that would strike the necessary balance between the legal framework's attractiveness and effectiveness in collecting revenue.

[21] Daniel, P. (2015) above.
[22] Cohen, M. and Burkhardt, P. (2013) above.
[23] *Ibid*.
[24] Daniel, P. (2015) above.

1.7. Methodology

In order to evaluate the selected provisions as well as the proposed changes thereto I will follow the qualitative approach. The study will be entirely literature based in making a critical analysis of the South African mining tax regime. A critical approach is necessary in this work to assess and determine the effectiveness of the South African fiscal regime as a medium for revenue collection. This will however be weighed against various factors that affect the industry financially and therefore affect the industry's ability to make greater contributions to state revenue. Prior to taking a critical approach particularly in the fourth chapter, a narrative approach will be taken for the second and third chapters to lay the necessary foundation to make an informed evaluation.

1.8. Structure

<u>Chapter 1:</u>

In this chapter as is evident above, an overview of the entire document is set out.

<u>Chapter 2:</u>

In chapter two I will narratively discuss selected tax provisions which apply to the mining industry in terms of the *ITA* and the *MPRRA*. Whilst on this chapter I will compare the South African mining tax regime with mining tax regimes of South Africa's competition; namely, Botswana, Zambia, Zimbabwe and Namibia.

<u>Chapter 3:</u>

In the third chapter I will discuss the three reports made by the ANC, IMF and the DTC respectively in respect of the need or otherwise to change the South African mining tax regime.

<u>Chapter 4:</u>

Chapter four will be an evaluation of the abovementioned reports' recommendations.

<u>Chapter 5:</u>

In the last chapter I will make a conclusion and recommendations based on the above evaluation.

1.9. Literature Review

It is notable that a great amount of this work is based on the *ITA*, The Mineral and Petroleum Royalties Act as well as the three reports by the ANC, IMF and the DTC. A detailed narrative of these reports is necessary in order to have an informed discussion of the calls or recommendations for review or change of the mining tax regime. This unfortunately leaves not much leeway to discuss other sources that could be used to evaluate the opinions aired on the reports. Despite the foregoing a number of sources will be used in the fourth chapter to discuss the recommendations made in the reports prior to making conclusions and recommendations in chapter 5.

It is unfortunate that not many South African scholars if any have directly responded to the abovementioned reports and for that reason sources used in the fourth chapter are almost entirely online sources instead of journal references. Of note worth are the responses of practitioners or institutions such as KPMG,[25] PwC,[26] Deloitte,[27] and SAICA.[28] These practitioners or institutions unfortunately merely make a narrative of the recommendations made in the *DTC report* and make little or no critical analysis of the recommendations therein. That being so, online sources of international scholars and practitioners are utilised in this document to respond to the reports. As such these sources should assist in making a profound evaluation and coming to informed conclusions and recommendations.

[25] 'Follow-up Communication on the Mining Report Issued by the Davis Tax Committee (DTC)' (2015, September 17). Available online: https://home.kpmg.com/za/en/home/insights/2015/09/follow-up-on-the-mining-report.html. Last Accessed on 21/12/2016.

[26] PwC: 'Davis Tax Committee Releases First Interim Report on Mining' (2015, August 25), Tax AletJohannesburg. Available online: https://www.pwc.co.za/en/assets/pdf/tax-alert-dtc-interim-report-on-mining-august-2015.pdf. Last Accessed on 21/12/2016.

[27] Deloitte, 'The Davis Tax Committee (the DTC / the Tax Committee) released its first interim report on mining for the Minister of Finance and has called on the public to provide comments on their recommendations', Press Releases: Johannesburg. Available online: https://www2.deloitte.com/za/en/pages/tax/articles/mining-tax-recommendations-.html. Last Accessed on 21/12/2016.

[28] South African Institute of Chartered Accountants, 'Davis Tax Committee: First report on mining' (February 2016), Issue 197: Pretoria. Available online: https://www.saica.co.za/integritax/2016/2491._First_report_on_mining.htm. Last Accessed on 21/12/2016).

1.10. Delimitations

The scope of this study will be limited to taxation of mining companies. Although focus will be on South Africa, a brief comparative study on countries such as Zimbabwe, Zambia, Botswana and Namibia will be made. In addition to the aforegoing the study will be narrowed down to selected provisions of the *ITA* as well as the *MPRRA*. Moreover, the selected provisions will pertain to income tax as well as royalties levied against mining companies in South Africa.

CHAPTER 2: THE SOUTH AFRICAN MINING TAX REGIME AS OF 2016

2.1. Introduction

In this chapter I will discuss the South African mining tax regime as of 2016. The South African mining tax law is a part of the South African corporate tax law and as such a brief overview of the general corporate tax law will be made herein. It is notable on the onset that the general corporate tax rate is currently prescribed at 28%. This rate applies to all companies which are tax residents of South Africa or which have acquired their income from a South African source subject to any applicable double tax agreements as the case may be.

Due to the importance of the mining industry to the South African economy the *ITA* makes special provision for mining companies on the one hand and all other non-mining companies on the other hand. The latter Act makes a further distinction between gold-mining companies on the one hand and non-gold mining companies[1] on the other hand. The latter distinctions are meant to ring-fence incentives which are meant for the benefit of mining companies carrying on mining operations in general and those which carry on gold mining in particular.

The aforementioned distinctions become useful in the determination of taxable income when certain incentives in the form of allowances and deductions are made in respect of mining companies and gold-mining companies as the case may be. Section *15(a)* read with section *36(11)* of the *ITA* provides for the deduction of all capital expenditure which is incurred prior to and during the operation of a mine. It is notable that this deduction is only deductible against income obtained during mining operations and as such it is not applicable to non-mining companies. That being the case, mining companies enjoy the benefit of a deduction which other companies do not enjoy and as such their tax liability is reduced.

[1] Mining companies which do not mine for gold.

2.2. Selected provisions which make up the South African mining tax regime

2.2.1. Corporate Income Tax: Mining Companies

Generally all companies are taxed at a flat rate of 28% in South Africa.[2] However, the *ITA* differentiates between mining companies and non-mining companies.[3] This is manifest in certain deductions that are only applicable to mining companies in terms of section *15*.[4] Non-mining companies are all taxed at the latter mentioned rate whereas a further distinction is made between gold mining companies and non-gold mining companies. Gold mining companies are taxed in terms of a formula.[5]

In terms of section *3(c)* of Schedule *1* of the *Rates and Monetary Amounts and Amendments of Revenue Laws Act*,[6] gold mining companies are taxed at "a rate equal to the average rate of normal tax or 28 per cent, whichever is higher". However, it is notable that the maximum rate of tax of gold mines in terms of the formula is 34%.[7]

Section *15(a)* provides that an amount ascertained in terms of section *36* is deductible, in lieu of section *11, 12D, 12DA, 12F and 13quin* allowances, from a taxpayer's income derived from mining operation.[8]In light of the foregoing, the section *11, 12D, 12DA, 12F and 13quin* allowances envisaged in section *15(a)* apply to non-mining companies whilst the section *15(a)* allowances are meant to be a greater incentive designed for the exclusive benefit of mining companies. This is a clear example of preferential treatment given to mining companies. Preferential

[2] Section *5(1)(d)* of the *Income Tax Act* 58 of 1962 read with section *3(1)* of the *Rates and Monetary Amounts and Amendments of Revenue Laws Act* 13 of 2016 and section 3(a) of Schedule *1* thereof.
[3] Schedule *1* of the *Rates and Monetary Amounts and Amendments of Revenue Laws Act* 13 of 2016.
[4] Section 15 of the *Income Tax Act* 58 of 1962.
[5] Section *3(b)* Schedule *1* of the *Rates and Monetary Amounts and Amendments of Revenue Laws Act* 13 of 2016.
[6] *Rates and Monetary Amounts and Amendments of Revenue Laws Act* 13 of 2016.
[7] International Monetary Fund: South Africa: Technical Assistance report – Fiscal Regimes for Mining and Petroleum: Opportunities and Challenges, IMF Country Report No. 15/244. Available online: https://www.imf.org/external/pubs/ft/scr/2015/cr15244.pdf. Last accessed on 26/01/2017.
[8] *Section 15(a) Income Tax Act* 58 of 1962.

treatment of mining companies is however not an aspect peculiar to South Africa's competition as will be noted herein below when a comparative study is made.

Section *15(b)* provides a further incentive to mining companies by ensuring that capital expenditure incurred by mining companies during the prospecting and exploration stage is capitalized until a mine commences production (or mining operations).[9]It provides that a taxpayer may deduct from mining operations any expenditure incurred by the taxpayer from prospecting operations.[10]This incentive is meant to capture capital expenditure which would have otherwise been deductible but does not strictly fall under the definition of "mining operations" as envisaged in section *1* of the *ITA*.[11]

It is notable however that manufacturing expenditure incurred from manufacturing operations is subject to a 40/20/20/20 depreciation. The 40/20/20/20 depreciation allowance is limited in percentage and duration of the write-off period unlike the section *15* expenditure deduction as well as the section *11A* deductions which allow for a 100% deduction and are not limited in their respective periods of application. This entails that a section *15* just as well as a section *11A* expenditure deduction can be carried forward indefinitely.

The reason for the indefinite carry forward is probably due to the fact that such deductions would not be deductible from the mining income due to the ring-fencing provisions of the *ITA*. Section *36(7C)* of the *ITA*[12] provides that amounts deductible in terms of section *15(a)*[13] from income derived from the working of any producing

[9] See also PwC, 'Corporate income taxes, mining royalties and other mining taxes: A summary of rates and rules in selected countries', *Global Mining Industry Update* (June 2012): Pretoria. Available online: https://www.pwc.com/gx/en/energy-utilities-mining/publications/pdf/pwc-gx-miining-taxes-and-royalties.pdf. Last Accessed on: 04/10/2016.
[10] See *section 15(b) of the Income Tax Act*.
[11] See also PwC (2012) (above).
[12] *Ibid*.
[13] In other words amounts of capital expenditure as envisaged in section 36(11) of the *Income Tax Act*.

mine shall be the amount of capital expenditure incurred however subject to the provisions of sections *36(7E),(7F)* and *(7G)*.

2.3. Brief comparative study: South Africa vs. neighbouring mining jurisdictions

In order to make a better informed consideration of the South African mining tax regime in respect of its competitiveness and suitability in collecting revenue it is essential to consider the immediate competition in the form of South Africa's neighbours which have to an extent similar geographic features and therefore similar mineral depositions. In this regard the mining income tax and royalty regimes of Namibia, Botswana, Zambia and Botswana will be considered briefly below. It is notable though that the comparison is based on the respective jurisdictions' mining income tax, royalties as well as capital allowances without going into other taxes levied in the respective jurisdictions.

2.3.1. Namibia

The Namibian income tax rate for hard-rock mining is levied at a rate of 37.5% whereas the diamond mining sector is levied at a considerably higher rate of 55%.[14] This could be an exemplary indicator in comparison to South Africa why there are calls for a greater share to be levied against South Africa's mines seeing that South Africa's corresponding rate ranges from 28% to 34% depending on whether the mining company is a gold mining company or a miner of other minerals.[15]

Just like South Africa, Namibian mining companies enjoy the 100 percent capex deduction. However, in respect of exploration and pre-production developments this

[14] EY, "Worldwide Corporate Tax Guide 2016", p1010 Available online: http://www.ey.com/Publication/vwLUAssets/Worldwide_Corporate_Tax_Guide_2016/$FILE/2016%20Worldwide%20Corporate%20Tax%20Guide.pdf. Last Accessed on 12 June 2017.

[15] The Davis tax Committee, First Interim Report on Mining for the Ministry of Finance, December 2014. Available online: http://www.taxcom.org.za/docs/20151201%20DTC%20First%20Interim%20Report%20on%20Mining%20(hard-rock).pdf. Last Accessed on 26/01/2017.

deduction is only allowable in the first year of production.[16] This is unlike in South Africa where these costs can be deferred indefinitely until they are set off against mining income. Moreover, in a similar fashion as in South Africa exploration and development expenditure is deferred until the inception of mining operations.

Costs on infrastructure or development costs incurred when production has begun are deductible in three consecutive equal annual instalments with the first year of production.[17] This is a notable difference from the South African mining tax regime which as stated does not limit the deferral time period. Without doubt this in theory enables the Namibian government to start reaping the benefits of mining operations much sooner in the life of a mine unlike in the case of South Africa where the exorbitant pre-operation costs prevent the state from collecting tax for a considerable time.

However, although the Namibian approach may be favourable to the state and the nation on face value, it may have a disincentivising effect on investors and should be considered carefully. In addition to Namibia's income tax imposition, a royalty is levied against mining companies on a relatively low rate of 2-3% depending on the minerals or metals mined.[18] South Africa's royalty rate is determined by a formula which provides a sliding scale between 0.5 to 5 or 7% depending on the specifications of the mineral question.[19] Despite the South African royalty rate being double the maximum royalty rate of Namibia, the flexibility of its sliding scale is of considerable attractiveness although some may opt for a high and less flexible rate.

[16] PwC, "Worldwide Tax Summaries, Corporate Taxes 2016/17, Africa", p251. Available online: https://www.pwc.com/gx/en/tax/corporate-tax/worldwide-tax-summaries/assets/wwts2017-africa.pdf. Last Accessed 12/06/2017. See also KPMG "Tax card 2016/17" p12. Available online: https://home.kpmg.com/content/dam/kpmg/pdf/2016/05/tnf-namibia-may-9-2016.pdf. Last Accessed on 13/06/2017.
[17] PwC (2016) (above), p251. See also EY (2016) (above), p1013.
[18] PwC (2016) (above), p256.
[19] DTC (2014) (above).

2.3.2. Zambia

Zambia's mining tax rate is not too far off from the general mining tax rate of South Africa. The Zambian mining income tax is levied at a relatively low 30% rate in comparison to that of Namibia. In this regard the Zambian corporate tax is merely 2% higher than that of South Africa and as such does not give much of a competitive urge to South Africa. However, in instances when mining income accrued is in excess of 8% of gross sales the tax rate is determined in terms of a formula and the rate of tax cannot be less than 30%.[20] This formula provides for the so-called 'variable profit tax' of up to 15% in addition to the normal 30% normal tax in cases where a mining company earns income in excess of 8% of gross sales.[21]

Although not limited to mining companies, a 2% decrease of the above tax rate is applicable in either case whether the mining company is liable for the normal 30% tax or more in respect of newly public listed companies.[22] Provided a mining company goes public, it can enjoy a tax rate of at least 28% which is the case with South African non-gold mining companies. In 2016 Zambia introduced a new mineral royalty tax based on a sliding scale of 4-6% depending on the price of copper in question.[23] This is within the range of South Africa's 0.5% to 5% or 7% royalty scale depending on the specification of the relevant mineral.

Zambian mining companies however do not enjoy the unlimited carry forward of losses enjoyed by South African mining companies. Zambian mining companies can only carry forward losses for a period of ten years.[24] Moreover it is notable that Zambia limits the mining income against which a tax payer can set off its losses. Operation losses were until 1 July 2015 deductible against 100% of the mining

[20] EY (2016) (above), p1653.
[21] PwC (2016) (above), p365.
[22] EY (2016) (above), p1653.
[23] Zambia Chamber of Mines, "Taxation and Mining Investment in Zambia", November 2016, p4. Available online: http://www.manic.co.zm/wp-content/uploads/2016/11/Taxation-and-Mining-Investment-in-Zambia.pdf. Last Accessed on: 13/06/2017.
[24] PwC (2016) (above), p373.

income. After 1 July 2015, operation losses can only be set off against 50% of mining income. Moreover it is noteworthy that losses cannot be carried back.[25]

A holistic view of the Zambian mining tax regime makes it clear that the South African mining tax regime is more attractive in comparison. However, the question remains on whether the South African tax regime is too generous. The fact that the South African tax regime is more attractive or lenient as some may take it to be does not necessarily mean that the South African tax regime is too generous as it may as well mean that the Zambian too rigid. It is therefore necessary to determine to whether there is a need for the South African tax regime to be revised.

2.3.3. Botswana

Except for diamond mining companies, Botswana charges a tax of 22-55% against mining companies.[26] The exact tax of a particular company in a given tax season is determined through a formula.[27] Diamond mines on the other hand are generally taxed in accordance with terms of an agreement entered into and between the state and the diamond company.[28] This is an attractive instrument in a tax regime which instrument South Africa does not have.

Moreover, Botswana just like South Africa allows mining and prospecting losses to be carried forward indefinitely.[29] Just like South Africa, Botswana mining companies enjoy a 100% capital allowance in respect of all capital expenditure.[30] This is unlike Zambia as has been indicated above. As such, the South African mining regime would generally appear to competitive urge against Botswana as it generally has

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[25] *Ibid*.
[26] KPMG, "Botswana Country Mining Guide", (2014), p17. Available online: https://assets.kpmg.com/content/dam/kpmg/pdf/2014/04/botswana-mining-guide.pdf. Last Accessed: 10/07/2017.
[27] KPMG (2014) (above), p18. See also PKF, "Botswana Tax Guide 2015/16" (2015), p6. Available online: http://www.pkf.com/media/10025969/botswana-tax-guide-2015-16.pdf. Last Accessed on: 10/07/2017.
[28] PKF (2015) (above) p6.
[29] KPMG (2014) (above) p16.
[30] I*bid*.

lower maximum tax rates than Botswana. However, this can also be interpreted as over generosity of the South African tax regime and as such can be considered a reason for the need for its revision and introduction of new instruments.

2.3.4. Zimbabwe

In Zimbabwe, mining companies are ordinarily taxed at the rate of 25%. If such companies hold special mining leases they are taxed at an even lower rate of 25%.[31] This is relatively the lowest corporate income tax rate amongst the five neighbouring mining jurisdictions compared herein. In this context, South Africa is almost exonerated from the accusations of its over generosity.

However when one considers Zimbabwe's circumstances as they are regardless of whether they were the cause of such a low rate or not, it is notable that Zimbabwe needs such desperate incentives when one considers the level of political risk in Zimbabwe compared to that of South Africa as well as Zimbabwe's indigenisation policies.

Zimbabwe also allows for an indefinite carry forward of mining losses.[32] However, just like in South Africa, mining losses are ring-fenced to specific locations.[33] A holistic comparison of the Zimbabwean and the South African mining tax regime in respect of the selected corresponding aspects thereof respectively puts the South African tax regime in a better light in as far as its alleged over generosity is concerned. However as stated, Zimbabwe's circumstances make it quite necessary for Zimbabwe to have such generous rates whereas South Africa's circumstances although also considerably weighing down South Africa's attractiveness might not necessarily justify such relatively low rates as those levied in South Africa.

[31] PwC (2016) p388.
[32] EY (2016) p1658 and 1662.
[33] *Ibid*.

2.4. South Africa's distinguishing factors

Despite having explored the South African mining tax regime and subsequently conducting a comparative study between the South African mining tax regime and tax regimes of South Africa's neighbouring completion, it is still necessary to state surrounding circumstances that may distinguish South Africa's mining tax challenges from those of its competition.

There are extraneous factors that have contributed to the South African mining regime's seeming inefficiency to capture a fair share of state revenues. These range from factors that are not necessarily in the hands of the government such as the volatility of the labour market and depletion of natural resources which have been the cash cow of revenue on the one hand to state policies and regulations which affect investor behaviour in the mining industry on the other hand.[34]

On the onset the IMF makes it clear that "taxation is far from top of the list in current challenges facing the development of EI in South Africa."[35] It further states clearly that "the operation of the current fiscal regime, or of new proposals, is circumscribed by multiple other considerations."[36] In light hereof it is without doubt that the IMF holds the opinion that there are extraneous factors that need to be considered which constrain the effectiveness of the tax regime regardless of the election to retain or abandon the existing tax regime.

2.5. Conclusion

In light of the above analysis, it is notable that South Africa has too generous tax instruments when compared to Namibia and as such the Namibia mining tax regime should theoretically be capable of taxing a greater or fairer share of mineral resources for its state unlike the South African mining tax regime. Despite the South

[34] Smit, C. 'The Role of Mining in the South African Economy', KPMG South Africa. See also Cohen, M. and Burkhardt, P. 'South Africa Faces Tax Dilemma as Mining Industry Costs Soar' (6 February 2013), Bloomberg.
[35] *IMF (2015) (above),* Executive Summary viii.
[36] *IMF (2015) (above),* Executive Summary xi.

African mining tax regime having a more competitive tax regime it unfortunately has led to an outcry for new tax instruments to be introduced. The same goes for the Zambian mining tax regime in as far as its theoretically greater ability to obtain a fairer share of taxes in comparison to the South African regime. This is true in terms of both the Zambian and Namibian mining tax regimes limiting the capex deduction incentive to a given number of years unlike South Africa which has no cap in the number of years for capex carry forward.[37] In this regard South Africa may need to reconsider its incentive.

Botswana on the other hand seems as generous as South Africa as it also does not cap its 100% capex carry forward.[38] However, as noted above, the Botswana general mining tax has a wide sliding scale which allows for flexibility and potentially high capture of revenue as the scale is not capped as low as 34% as in the case of South Africa in respect of gold companies.[39] Botswana instead caps its mining tax at a high rate of 55% and such should theoretically be able to capture a fairer share of revenue.[40]

The most generous tax regime amongst the five states compared herein is perhaps Zimbabwe but as states above, this may be due to some dire circumstances prevailing in Zimbabwe which may make it unjustifiable for South Africa to justify its own relatively ungenerous tax regime in comparison to Zimbabwe. With the foregoing in mind, it may be necessary for South Africa to introduce a new instrument to capture a greater share of mineral resources or to increase its tax rates. However this would have to be done cautiously taking into consideration other factors that make South Africa not as attractive as it could be.

[37] PwC (2016) (above).
[38] KPMG (2014) (above). See also PKF (2015) above.
[39] DTC (2014) (above).
[40] KPMG (2014) (above). See also PKF (2015) above.

CHAPTER 3: CALLS FOR A CHANGE IN THE MINING TAX REGIME

3.1. Introduction

Despite the South African mining tax regime having been in place for several decades, there are recent calls for a regime change. The most notable call emanates from the ANC, South Africa's ruling party which released the State Intervention in the Minerals Sector (SIMS) report in March 2012 in which several reasons for the call for change are outlined.[41] The ANC gives reasons for the call for change and explores potential alternatives to the current tax regime and makes an attempt to weigh them against each other as well as against the current tax regime.

In response to the ANC the Minister of Finance appointed the Davis Tax Committee (DTC) which has been mandated to investigate the necessity of a regime change as well as potential alternatives to the current mining tax regime. In preparing its report, the DTC engaged the services of the IMF on an advisory basis. The IMF compiled a report for the DTC in which it scrutinized, among others, the South African mining tax regime pointing out its strengths and weaknesses as well as giving recommendations.

In light of the *SIMS* report, the ANC as well as the DTC's own findings, the DTC has issued an interim report for comment. The DTC essentially favours the retention of the current tax regime with some minor changes in selected aspects of the tax regime. The IMF and the DTC differ in some aspects of their findings and make differing recommendations to an extent.

[41] African National Congress, Maximising the Development Impact of the People's Mineral Assets: State Intervention in the Minerals Sector (SIMS) report, March 2012. Available online: http://anc.org.za/docs/discus/2012/sims.pdf. Last Accessed on 26/01/2017.

3.2. The SIMS Report

The ANC[42] acknowledges the fact that South Africa is wealthy in mineral resources and has some of the world's largest reserves of certain mineral resources.[43] It however also indicates that some reserves are declining and moving towards depletion.[44] The ANC further notes the important role that has been played by the mining industry in the South African economy, stating that the mining industry has been the largest contributor to the South African GDP, exports, capital formation and employment since World War ll.[45]

Although the SIMS report is not solely focused on taxation of the mining industry, it is clear from the objectives of the report that capturing of resource rents is not just one of the objectives but it plays a central role in archiving other objectives.[46] The ANC expressly states four objectives that are sought to be achieved upon implementation of the proposals made in the SIMS report. The most notable objective for our purposes is maximising the developmental impact of minerals through capturing resource rents among others.[47]

In terms of the report resource rents are taxes levied on the surplus revenue generated by mining houses.[48] In this regard revenue is regarded as surplus when a mining house has recovered all its costs for exploration, development and extraction.[49] The latter also entails that the investor has met its desired return on investment as adjusted by the incumbent risk of such investment.[50]The report argues further that resource rents can be taxed without upsetting the principle of neutrality

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42 ANC (2012) (above).
43 ANC (2012) (above) p4.
44 *Ibid*.
45 ANC (2012)(above) p5.
46 ANC (2012) (above) p27.
47 *Ibid.*
48 *Ibid, p15*.
49 *Ibid*.
50 *Ibid*.

and states that resource rents can be taxed at least for the fact that minerals belong to the state.[51]

Following the report's justification for the state levying resource rents in the mining sector, the report acknowledges the existence of rents and risks in other sectors as well.[52] The report however qualifies the latter by stating that the magnitude and characteristics of the risks in the mining sector necessitate special tax treatment of the sector by way of varying fiscal instruments in capturing revenue.[53]

Without neglecting the disadvantages of utilising the varying fiscal instruments the report refers to royalties, resource rent taxes, windfall taxes, corporate income taxes and state ownership as examples of fiscal instruments that a state may utilise in capturing resource revenues.[54] The report acknowledges the existence of both advantages and disadvantages in as far as influence on the attractiveness of investment in a jurisdiction is concerned.[55]

The South African mining tax regime mainly consists of royalties, corporate income tax, withholding taxes and capex expensing.[56] With the latter instruments in place, the report argues that South Africa is not capturing a fair share of resource rents in the mining sector.[57] The report suggests that a resource rent tax should be introduced in the mining sector.[58] The latter suggestion and argument fall at the centre of two of the three questions addressed in this paper; namely, whether the selected tax instruments embodied in the *ITA* and the *MPRRA* respectively are effective instruments for capturing a fair share of state revenues and whether it is necessary to introduce new instruments to ensure capture of a fair share of revenues.

[51] *Ibid*.
[52] *Ibid*.
[53] *Ibid*.
[54] *Ibid*.
[55] *Ibid*.
[56] *Ibid*.
[57] *Ibid* page 36.
[58] *Ibid*.

Strengthening its argument by way of case studies on *inter alia,* Australia which is stated to be in the process of implementing a resource rent tax in the hard rock mining sector as well as Botswana's capture of the surplus value calculated using a formula, the report argues that the introduction of a resource rent tax which would only be taxable when an investor has made a "reasonable return" would not have a negative effect on investor behaviour towards the South African mining industry.[59] In this regard, the SIMS report indirectly touches on the question of striking the balance between the effectiveness of the tax regime on the one hand the its attractiveness on the other.

Arguing that there is a need for progressive tax instruments that capture resource rents, the report recommends that a resource rent tax of 50% must be imposed on all mining projects.[60] This percentage probably emanates from the report's observation that the resource rent tax in numerous countries that impose such a tax ranges between 50% and 90% of the surplus value or excess profits.[61] The report suggests further that the recommended tax would only be leviable excess income which is made by mining houses in addition to the normal return on investment.[62]The report argues that such an instrument would accordingly not come into effect in respect of marginal and low grade deposits.[63]

The report observes that a resource rent tax levied at 50% would generate about 40 billion rand per annum in revenue.[64] In light hereof the report recommends that the existing gold mining tax formula should be replaced with the corporate income tax plus the resource rent tax and that the latter two should apply to all minerals.[65] In addition to the aforegoing, the report argues that the current mining royalties "add to costs, increase the cut-off grade and sterilise the people's mineral assets" and

[59] *Ibid*, page 36.
[60] *Ibid*.
[61] *Ibid*.
[62] *Ibid*.
[63] *Ibid*.
[64] *Ibid*, page 37.
[65] *Ibid*.

therefore should be reduced from 5% and 7% respectively to 1% once the recommended resource rent tax is implemented.[66] The report submits that the latter would still generate about 4 billion Rand per annum and would enhance optimal resource extraction.[67]

Admitting that it would be a challenge to ensure that more surplus value returns are captured by the state, the report concludes by stating that growth, development and job creation amongst other objectives cannot be achieved through "market forces" alone.[68] It argues *inter alia* that South Africa's taxes are generally lower than those of its counterparts and that a resource rent tax, among other measures, should be introduced in order to achieve the aforementioned objectives.[69] This essentially entails that the South African mining tax regime is too generous in the opinion of the ANC.

3.3. The IMF Report

3.3.1. Mining Income Tax

The IMF takes a more technical approach in addressing the question of changing the current mining tax regime in South Africa. The IMF is critical of the current relationship between the *MPRDA* and the *ITA*. In the words of the report the *ITA* is not in line with the *MPRDA*. This has resulted in the *ITA* having multiple definitions setting out the scope of what is considered the extractive industry.[70] The report however does not attribute all the blame to the *MPRDA* and states that although the *MPRDA*'s scope is uncertain the issue may also lie with the lack of consistency of the *ITA* provisions themselves.[71]

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66 *Ibid*.
67 *Ibid*.
68 *Ibid*, p51.
69 *Ibid*, p52.
70 International Monetary Fund: South Africa: Technical Assistance report – Fiscal Regimes for Mining and Petroleum: Opportunities and Challenges, IMF Country Report No. 15/244. Available online: https://www.imf.org/external/pubs/ft/scr/2015/cr15244.pdf. Last accessed on 26/01/2017.
71 *Ibid*.

The report further criticises the *ITA* mining tax provisions for being scattered and states that although not compulsory the provisions could be collected in a dedicated division of the Act.[72] It is submitted further in the report that some uncertainty exists in respect of the interface of provisions that apply to mining companies and those that apply to general non-mining companies.[73] The report suggests that this defragmentation may be resolved by collecting all the mining tax laws into one division as suggested earlier.[74] Essentially the IMF argues that the structure of the provisions of the mining tax regime are generally scattered in a manner that causes uncertainty and thus ineffectiveness of the tax regime.

The report submits that the 'sideways relief' provided by the *ITA* can be distortive in a competitive environment when one taxpayer is compared to another taxpayer within the same industry.[75] The sideways relief refers to the provision for a taxpayer to set off its losses incurred in one activity against income accrued in another activity of the same taxpayer.[76] The report explains this to have a potential distortive effect in instances when a taxpayer on the one hand is engaged in one or more activities in which the taxpayer suffered losses and has the benefit of setting off such losses against its profitable activities whereas another taxpayer on the other hand is engaged in only one activity or more than one activity without any profitable activities to set off losses bears the full impact of the losses without relief from such.[77]

The report submits that the current mining tax system is complex and that a uniform rate similar to all other corporate industries should be imposed in the interests of equal treatment of equity investment.[78] The report however admits that it might not be easy to apply the same analogy to the current capital allowance applicable to the extractive industry. The current capital allowance deductible by mining companies is

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72 *Ibid*.
73 *Ibid*, p12.
74 *Ibid*.
75 *Ibid*, p18.
76 *Ibid*.
77 *Ibid*.
78 *Ibid,* p31.

100 percent of the capital expenditure and makes the current regime attractive.

The report however indicates that although immediate expensing (accelerated capital allowance) eliminates the need to distinguish between capital and revenue expenditure it goes against the premise of imposing a corporate income tax.[79] Corporate income tax is intended to be a tax on returns to equity while "capital allowance should approximate the depreciation of economic value of the asset to its owners."[80] If a 100 percent deduction is made it offers a normal return on capital and a further deduction of interest on debt amounts to double deduction as does the allowances for gold mining capital expenditure.[81]

The report correctly points out the fact that the taxation on gold mines is currently different from that of other mines as well as oil and gas extractors.[82] Mining companies are generally taxed at the standard corporate tax rate of 28%. However gold mines are taxed in terms of a tax formula.[83] The tax formula is designed to tax profits made by mining companies in respect of profit in excess of 5%.[84] If a company makes a profit of less than 5% it is not subject to tax.[85]

The 5% rule establishes a so-called 'tax tunnel' in which companies are allowed to grow the business to such time that they make profits above 5% without being taxed.[86] The tax formula also places a maximum tax threshold of 34%, above which a gold-mining company cannot be taxed.[87] The report submits that although the maximum rate may be as high as 34%, the effective tax rate is 32.3% due to the 5% tax tunnel.[88] The tax tunnel is a clear example of the generosity of the South African mining tax regime which arguably further delays or prevents the government from

[79] *Ibid*.
[80] *Ibid*.
[81] *Ibid*.
[82] *Ibid*, p34.
[83] *Ibid*.
[84] *Ibid*, p35.
[85] *Ibid*.
[86] *Ibid*.
[87] *Ibid*.
[88] *Ibid*.

taxing mining income sooner. That being the case it still remains that the tunnel promotes the survival of the capital intense industry.

The report states that the purpose of introduction of the tax formula was to encourage extraction of lower grade ore.[89] Due to the high gold prices at the time, the purpose of the formula was achieved as a number of mines focused on mining the low-grade ore as was intended to promote but some chose to remain below the 5% threshold as well.[90] The report also commends the formula for having lengthened the lifespan of gold mines but submits that there currently remain not much justifiable reasons for the retention of the gold formula.[91]

The report reflects on the previous recommendations to abolish the gold formula made by the Marais report as well as the *SIMS* report before also recommending same.[92] The report submits that "[m]any deposits are essentially uneconomic, too deep for economic exploration, and the rising cost structure due to regulatory measures, power shortages and rising labor costs has put most of the mines into a permanent loss position (or they continue to operate within the 0-5 percent tax tunnel)."[93]

It is submitted that only four gold mines enjoy the benefit of the capital redemption allowance despite the fact that they already enjoy the benefit of interest deduction and therefore enjoy double deduction.[94] In this regard, the IMF implies that the capital allowance has to a greater extent become obsolete which entails that it may as well be done away with.

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[89] *Ibid*.
[90] *Ibid*.
[91] *Ibid*.
[92] *Ibid*.
[93] *Ibid*.
[94] *Ibid*.

The depth of existing gold mines exceeds 4 000 metres and unavoidable mining technology constraints eliminate the justification of the formula on the grounds of promoting mining of low-grade ore taking into consideration that at such depths one cannot easily access the low grade ore if at all.[95] In light of the foregoing the report suggests that the allowance for corporate capital should be introduced in place of the gold formula and that it should be applied to the entire mining industry.[96]

3.3.2. Mining Royalties

According to the IMF the fact that royalties are imposed at the point of "transfer" of minerals gives rise to complications.[97] Some of these problems, the report submits are caused by the differentiation between "refined" and "unrefined" minerals.[98] This becomes an issue during valuation when it turns out that the relevant mineral does not fall within a grade considered to be "refined" or "unrefined".[99] In such an instance the *MPRRA* provides that the transaction price must be adjusted to the effect that the mineral is deemed to fall within either of the two categories of beneficiation.[100] This is likely to result in uncertainty and potentially loss of revenue. It therefore instigates the opinion that the MPRRA lacks effectiveness in collecting royalty revenues.

The report argues that the existing royalty system may have the converse effect from what was intended upon promulgation of the relevant provisions.[101] This follows the fact that a mineral of a higher grade attracts a higher royalty and may therefore discourage local beneficiation (which the *MPRRA* strives to encourage).[102] In other words, due to the fact that beneficiation improves the grade of a mineral, a higher

95 *Ibid*.
96 *Ibid*.
97 *Ibid*, p25.
98 *Ibid*.
99 *Ibid*.
100 *Ibid*.
101 *Ibid*, p26.
102 *Ibid*. This is not necessarily always the case as one would note that the *MPRRA* provides for a higher maximum royalty leviable on unrefined minerals as opposed to refined minerals. This might not always achieve a lower royalty for refined minerals but the idea is to keep it lower and therefore promote local beneficiation. Although grade has a tremendous factor on mineral pricing it is not the main determining factor when considering the question of beneficiation. Beneficiation without doubt also increases the value of a mineral and therefore the transfer price but it does not necessarily improve the grade of a mineral as the IMF Report seems to suggest.

royalty would be payable when a mineral is beneficiated, unlike in the case when its not.

3.3.3. IMF Recommendations

Ultimately the IMF recommends three options to reform the South African mining tax and royalty system.[103] The first option is to implement comprehensive reform to the current system although it may be challenging to do so.[104] Secondly, the current framework could be retained however making partial changes thereto.[105] Lastly the report suggests that the state could elect to do very little or nothing to the existing tax framework however at the risk of maintaining the tax contribution of mining companies low.[106] The DTC vehemently disagrees with this latter suggestion and prefers a compromise between the first and the second option as will be discussed below. Moreover, the third option is the reason why the state suggested a regime change as envisaged in the SIMS report.

If the state elects the first option of effecting comprehensive change to the tax structure, the *IMF report* suggests that a flat rate royalty on gross sales would be more suitable instead of the current royalty rate which is subject to a royalty formula.[107] Moreover, the report suggests that the first option would be preferable if a standard corporate income tax with a licence by licence (or right by right) mining ring-fence is imposed on the entire mining industry.[108] Such ring-fence, the report suggests, should be accompanied by an economic depreciation and the allowance for corporate capital.[109] The report submits that the allowance for corporate capital would serve as a replacement of the interest deduction and "provide a uniform annual tax free return on capital employed, after tax depreciation."[110]

[103] *Ibid*.
[104] *Ibid*.
[105] *Ibid*.
[106] *Ibid*.
[107] *Ibid*.
[108] *Ibid*.
[109] *Ibid*.
[110] *Ibid*, p36.

In as far as additional taxation is concerned the report suggests that a cash flow tax that is triggered by high profits and does not discourage marginal operations would be best suited for an election of a comprehensive reform of the current tax system.[111] The report however advises that the implementation of a flexible and progressive rent tax mechanism should be considered over the medium term.[112] The report points out that there are three options of resource rent taxes, namely the 'brown tax' the 'r-based cash flow tax' and the resource rent tax.[113]

In respect of the royalty system, the report states that the current administration of the royalty is complex owing to the adjustments that need to be made when a mineral is transferred at a grade lower (unrefined), higher (refined) or between the latter two specified ranges.[114] The report suggests that instead of the latter system a net smelter return valuation system should be used in determining the royalty.[115] The net smelter return,[116] unlike the current refined vs. unrefined system is automatically adjusted without the need for a differentiation between refined and unrefined minerals.[117]

The report submits that the imposition of royalties on gross revenue (as the current formula does) provides earlier revenues for government when commercial production commences and protects revenue from overstatement of cost.[118] However the report argues that it also adds cost and in some instances makes extraction of some deposits economically unfeasible.[119]

111 *Ibid*.
112 *Ibid*.
113 *Ibid*.
114 *Ibid*, page 38.
115 *Ibid*, page 39.
116 *Ibid*. "Net smelter return" is defined as the net revenue that the owner of a mining property receives from the sale of the mine's metal/non-metal products less transportation, processing and refining costs.
117 *Ibid*.
118 *Ibid*.
119 *Ibid*.

3.4. The DTC Interim Report

It is notable that the DTC *[120]* is made in light of the IMF recommendations and that these two reports' recommendations will therefore be compared where applicable herein below. Moreover, what was discussed in the *IMF report* which is also discussed in the *DTC* report will not be discussed again herein below.

The DTC states that tax design policy has an impact on the behaviour of investors however the impact thereof is fairly low in comparative terms.[121] The report submits that various factors have resulted in a negative influence to the mining industry but warns that the impact of tax policy should not be underestimated.[122] Despite the comparative importance of the mining sector as a contributor to the GDP and revenue collection having declined the mining sector retains its value in job creation, foreign currency generation as well as South Africa's balance of payments.[123]

The report states that investors largely base their decisions on predictability, stability as well as competitiveness of policy and legislative framework instead of tax issues.[124] On this premise the report argues that amendments to tax systems should therefore not be regarded as the solution to increase investment and therefore revenue.[125] The report however warns against radical changes being made to tax systems as it may lead to uncertainty and decreased investor-friendliness.[126]

Without necessarily criticising the current mining tax regime, the DTC recommends that the distinction between gold mining companies and other mining companies be eliminated.[127] The report submits that doing away with this distinction would advance

[120] DTC (2014) (above).
[121] Ibid, p6.
[122] *Ibid*.
[123] *Ibid*.
[124] *Ibid*, p16.
[125] *Ibid*.
[126] *Ibid*.
[127] *Ibid*, p58.

the principles of tax neutrality and equality.[128] Similar to the IMF's recommendations the DTC recommends that the same rate be generally applied to all mining companies.[129] This may be more welcomed by the gold mining companies that pay an average rate of more than 28% in terms of the gold formula and would serve as a bit of consolation for any other unfavourable changes that could be made to the regime.

However in as far as the retention of the upfront capex allowances is concerned the DTC seems to have a different opinion from that IMF which suggests that the provision for upfront capex would avoid the challenge of differentiating between capital and current expenditure.[130] The DTC submits that it is not difficult to distinguish between capital and current expenditure as taxpayers keep records of this information in any case.[131] It is suggested that the upfront capex be replaced with the 40/20/20/20 capex depreciation regime similar to that currently applicable with regards to manufacturing.[132] This would in all certainty reduce the generosity and therefore the attractiveness of the South African mining regime. However, it would not necessarily entail that investors will be driven away by same but impact would be great.

The report further addresses the issue of determining when mining ends and when manufacturing commences in the context of mining.[133] The report suggests that the different tax treatment between write-offs for mining and those for manufacturing be done away with.[134] The DTC suggests that a standard write-off be applied for both mining and manufacturing purposes.[135] This, the DTC suggests, would eliminate the

[128] *Ibid*.
[129] *Ibid*.
[130] *Ibid*.
[131] *Ibid*, p59.
[132] *Ibid*, p62.
[133] *Ibid*, p61.
[134] *Ibid*.
[135] *Ibid*.

issue of determining when mining ends and when manufacturing commences for mining tax purposes.[136]

In a further attempt to bring the mining sector in line with the manufacturing industry, the *DTC* report considers whether the depreciation of mining assets should be calculated from the date that such assets are brought to use rather than the date when expenditure is incurred in relation to the said assets.[137] The DTC states that this approach may present its on challenges with particular reference to defining when assets are brought into use.[138] The conclusion to calculate write-off from the date of expenditure instead of date of use is reached by report.[139]

The DTC submits that if the capex tax allowance is removed it would make sense to also remove the ring-fence provisions as well.[140] In light of the DTC's argument that upfront capex allowances distort the principle of tax neutrality, the DTC submits that ring-fences are only necessary if the tax regime lacks inter-sectorial neutrality.[141] Indirectly criticising, *inter alia*, the capex allowance for causing lack of neutrality, the DTC argues that "lack of neutrality gives rise to tax sheltering, tax avoidance and arbitrage opportunities".[142]

As if in direct response to the IMF's criticism against sideways relief, the DTC states that sideways relief (which is currently limited by ring-fences) would assist taxpayers to structure or plan their taxes in such a manner that would allow them to reach ideal tax results.[143] The report further argues that this kind of relief is recognised in South African tax policy as an accepted element of tax structure and design.[144] The DTC therefore recommends that the non-gold mining ring-fences be done away with as

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[136] *Ibid*.
[137] *Ibid*, p62.
[138] *Ibid*.
[139] *Ibid*.
[140] *Ibid*, p65.
[141] *Ibid*, p64.
[142] *Ibid*.
[143] *Ibid*.
[144] *Ibid*.

this would also recompense for the removal of the upfront capex allowance.[145] It would appear that the DTC is of the opinion that sideways relief is favourable and that the only coz of distortion referred to by the IMF emanates from the ring-fencing provisions that limit sideways relief.

Although clearly opposed to the proposal to the partial removal of the ring-fences, the DTC warns against the immediate removal of the ring-fences as it could lead to an influx of set-offs against non-mining income.[146] Such an influx, the report submits, could result in great loss of revenue.[147] The report further states that the phased removal of the ring-fences on a 40/20/20/20 basis would still result in substantial loss and therefore the report defers its recommendation on the timing of removal of ring-fences to the Treasury.[148]

The report criticises the gold formula for distorting and breaching tax neutrality but for the sake of preserving the job market that is sustained by the continued existence of incentives such as the gold formula it recommends that the gold formula be retained.[149] On a hopeful note, the report submits that it is likely that the challenges posed by the retention of the gold formula might eventually come to an end owing to attrition of the sector.[150]

It is further submitted on the contrary that the formula should be abandoned in as far as new gold mines are concerned.[151] Such new mines are suggested to be made subject to the same tax rate as other mining companies.[152] Fearful of the unequal position created by the above suggestion in as far as when new mines are compared

[145] *Ibid*, p65.
[146] *Ibid*.
[147] *Ibid*.
[148] *Ibid*.
[149] *Ibid*, p69.
[150] *Ibid*.
[151] *Ibid*.
[152] *Ibid*.

to older mines is concerned the report makes an alternative suggestion to rid of the gold formula in a gradual fashion.[153]

The report submits that the original purpose of additional capital allowance available to gold mines has been to encourage deep level mining whilst making it worthwhile for the companies which delve into such risky ventures.[154] The additional capital allowance was meant to compensate for the high cost of funding particularly at the time of introduction thereof. The DTC submits however that the cost of funding has substantially decreased and that the additional allowance should be removed. In further justification hereof the report states that the additional tax allowance amounts to a double deduction and overcompensation as mining taxpayers are often permitted to make deductions in respect of interest resulting from financing costs.[155] In this respect the DTC considers the *ITA* to be overgenerous to mining companies.

The report further contends that the compounding nature of the additional capital allowance causes the said allowance to keep being carried forward as an unredeemed capital expenditure.[156] This has a perpetual effect of potentially depriving the state of the ability to collect any tax from such a mine throughout its life time.[157] Alternative to removing the additional capital allowance entirely, the report suggests that the additional capital allowance be retained provided that it is limited in some manner.[158]

In as far as the mineral royalty system is concerned; the report submits that the taxation of royalties is fairly new and that there is not much data to work on in order to comment on its success. [159] Following its argument that the current mineral royalty system has been carefully designed the report submits that the royalty system

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153 *Ibid*.
154 *Ibid*, p71.
155 *Ibid*, p73.
156 *Ibid*.
157 *Ibid*.
158 *Ibid*.
159 *Ibid*, p77.

should be afforded the opportunity to showcase its abilities.[160] The report argues that changing the royalty system while it is still relatively new would add to the legislative uncertainty which already exists.[161]Despite speaking in favour of the retention of the current royalty system, the report acknowledges the need to bring clarity on certain aspects of the royalty system.[162]

The DTC report suggests that the determination of the royalty tax base may be the solution of many royalty related challenges mentioned above.[163] The report criticises the fact that the royalty tax base is currently based on adjustable gross sales.[164] The report submits that this presents challenges mostly in respect of unrefined minerals which do not always fall within terms specified by schedule 2 of the of the *ITA* and therefore gives rise to uncertainty and discrepancies in the tax base.[165] The DTC avoids making a specific recommendation for a replacement of the current royalty regime but gives three options.[166]

Although with its reservations, the DTC states that the first option would be to replace the royalty formula with a flat rate as suggested by the IMF.[167] The DTC's reservations relate to the fact that a flat rate would not necessarily be flexible to respond to changing commodity prices.[168] The report further suggests that an alternative to the IMF's suggestion of a flat rate would be to retain the current mineral royalty rate structure (formula) however with some changes thereto.[169] The third option suggested by the DTC is to have one formula as opposed to two.[170] This, the

160 *Ibid*, p81.
161 *Ibid*.
162 *Ibid*.
163 *Ibid*.
164 *Ibid*.
165 *Ibid*.
166 *Ibid*, p83.
167 *Ibid*.
168 *Ibid*.
169 *Ibid*.
170 *Ibid*. This is preferable as it can respond to changing commodity prices and also address the argument raised by the IMF earlier.

report submits, would eliminate the abovementioned challenge of making adjustments when certain minerals fall outside conditions specified.[171]

The DTC submits that proposals have been made for *inter alia* new instruments of taxation including the windfall taxes and specifically the resource rent tax which is a form of windfall taxes.[172] It is important to note the reluctance of the DTC to consider many of the proposed tax instruments as it submits that many of the suggested instruments are already covered by existing tax instruments and therefore would need sufficient reason to justify the administrative costs of changing the existing instruments.[173]

In as far as the general windfall taxes are concerned the report submits that the existing royalty and gold formulas have elements of the windfall taxes.[174] The DTC submits that for this reason as well as for below-mentioned reasons for not supporting the introduction of the resource rent tax, it recommends that the windfall taxes should not be enacted to form part of the South African mining tax regime.[175]

In respect of the resource rent tax as a separate tax instrument, the DTC report argues that the resource rent tax would pose a revenue risk to the revenue authority.[176] It submits that due to the fact that the resource rent tax is based entirely on the excessive profitability of a mining operation taxpayers can only taxed on such surplus after all losses carried forward and accumulated losses are have been deducted.[177] This would essentially delay the government's ability to generate revenues taking into consideration the extensive periods of time prior to mining

[171] *Ibid*.
[172] *Ibid*, p85-86.
[173] *Ibid*, p85.
[174] *Ibid*.
[175] *Ibid*.
[176] *Ibid*, p86. This is why it may be necessary to consider changing from an indefinite carry forward to a limited carry forward as in the case of Namibia and Zambia.
[177] *Ibid*.

projects receiving income which income would still have to be set off against losses and deductible capital expenditure.[178]

Although in favour of taxing taxpayers who are clearly capable of paying taxes from surplus profits the report argues on the contrary that the resource rent tax is not the best instrument to capture rents.[179] The report supports rather an instrument that could capture rents as well as able to collect minimum non-profit based revenue.[180] In this regard the report suggests that a hybrid instrument would be ideal as it would guarantee a stable revenue stream whilst capturing rents where applicable.[181] The report however does not suggest any new hybrid instrument but rather argues that the existing royalty system serves the proposed dual function.[182] The report however concedes that the current royalty system would need some refinement to reach the desired targets.[183]

In response to the IMF's suggestion to make a comprehensive change of the current mining tax regime the DTC reiterated that it is against the introduction of an entirely new instrument unless it is absolutely necessary.[184] The DTC expresses its lack of support for the suggestion by the IMF to replace the current royalty formula with a flat royalty rate by stating not only that it is satisfied with the current royalty system but also that a flat rate would take away the ability of the current formula to respond to varying economic conditions.[185]

The DTC professes support for the IMF's suggestion to standardise the mining tax rate throughout the industry as well as the removal of ring-fences.[186] The DTC

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[178] *Ibid*.
[179] *Ibid*, p88.
[180] *Ibid*. This view is not entirely supported as the resource rent tax need not be the sole source of revenue but could be a supplement to the general income tax.
[181] *Ibid*.
[182] *Ibid*.
[183] *Ibid*.
[184] *Ibid*, p93.
[185] *Ibid*, p 94.
[186] *Ibid*.

however does not agree with the introduction of an additional capital allowance as it disputes that this allowance is a proxy and not necessarily reflective of the actual cost of capital.[187] The DTC prefers therefore that the actual cost of capital in the form of interest be deductible instead of replacing it with an additional allowance despite noting the advantages of such an allowance.[188]

The DTC agrees with the IMF's proposition to align mining capital allowance with other mining jurisdictions by bring the depreciation closer to the economic depreciation of producing assets as it would bring the tax treatment of the mining industry closer to that of other non-mining sectors.[189] The DTC also expresses its support of grandfathering tax incentives such as the section 12I allowance for manufacturing, the accelerated capital allowances in the mining industry as well as the additional capital allowance applicable to the gold mining industry.[190] The DTC however does not fully support the removal of the gold mining formula and states that it would prefer to also gradually remove the formula instead of doing so abruptly.[191]

In response to the IMF's second option the DTC indicates its dissatisfaction with the retention of the 100 percent capital allowance and suggests that the latter be replaced with an allowance spread over four years in a manner that mimics the manufacturing depreciation.[192] The latter position of DTC is without surprise taking into consideration its reluctance to the introduction of new instruments and support for partial changes whilst maintaining the current instruments as suggested by the IMF's second option.[193]

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[187] *Ibid*, p95.
[188] *Ibid*.
[189] *Ibid*.
[190] *Ibid*.
[191] *Ibid*, p96.
[192] *Ibid*.
[193] *Ibid*.

In the context of the second option, the DTC supports the deferral of cash-flow tax or resource rent tax in favour of the current royalty system.[194] The DTC voices reluctance towards adopting a net smelter return calculation system for royalties, however it refuses to make conclusive arguments against such adoption.[195] In respect of the third option suggested by the IMF the DTC dismisses this option without any consideration of its strengths and weaknesses. The DTC concludes that it prefers a hybrid system with features of the first and second option leaning more towards the second option.[196]

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[194] *Ibid*, p97.
[195] *Ibid*.
[196] *Ibid*.

CHAPTER 4: CONSIDERATION OF VARIOUS MINING TAX INSTRUMENTS THAT COULD POTENTIALLY BE INTRODUCED TO THE SOUTH AFRICAN REGIME

4.1. Introduction

In this Chapter I will directly address the question of whether it is necessary to change the current mining tax regime or not. An evaluation will therefore be made to determine essentially whether the South African mining tax regime is on the one hand too lenient and thereby not capturing a fair share of the South African Mineral wealth or on the other hand too stringent and unattractive to investors thereby explaining why not much revenue is realised in the mining industry.

Essentially this chapter embodies a balancing exercise to determine the right balance between attractiveness and capability to capture sufficient revenue. Moreover the evaluation will include an assessment of whether criticism made against the current regime is founded and whether the recommended solutions to the challenges pointed out would solve the problems mentioned.

In making an evaluation of the South African mining tax regime as set out in chapter 2 above, taking into consideration the reports, observations and/or recommendations of the ANC, the IMF as well as the DTC (in Chapter 3) respectively, it would be apposite to consider extraneous factors that have an impact on the economic performance of the South African mining industry and the efficiency of the mining tax regime to capture a fair share of the mining industry's benefits in such economic conditions. Such extraneous factors to be considered in this regard are factors which through their negative impact on the mining industry's performance lead to lesser taxable income for the state to tax.[1]

[1] International Monetary Fund: South Africa: Technical Assistance report – Fiscal Regimes for Mining and Petroleum: Opportunities and Challenges, IMF Country Report No. 15/244. Available online: https://www.imf.org/external/pubs/ft/scr/2015/cr15244.pdf. Last accessed on 26/01/2017.

4.2. The Income Tax Regime

Mark Curtis[2] criticises the South African mining tax regime for *inter alia* consisting of generous tax treatment towards mining companies.[3] *Curtis* further submits that the introduction of new legislation applicable to the mining sector including the *MPRDA* and the royalty bill (now the *MPRRA*) were positive steps on the part of the state towards an opportunity to increased revenue collection.[4] He however argues that this opportunity was wasted as these pieces of legislation among others created rather an opportunity for tax abuse.[5] He however does not state precisely how tax abuse can be imputed to these statutes.

Curtis does however expand on his submission that the South African tax regime is generous. In support hereof he alludes to the fact that the *ITA* permits mines to set off all capital expenditure against their taxable income and to carry forward any losses that are realised by mines for an indefinite period regardless of whether such losses are created by the first incentive which is to set off all capital expenditure against taxable income.[6]

Moreover, *Curtis* submits that mining companies are not only exempt from paying Value Added Tax (VAT) on their exports but they are also entitled to claim input taxes that they may have paid to a VAT vendor in the carrying out of their mining operations.[7] In light of the foregoing it is without doubt that the current tax regime is quite generous to mining companies as these companies clearly enjoy a double incentive in this regard.

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[2] Curtis, M. "Improving South Africa's mining revenues and transparency: The need for government action", Oxfam: Johannesburg. Available online: http://curtisresearch.org/wp-content/uploads/Mining-Revenues-and-Transparency-Policy-Brief.pdf. Last accessed on: 29/11/2016. See also Curtis, M. "Extracting Minerals, Extracting Wealth: How Zambia is losing $3 billion a year from corporate tax dodging", October 2015, Reuters: London. Available online: http://www.waronwant.org/sites/default/files/WarOnWant_ZambiaTaxReport_web.pdf. Last accessed on 29/11/2016.
[3] *Ibid*.
[4] *Ibid*.
[5] *Ibid*.
[6] *Ibid*.
[7] *Ibid*.

Curtis further discusses the tax tunnel as another generous incentive in the *ITA* which also opens a door to abuse in cases where a taxpayer owns more than one mine.[8] *Curtis* argues that the tax tunnel potentially enables taxpayers who own more than one mine to distribute their income in such a manner that causes the taxpayer to fall below the 5% threshold established by the tax tunnel. Apart from the potential abuse, Curtis argues that the tax tunnel is generous in that if a company makes profit less than 5%, if any, the state receives no revenue although the shareholders may still receive their dividends.[9] In this regard it is notable that the state is not necessarily at total loss as it is still entitled to dividends tax in specific circumstances.[10]

In light of *Curtis*' submissions on the generosity of the current mining tax regime one would be more inclined to disagree with the *DTC* report which seems to be more in favour of keeping the current tax regime as it is. It follows therefore that one would favour the first option suggested by the *IMF* report to do away with the 100 capital allowance and add new taxes with particular reference to the resource rent tax. However as stated before, one needs to tread carefully not to upset the balance of attractiveness of the tax regime.

Although the *IMF* report and the *DTC* report are in disagreement in as far as the introduction of new tax instruments is concerned it is worth noting that the DTC's reasons for its position are sound. However, as mentioned earlier the DTC argues that it prefers a hybrid tax instrument that would tax both the surplus and the base tax instead of the resource rent tax that would only come into effect when all losses and expenditures have been set off.

[8] *Ibid*.
[9] *Ibid*.
[10] See *inter alia section 64EA and 64J of Income Tax Act* 58 of 1962.

On the above background it seems that the DTC assumes that the resource rent tax would be introduced without an underlying tax that would maintain a stable revenue regardless of availability of taxable surplus or not. It is in this regard that the DTC's argument against the introduction of new instruments is not supported. It follows therefore that in response to the criticism of the current regime for being generous one would be in support of the introduction of a resource rent tax.

Cottarelli et al appear to be in agreement with the *SIMS* report in that they submit that although royalties on gross revenue provide the state with revenue from the commencement of production regardless of whether the venture is profitable or not, such royalties are an additional cost of production and they make extraction of minerals economically unfeasible in some ventures.[11] *Cottarelli et al* submit further that a fiscal regime that has a higher dependence on royalties tends to be complex in that it would require refinements in order for it to respond to profitability.[12] They substantiate this argument by stating that royalty rates that vary with profitability do not vary with the cost.[13] This explains why such a royalty regime can easily be an added cost which leads to economic unviability of ventures as it neglects costs of production in its imposition.

In context of the above it is notable that the South African royalty formulae also provide for adjustment and as criticised by the IMF report they are also complex owing to the said adjustments.[14] However due to the fact that the South African mining tax regime does not seem to be highly dependent on royalties when speaking in the terms of the maximum royalty rates taxable, it follows that the issue of economic unfeasibility would be less alarming unlike in the case of jurisdictions that have a higher dependence on royalties.

[11] Cottarelli, C. "Fiscal Regimes for Extractive Industries: design and Implementation", 15 August 2012, International Monetary Fund. Available online: https://www.imf.org/external/np/pp/eng/2012/081512.pdf. Last Accessed on 29/11/2016.
[12] *Ibid*, p18.
[13] *Ibid*.
[14] See IMF (2015), p38.

In support of their contentions against price or profit based royalties *Cottarelli et al* make reference to the fact that the Mongolia and Zambia both implemented the windfall taxes which were in essence a profit based royalty and withdrew them not long after their introduction.[15]

Prof. Andreas Peichl[16] seems to be in agreement with the Adam Smith Institute's observation that a flat rate simplifies tax and leads to increased tax compliance as there would be reduced tax planning, avoidance and evasion.[17] *Peichl* states that although flat rate tax can improve tax efficiency, equity and simplicity, this can be achieved without a flat rate being imposed.[18] This entails that in as much as flat rate tax can lead to reduced unemployment as a result of lower tax rates as well as a broadened and simplified tax system, this can be attained without necessarily imposing a flat rate.[19]

Chris Evans and Sally-Ann Joseph argue that the South African tax system is not fit for its purpose but they submit that South Africa does not have the luxury to increase existing taxes as its current system is generally stretched to the extent that any increase may cause "economic distortions and other systemic failures".[20]

It is notable that the South African mining tax regime is characterised with several and far-reaching incentives which include the 100 percent upfront capex deduction and the additional 10% or 12% capex allowance applicable particularly to gold mines. It is therefore necessary to evaluate the necessity to retain or do away with some if not all the tax incentives existing in the mining tax regime. In this regard

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15 Cottarelli *et al,* fn 18.
16 Peichl, A. 'Flat-rate tax systems and their effect on labor markets' University of Mannheim and IZA World of Labor: Germany. Available online: http://wol.iza.org/articles/flat-rate-tax-systems-and-their-effect-on-the-economy.pdf. Last accessed on 15/12/2016.
17 *Ibid*.
18 *Ibid*.
19 *Ibid*.
20 Evans, C. and Joseph, S. "The South African Tax System: Fit for Purpose?", *Journal of Tax Administration*, Vol. 1:2 2015.

Chikonzo[21] submits that economic efficiency of tax incentives relates to the incentives' capability to attract favourable investment decisions. It is contended that the social benefits as well as increased revenue that flow from investments attracted by incentives outweigh the loss of revenue and indirect costs such as costs of administration, tax evasion and distortion costs which result from the incentives.[22]

In an article by *Action Aid International* and *Tax Justice Network-Africa*,[23] the view that there are more disadvantages than advantages materialised from incentives is held. It is further held that there is no need to attract foreign direct investment which implies that tax incentives are a redundant exercise considering the fact that one of the main reasons why incentives are introduced especially in developing countries is to attract foreign direct investment.[24]

The DTC seems to be convinced that the current royalty system is sufficient and that there is no need for a resource rent tax as the royalty formulae respond efficiently to taxpayers' income fluctuation. In this regard *Prof. John Freebairn* makes a comparative assessment between a royalties and resource rent taxes.[25] *Freebairn* submits that royalties place an extra cost per unit on mineral products sold with the effect of moving the mining product supply curve upwards.[26] In this regard *Freebairn* argues that the effect of the extra cost imposed by the royalty is greater if the mining supply curve is also elastic.[27] In such instances Freebairn submits that the greater the impact of the royalty the greater the efficiency cost of the royalty.[28]

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[21] Chikonzo, R. 'Incentives in SADC and their Effectiveness' (2013, February 12), SADC Tax Incentives Working Group. Available online: https://www.taxcompact.net/documents/workshop-lusaka/2013-02-12_itc_Chikonzo_SADC.pdf. Last Accessed on: 15/12/2016.

[22] *Ibid*.

[23] Tax Justice Network-Africa & Action Aid International, 'Tax Competition in East Africa: A Race to the Bottom' (April 2012). Available online: http://www.actionaid.org/sites/files/actionaid/eac_report.pdf. Last Accessed on 16/12/2016.

[24] *Ibid*.

[25] Freebairn, J. 'Royalties or Resource Rent Taxes' (2015, December 2015), *Tax and Transfer Policy Institute*. Available online: http://www.austaxpolicy.com/which-is-more-efficient-and-effective-comparing-royalty-and-resource-rent-taxes/. Last Accessed on 19/12/2016.

[26] *Ibid*.

[27] *Ibid*.

[28] *Ibid*.

In light of the above, it is submitted further that royalty has a dispiriting impact on investment.[29] In as far as the question of who would bear the cost of the royalty is concerned; Freebairn contends that this would depend on the elasticity of the supply curve.[30] If the curve is less elastic chances are that the cost will be borne by the buyer and not the mining shareholder.[31]

In respect of the resource rent tax, *Freebairn* submits that resource rent tax ideally speaking would capture a share of the economic rent; be of no consequence to production decisions as it would be efficient; and its cost be borne by investors.[32] He argues however that this is not the case in practice. He submits that investment decisions are inconsistently taken due to the disuniform capture of resource rent profits and losses. [33] It is unfortunately unclear as to who between the investors and the state is to blame in this regard.

Furthermore, Freebairn contends that the resource rent is inaccurately measured as it includes Ricardian rents and quasi-rents earned on investments in exploration as well as investments made to counter production costs.[34] He submits further that by cutting the returns from such investments the resource rent tax shifts the product supply curve as the royalty does.[35]

Freebairn submits that an effective comparison between the royalty and the resource rent tax should be made in context of approximately revenue neutral tax rates.[36] Despite the foregoing, *Freebairn* notes that a royalty provides a better inflow of special tax revenue in comparison to the resource rent tax especially in times of great commodity price fluctuation.[37] On the contrary, *Freebairn* argues that

[29] *Ibid*.
[30] *Ibid*.
[31] *Ibid*.
[32] *Ibid*.
[33] *Ibid*.
[34] *Ibid*.
[35] *Ibid*.
[36] *Ibid*.
[37] *Ibid*.

(assumedly in normal conditions) “mining industry revenues and profits are more stable under a resource rent tax regime”.[38]

It is submitted that when one considers the efficiency of royalty in comparison to the resource rent tax, a need for a trade-off arises.[39] A balance has to be struck between the aforementioned larger distortion presented by the royalty on investment decisions as well as production of particular minerals on the one hand and the potentially large distortion presented by the resource rent tax on levels of investment on inter alia the development of technology, management and work practices to lower production costs on the other hand.[40]

The resource rent tax base is smaller than the royalty base; the resource rent tax rate should therefore be a number of times greater than the royalty rate in order to capture approximately the same revenue as the royalty.[41] It is submitted however that bot the royalty and the resource rent tax cut off from the after-tax-return on mobile investments but since the resource rent tax has to have a higher rate it has a higher disincentivising impact on investment in exploration and cost effective technology.[42]

It is reported that both the resource rent and the royalty can capture similar revenues from non-residents taken as an aggregate of buyers and investors but the resource rent tax would capture a higher aggregate from investors especially those with more favourable deposits.[43] It is however argued that in the context of simplicity the royalty system is more favourable than the resource rent tax.[44]

[38] *Ibid*.
[39] *Ibid*.
[40] *Ibid*.
[41] *Ibid*.
[42] *Ibid*.
[43] *Ibid*.
[44] *Ibid*.

Sunley and Baunsgaard submit that royalties are imposed immediately when production occurs unlike the resource rent tax.[45] They submit that if the resource rent tax were to be the only tax instrument (i.e. without the income tax) the revenue stream would be back loaded.[46] Due to the fact that the royalty is based on volume or value of production, *Sunley and Baunsgaard* state that if the royalty rate is set too high it may disincentivise development of smaller ore deposits and may shorten the life span of productive mines.[47]

They however submit that it is necessary to have a royalty imposed to justify extraction of resources and to broaden the tax base as well as stabilise the fiscal regime with a steady revenue inflow.[48] *Sunley and Baunsgaard* warn on the other hand that investors are not in favour of substantial royalties regardless of the profitability of the deposit due to the fact that the royalty is deductible and not creditable at the investors' home jurisdiction.[49]

In respect of the resource rent tax, it has been stated that *Sunley and Baunsgaard* argue that if the latter tax is the only tax imposed the government's revenue stream would be back-loaded.[50] In this regard *Sunley and Baunsgaard* state further that in respect of less profitable projects the government would receive little or no revenue.[51] It is therefore recommended that the resource rent tax be coupled with a royalty and a standard profit tax to prevent a delayed revenue stream.[52]

Sunley and Baunsgaard submit that if the resource rent tax is to be effective, each contract area (i.e. each area in respect of a given mining right) needs to be ring-

[45] Sunley, EM. & Baunsgaard, T. 'The Tax Treatment of the Mining Sector: An IMF Perspective' (January 2014). Available online: http://siteresources.worldbank.org/INTOGMC/Resources/sunley-baunsgaard.pdf. Last Accessed on 19/12/2016.
[46] *Ibid*.
[47] *Ibid*.
[48] *Ibid*.
[49] *Ibid*.
[50] *Ibid*.
[51] *Ibid*.
[52] *Ibid*.

fenced.[53] In the South African context this would entail that the capex of one mining area (or one mine as the case may be) would not be set off against mining income of another mining area regardless of the ownership of the two respective areas.[54] *Sunley and Baunsgaard* however recommend that an exception should exist whereby a taxpayer is permitted to set off unrecovered costs from an abandoned mining area against mining income of a mine that remains operational.[55]

Sunley and Baunsgaard justify the above exception by stating that it would avoid discrimination against exploration.[56] *Sunley and Baunsgaard* do not explain this exception any further but it appears to be a measure to encourage exploration of highly risky deposits as investors would have the reassurance that if the project fails they have a remedy to fall back on. Moreover it encourages a new investor not to totally abandon the jurisdiction all together but to try another deposit within the jurisdiction with the hope to set off the costs of the abandoned project against the income of the new project if the latter project turns out to be lucrative.

Despite the above, *Sunley and Baunsgaard* argue that the resource rent tax may be theoretically favourable but experience has proven that it does not raise much revenue.[57] They however state that the foregoing may be due to various reasons including the difficulty of designing the tax policy.[58] In this regard they submit that if discount rate and the tax rate are set too high, the rent may not be captured at all and that if these are set too low they may capture too much rent and therefore be a disincentive to investment.[59] *Sunley and Baunsgaard* note further that if the threshold of return or tax rate is inaccurately specified to a material extent the resource rent tax may have the negative impact of encouraging tax avoidance.[60]

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[53] *Ibid*.
[54] *Ibid*.
[55] *Ibid*.
[56] *Ibid*.
[57] *Ibid*.
[58] *Ibid*.
[59] *Ibid*.
[60] *Ibid*.

4.2.1. Volume Based vs Value Based Royalties

Although the above authors seem to tip scales more in favour of the royalty than the resource rent tax, it is important to note the following in respect of the different types of the royalty. *Dr. Glave and Dr. Damonte* state that volume-based royalty (or tax) is considered to be the simplest royalty however it presents challenges in respect of determination of volume as it requires a physical audit.[61] They state further that the measuring process should be capable of determining quality and monitor production flow to prevent illegal extraction.[62] It is noted that it is challenging to determine volumes of minerals in large quantities prior to exportation thereof.[63]

Ad valorem (value-based) royalty (or tax) is determined by multiplying the volume of minerals with the price thereof.[64] *Dr. Glave and Dr. Damonte* note that the challenge of determining the volume of minerals is carried forward to the determination of the value of minerals if the value based royalty is imposed.[65] The unstable commodity prices exaggerate the aforegoing issues with the volume based royalty as these volatile prices create an opportunity for mispricing in the case of transactions between related parties.[66]

Dr. Glave and Dr. Damonte state that profit-based royalties (or taxes) are based on a taxpayer's profits and they are argued to be the most difficult in comparison to the latter two royalty (or tax) options.[67] In this regard it is recommended that the government should have an efficient financial, technical and administrative capacity in order to effectively capture such royalties.[68] *Dr. Glave and Dr. Damonte* submit that there is no right combination of royalties and taxes for greater revenue

[61] Glave, M. and Damonte, G. 'Profit-Based Versus Production-Based Tax regimes: Latin America's Experience'. *Evidence and Lessons from Latin America*. Availanle online: http://ella.practicalaction.org/wp-content/uploads/files/130319_ECO_ExtIndInvPol_BRIEF4.pdf. Last Accessed on 19/12/2016.
[62] *Ibid*.
[63] *Ibid*.
[64] *Ibid*.
[65] *Ibid*.
[66] *Ibid*.
[67] *Ibid*.
[68] *Ibid*.

capture.[69] Some instruments may be more effective in certain jurisdictions yet not so much in others.[70]

4.2.2. Ring-fencing

In as far as ring-fencing is concerned *Alexandra Readhead* submits that in the extractive industry it is possible for companies with numerous projects concurrently running within one jurisdiction to implement tax optimisation tactics in terms whereof the expenses or losses of one project are set off against the profits of the other.[71] *Readhead* submits however that in consideration of the excessive capex in the extractive industry, ring-fencing may be more necessary particularly where revenue is immediately needed by the state.[72] This is in light of the fact that sideways relief has the effect of delaying revenue collection at times for a number of years.[73]

Readhead however warns that ring-fencing should be used cautiously as it may deter exploration and development despite speeding up tax payment.[74] It is therefore suggested that equilibrium should be struck between the benefits of early revenue and the increased revenue over a longer period of time.[75]

The recommendation to get rid of the differentiation between the manufacturing industry and the mining industry would seem more attractive in light of the issues that have arisen in practice within the mining industry on its own. The question of when mining stops and when manufacturing starts remains an unresolved issue which has been adjudicated in a number of cases and legislated upon hover not to satisfaction.

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[69] *Ibid*.
[70] *Ibid*.
[71] Readhead, A. 'Getting a Good Deal: Ring-fencing in Ghana' (March 2016), Natural Resource Governance Institute. Available online: http://www.resourcegovernance.org/sites/default/files/documents/getting-a-good-deal-ring-fencing-in-ghana.pdf. Last Accessed on 19/12/2016.
[72] *Ibid*.
[73] *Ibid*.
[74] *Ibid*.
[75] *Ibid*.

4.3. Conclusion

Taking into consideration the above submission by various scholars and authorities I will therefore proceed to make recommendations and conclusions in light of the three reports discussed above.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

The above chapters have set out the overview of selected provisions that arguably make up the main structure of the South African mining tax regime. Calls for a change in the said provisions have been discussed with various reasons for the calls for such change as well as recommendations to replace the current tax regime. Consideration of various potential instruments that could be introduced if conclusion is reached that new instruments are necessary was discussed as well. In this chapter recommendations will be made on how the state may proceed in reviewing the current mining tax regime taking into consideration the foregoing.

5.2. Recommendations

Having considered the arguments for and against the resource rent tax I am of the opinion that it would be equitable to levy a resource rent tax on surplus income. This conclusion is reached taking into consideration the numerous incentives that are made in favour of the investor to cater for the investor's risk; which incentives tend to be over generous. Moreover the foregoing takes into consideration the state's sovereignty over minerals and the intention to capture a fair share in the benefits of mining.

In light of the above evaluation of the South African mining tax regime, it is without doubt that *Curtis* is correct to say that the South African mining tax regime is quite generous taking into consideration the deductions and allowances afforded to the mining companies.[1] It may be advisable for the state to consider limiting the deduction of the capex to a certain percentage of the mining income as is the case in

[1] Curtis, M. "Improving South Africa's mining revenues and transparency: The need for government action", Oxfam: Johannesburg. Available online: http://curtisresearch.org/wp-content/uploads/Mining-Revenues-and-Transparency-Policy-Brief.pdf.

Zambia.[2] Alternatively, the state could limit the number of years of carry forward following the example of Zambia[3] as well as Namibia.[4]

A suggestion in favour of the DTC's recommendation to replace the upfront capex allowance with the 40/20/20/20 depreciation seems to be more acceptable.[5] This would not only retain a measure of attractiveness of the tax regime but also bring about tax equality between the mining industry and other industries. The additional allowance however is suggested in line with the DTC's recommendations to be too generous and should accordingly be removed.[6]

It notable however that generosity of the mining tax regimes is not an uncommon aspect especially in developing countries where South Africa faces most of its competition as seen from the Zimbabwean[7] and Botswana[8] case study earlier herein.[9] This generosity unfortunately gives rise to loss of revenue that is greatly needed by the state and as such South Africa needs to look into it. The greatest challenge that South Africa faces in making attempts to toughen its mining tax regime is the fact that if it does makes its tax laws more demanding it risks losing investors whilst if it does not do so, it faces the risk of massive protests that can be damning in any way to the mining industry and as stated before cause a great deal of unattractiveness to the South African mining jurisdiction.[10]

Moreover, it is important to note that retaining tax incentives does not guarantee a successful regime especially if there are surrounding circumstances in the state

[2] PwC, "Worldwide Tax Summaries, Corporate Taxes 2016/17, Africa". Available online: https://www.pwc.com/gx/en/tax/corporate-tax/worldwide-tax-summaries/assets/wwts2017-africa.pdf. Last Accessed 12/06/2017.
[3] *Ibid*.
[4] PwC (2016), p251.
[5] See page 40 herein above.
[6] See page 43 herein above.
[7] PwC (above), p388.
[8] KPMG "Tax card 2016/17". Available online: https://home.kpmg.com/content/dam/kpmg/pdf/2016/05/tnf-namibia-may-9-2016.pdf. Last Accessed on 13/06/2017.
[9] See pages 24-25 herein above.
[10] Smit, C. 'The Role of Mining in the South African Economy', KPMG South Africa. See also Cohen, M. and Burkhardt, P. 'South Africa Faces Tax Dilemma as Mining Industry Costs Soar' (6 February 2013), Bloomberg.

which militate against the tax regime's attempt to attract investors. This is the case with Zimbabwe which has arguably one of the lowest tax rates as was noted above but due to surrounding circumstances the industry is still struggling to stay afloat.[11] One the same note, the Zambian Minister of Finance in an article by *Curtis* reportedly stated that the Zambian tax incentives are some of the most competitive yet they seemed not to be of much use particularly in respect of the labour market.[12]

On the same line of though, it is important to remember *Chikonzo's* comment that the disadvantages of incentives tend to outweigh the advantages thereof.[13] In as much as South Africa may find itself in a weight balancing dilemma it may reach the same conclusion as *Chikonzo*. In this regard it seems more apposite to conclude that a need to revise the South African incentives exists with the possibility of doing away with many incentives. This is more so when one considers the DTC's and the IMF's earlier-mentioned respective arguments against incentives such as the additional allowance applicable to mining companies which is argued to have a double deduction effect and as such unnecessarily causes revenue loss.[14]

Although the IMF submits that the tax regime is not one of the top issues faced by the South African mining industry,[15] it remains important for South Africa to consider revising its mining tax incentives as suggested herein above. In essence such revision should be aimed at striking a balance to the effect that the tax system does not become too rigid and completely unattractive thereby pushing the tax system up towards the top of the list of unattractive aspects of the South African mining industry.

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[11] See page 25 herein above.
[12] Curtis, M. "Extracting Minerals, Extracting Wealth: How Zambia is losing $3 billion a year from corporate tax dodging" above.
[13] Chikonzo, R. 'Incentives in SADC and their Effectiveness' (2013, February 12), SADC Tax Incentives Working Group. See page 53-56 above.
[14] See pages 35 and 43 herein above.
[15] See page 26 herein above.

The foregoing is quite important when considering the gold-mining formula which was argued to be still necessary to retain in order to prevent labour cuts in the industry although this was argued against by the DTC which holds the view that the purpose for the gold mining formula is no longer applicable and as such the formula is no longer a necessity.[16] In light hereof it is unsurprising that unanimous recommendation appears to exist among the three reports to abolish the gold formula.

Moreover, the special treatment received by the South African mining industry gives rise to tax inequality and oddly tax inequity as well. The tax inequality is obvious as the mining industry has several incentives that are applicable to it alone and theoretically when considering the higher effective tax rate that mining companies are subjected to. On the other hand the tax inequity is notable when one considers the fact that although the intention is to tax the mining industry at a higher effective rate of 32.3% with tax equity in mind,[17] in current market conditions that have seen a decrease in the contribution of the industry it is quite possible that many mining companies are taxed below 28% and at times not taxed at all owing to the tax tunnel discussed above thereby achieving inequity rather than equity.

In light of the above it is suggested that a flat rate should be imposed throughout the entire mining industry following also the DTC's submissions that the gold mining formula has fallen out of necessity and should essentially be removed.[18] This would achieve both tax equality and tax equity especially in the current market conditions of the mining industry. To ensure that tax equity is maintained when market conditions turn for the best in the mining industry, it is suggested that the resource rent tax be imposed despite the vehement disapproval of the DTC.[19]

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[16] See page 43 herein above.
[17] International Monetary Fund: South Africa: Technical Assistance report – Fiscal Regimes for Mining and Petroleum: Opportunities and Challenges, IMF Country Report No. 15/244. Available online: https://www.imf.org/external/pubs/ft/scr/2015/cr15244.pdf. Last accessed on 26/01/2017.
[18] See page 43 herein above.
[19] See page 46 herein above.

Introduction of the resource rent tax is supported despite the DTC's arguments as the DTC seems to suggest that a resource rent tax would be introduced as the main or sole tax instrument to collect revenue.[20] The resource rent tax need not be the sole source of revenue but could be a supplement to the general income tax and as such it need not be capable of capturing rents as well as minimum non-profit based revenue as the DTC would have preferred. It follows therefore that a general mining tax which captures minimum non-profit based revenue assisted by a sales based royalty may be applied coupled with the resource rent tax which would capture super profits during a boom and be dormant at a time of lesser profits.

In addition to the foregoing, *Mclaren J and Passant J* submit that the analogy behind the imposition of the super profit taxes such as the mineral resources rent tax is the fact that mineral resources are limited.[21] This on its own as argued by the latter is also an important fact that dampens an investor's spirit and to add to it the resource rent tax may make matters worse.[22] *Mclaren J and Passant J* explain that the basis of the imposition of the mineral resources rent tax in Australia was based on a consideration that if an investor is willing to invest for a set return and it turns out that he receives more than what he bargained for, it is without doubt that such an investor will not be discouraged if the surplus return is considered economic rent.[23] It follows that the argument is basically that imposition of a resource rent tax should theoretically not be a disincentive. This is substantiated by the fact that when mineral prices fall and extraction costs increase; economic rents also fall away.[24]

However, prior to introducing a resource rent tax it is important for South Africa to learn from the mistakes of Australia. Using Australia as a case study for the applicability of the resource rent tax, *Dollery* submits that resource rent tax has a high potential in theory to achieve great revenue results but practical implementation

[20] See page 46 herein above.
[21] Mclaren J and Passant J, 2005, *Journal of the Australasian Tax Teachers Association*, Vol 10 No. 1.
[22] *Ibid.*
[23] *Ibid.*
[24] *Ibid.*

thereof may have disconcerting results.[25] Another case study for South Africa to learn from is Zambia. Although Zambia did not introduce a resource rent tax but introduced a windfall tax which it later withdrew as in the case of Australia in respect of its resource rent tax, South Africa can learn from Zambia's mistakes and in any case the DTC submits that there have been calls for introduction of not only the resource rent tax but also the windfall tax respectively.[26]

It has been suggested and argued by the DTC that there is no longer a need for the gold-formula and that gold should be taxed at a flat rate equal to other mining companies.[27] The DTC argued further that ring-fences are only necessary when there is a lack of sectorial neutrality which is generally caused by the special treatment of mining companies.[28] With a flat mining tax rate equal to that of other industries, the need for a ring-fence of mining income against expenses from non-mining activities would generally fall away.[29] However, the ring-fence protecting mining income should be retained in order to prevent any longer delay than necessary before the state can share in the mining proceeds. It is advisable though that side-ways relief between new mines and older mines of the same entity be retained as this would promote green field exploration.

It is suggested that the mining royalty base should remain governed by a gross sales system as it was stated that several challenges exist in respect royalties by volume, royalties by value and royalties by profit.[30] This is not to say that there are no challenges with a gross sales based system but it may be easier and wiser to use the gross sales as the laws of accounting and auditing would be the best chance of the revenue authorities receiving a higher and more trustworthy amount. The latter can be achieved without any strain to the revenue authority's human capacity.

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[25] Dollery (2016) (above).
[26] See page 45 herein above.
[27] See page 42 herein above.
[28] See page 42 herein above.
[29] See page 41 herein above.
[30] See page 59 herein above.

Apart from the tax instruments that the state may choose to implement following the above recommendations including those of the three reports discussed above, it is notable that tax design plays a crucial role on deciding which instruments to introduce. It is suggested in this regard that a tax regime should consist of a balanced resource allocation, income distribution and economic stabilisation.[31] It is further argued that failure to reach these goals can result in fiscal imbalances and insufficient tax revenue among others.[32] In this regard it is suggested that tax design should strike a balance between state revenue and economic development. If taxes are too high, development could be hampered whilst if they are too low the state loses revenue.[33]

The most favourable change that could be brought about by the recommendation to have the same tax rate and therefore same treatment between mining companies and manufacturing companies would be the fact that this change would alleviate the issue of when mining stops and when manufacturing starts during the life of a mineral. In the matter of *CSARS v Foskor*[34] the court was faced with among other questions, the question of when mining stops and when manufacturing starts. In this respect the court held that mining operations end the moment when the ore is extracted from the ground.[35]

In this regard I find it difficult to agree entirely with the honourable court as it seems the court did not give enough clarity on the question. The refining process cannot be considered to be mining and neither can it strictly speaking be referred to as mining. If mining were to be given a broad definition it would be easy to include the refining process in the definition of mining as it is still a process of extracting or separating

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[31] Bonus, NS. And Pedro, MP. "The Impact of Income Tax Rates on the Economic Development of Botswana", *Journal of Accounting and Taxation*, Vol. 1:1, pp008-022, April, 2009.
[32] *Ibid.*
[33] *Ibid*.
[34] *CSARS v Foskor* [2010] 3 All SA 594 (SCA). See also *Richards Bay Iron & Titanium (Pty) Ltd and Another* 1991 (1) SA 311 (A) where the court also had to decide on the question of when mining stops and when manufacturing starts.
[35] See also Janse van Rensberg, W. and van Niekerk, L. "Where Does Mining Stop and Manufacturing Commence? A Critical Analysis of Section 15A of the Income Tax Act", *De Jure*, 2012. Mosupa, F. "Miner or Manufacturer? The Plot Thickens", *Without Prejudice*, December 2014.

the actual mineral from the ore or impurities. However including the refining process in the definition of mining could have some undesired consequences such as requiring refining plants to have mining licences.

It follows therefore that the court should have differentiated among mining in the strict sense as the court did; the refining process and the manufacturing process. This flows from the fact that one cannot manufacture natural resources which have been extracted from the ground as they are already created through the course of nature. The only instance when the manufacturing of natural resources is to be considered is in the case of synthetic minerals such as synthetic diamonds. In the case where one uses minerals to construct a necklace or a computer chip it would be absurd to consider that to be the manufacturing of mineral resources.

Despite the *Foskor* decision not providing finality to the question of when mining would end and when manufacturing would commence, it did however catalyse the enactment of section 15A of the *ITA*. Section 15A however does not give a satisfactory answer to the question and it is submitted that the legislator missed an opportunity to put to an end the latter question.[36] It is in this regard that I suggest that the removal of the differentiation between mining companies and manufacturing companies would make the question of when mining ends and when manufacturing commences superfluous.

5.3. Conclusion

After considering the above submissions it is conceivable that South Africa is not receiving a fair share of its mineral resources as it appears that a lot of revenue is lost through over generous provisions and some incentives that are no longer necessary. Moreover there is a need to update the tax provisions as suggested by

[36] *Ibid.*

the IMF to ensure that all definitions and provisions correspond within the mining tax legislation itself and with other mining legislation.[37]

In light of the above, it is safe to conclude that a revision of the mining tax regime is necessary but the state should not be focussed on the tax framework *per se*. A great need for the state to address extraneous circumstances that affect the industry exists and such address would go a long way in improving the performance of the industry and therefore the contribution received by the state from the industry.[38]

[37] See page 32 herein above.
[38] See page 25 herein above.

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