UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

DIFFERENTIATING BETWEEN PROCESSES OF MANUFACTURE AND OTHER PROCESSES WITHIN A BUSINESS FOR PURPOSES OF THE INCOME TAX ACT

Mini dissertation by

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Submitted as partial fulfilment of the requirements for the degree

MAGISTER COMMERCII

in the

FACULTY OF ECONOMIC BUSINESS MANAGEMENT

at the

UNIVERSITY OF PRETORIA

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SEPTEMBER 2008

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AFRIKAANSE OPSOMMING

Besighede het so onlangs as 'n dekade gelede net een produk of een diens gelewer. Dit het die eis van kapitale toelaes ingevolge die Inkomste Belasting Wet (IBW) baie maklik gemaak, want die belasting pligtige was of 'n boer, of 'n vervaardiger of 'n verskaffer van goedere en / of dienste.

Daar is 'n dramatiese verskil tussen die hedendaagse besighede en die besighede van 'n dekade gelede. Die hedendaagse besighede het êrens in die laaste paar jaar 'n metamorfose ondergaan om by die deurentydse veranderde vraag van verbruikers aan te pas. Besighede bied nou meer as een produk of meer as een diens of 'n kombinasie van die twee aan.

Die eis van kapitale toelaes het ook moeiliker geword want die boer is nou ook 'n vervaardiger en 'n verskaffer van produkte. Die vraag wat nou gevra word is op watter kapitale toelaes is die belastingpligtige nou geregtig. Is dit net die boerdery aftrekkings, of mag hy vervaardigings toelaes eis in terme van artikel 12 van die IBW of mag hy alles eis. Indien al die toelaes geeis kan word, hoe kan die belastingpligtige bepaal waar, byvoorbeeld, die boerdery aktiwiteite stop en die vervaardigingsproses begin.

In Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue (1996 (3) SA 942 (AD) at 950I-951B, 58 SATC 229 at 238) het die hof beslis dat die belastingpligtige die reg het om sy sake op die mees belasting doeltreffende manier te bestuur, maar dit is vir die hof om te besluit of die gewenste uitslag behaal is al dan nie. Die uitslag hang af van die feite van die saak (Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste 1978(1) SA 101(A), 39 SATC 163 at 176) of op die toepassing van die wet op die feite (Secretary for Inland Revenue v Hartzenberg 1966(1) SA 405(A), 28 SATC 94 at 99).

Die navorsing het dus gepoog om te differentiëer tussen 'n vervaardigingsproses en enige ander proses teenwoordig in die alledaagse aktiwiteite van 'n besigheid. Daar is gekyk na wat 'n vervaardigingsproses is, waar dit begin en waar dit eindig.

Die IBW bevat nie 'n definisie van 'n "vervaardigingsproses" nie en daarom is daar op hofuitsprake staat gemaak om te bepaal wat 'n "vervaardingingsproses" is, waar dit begin en eindig en wat bedoel word met die term "gebruik direk in die proses van vervaardiging".

Die slotsom wat bereik is, is dat as menslike insette en arbeid tesame met masjinerie, gespesialiseerd of nie, gebruik word om 'n produk te vervaardig en die eindproduk verskil van die oorspronklike produk in kleur of tekstuur of gebruik of vorm of chemiese samestelling, dan kan daar gesê word dat 'n vervaardigingsproses teenwoordig is.

Om te bepaal of 'n item direk in die proses van vervaardiging gebruik is, moet daar eers bepaal word waar die proses begin.

In meeste gevalle is die beginpunt van die proses, daar waar die oorspronklike produk begin verander in die eindproduk. Waar die hele proses masjien aangedrewe is, en al die masjiene in die proses vorm 'n geheel, dan begin die proses by die eerste masjien en nie waar die vorm van die produk begin verander nie.

As die eindproduk dramaties van die beginproduk verskil, dan kan gesê word dat die proses geëindig het.

As daar meer as een proses in 'n besigheid se daaglikse aktiwiteite teenwoordig is, sal die bestuur van die besigheid moet bepaal, deur na die feite van die saak te kyk, of daar 'n vervaardigingsproses teenwoordig is al dan nie, en of hulle geregtig is op belastingtoelaes wat direk met 'n vervaardigingsproses te make het.

Sou daar 'n vervaardigingsproses teenwoordig wees, sal daar doodseker gemaak moet word wat met geboue, masjinerie en aanleg bedoel word om sodoende die korrekte toelaes te eis.

Om binne 'n besigheidsopset te kan differentiëer tussen 'n vervaardigingsproses en enige ander proses, sal daar aan elke saak, gebaseer op sy eie spesifieke feite, meriete toegeken moet word, gemeet aan die voorgestelde kriteria wat die howe ons bied.

INTRODUCTION

Background to the research

A decade ago a business used to perform one service, or supply one specific product. For example, a farmer used to grow peaches. After harvesting the peaches, he would sell his produce to an agent that would sort, grade and package the produce. The "packaged produce" would then be sold to either the end user or to a third party (manufacturer) that would put the produce through a preserving process so that jams, spreads and preserves can be sold to the end user. There would thus be at least 3 parties involved in providing a single product.

In terms of the Income Tax Act (ITA) the farmer would claim capital allowances on the farming equipment, the agent would be able to claim capital allowances on the buildings where the sorting and packaging happened and the manufacturer would be able to claim capital allowances on the machinery used in the preserving process (manufacturing) as well as on the buildings in which the machinery was located.

In our current business environment, businesses have evolved to provide more than one service or more than one type of product or a combination of services and products. For example the farmer mentioned above will not only grow produce, but he will sort, grade and package some of the produce himself so that he can sell the produce in his own farm stall or directly to a retailer. The farmer might also be in a position to put the produce through a preservation process himself, to also sell directly. The farmer has therefore evolved from being just a farmer that grows fruit, to a farmer that grows fruit, manufactures preserves and spreads and sells his produce and by-products to the end user.

The farmer might now be seen as a manufacturer. The allowances and deductions available to farmers might now not be available to the taxpayer. If the taxpayer can claim both farming allowances as well as manufacturing allowances, how will he be able to determine where the farming activities stop and the manufacturing begin?

In *Erf 3183/1 Ladysmith (Pty) Ltd and Another v Commissioner for Inland Revenue* (1996 (3) SA 942 (AD) at 950I-951B, 58 SATC 229 at 238) the court held that even though it is the right of the taxpayer to arrange his affairs in the most tax efficient manner, it is for the court to decide whether this has been achieved. The outcome may depend entirely on the facts (*Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste* 1978(1) SA 101(A), 39 SATC 163 at 176) or on the application of the law to the facts (*Secretary for Inland Revenue v Hartzenberg* 1966(1) SA 405(A), 28 SATC 94 at 99).

The research object

The research tends to explore the difference between a process of manufacture and other processes within businesses as pertains to the ITA. The process of farming, transport or construction must be distinguished from manufacturing for the purposes of the Income Tax Act (*National Co-operative diaries Ltd v CIR* 1992 (1) SA 694 A, 54 SATC1; *Formscaff Investments (Pty) Ltd v CIR* 1993 (4) SA 76 (T), 55 SATC 251) to give effect to the intention of the legislature and the specific provisions of the ITA in that specific context (*COT v Processing Enterprises (Pvt) Ltd* 1975 (2) SA 213 (RAD), 37 SATC 109 at 111).

According to the rule of interpretation of statutes words of the statute must be interpreted in the ordinary, literal grammatical meaning (*President Insurance Co Ltd v Yu Kwam* 1963 (3) SA 766 (A) at 779; *Volschenk v Volschenk* 1946 TPD 486 at 487)

"Process" is defined in the Shorter Oxford Dictionary as:

> *"a continuous and regular action or succession of actions taking place or carried on in a defined manner; or*
> *A continuous operation or series of operations; or*
> *a particular method of operation in any manufacture"*

"Manufactured" is defined in the Merriam Webster Dictionary as:

> *"something made from raw materials by hand or by machinery; or the act or process of producing something"*

The taxpayer does not even have to be engaged in the production of the final product to be engaged in the process of manufacturing and the final product would constitute anything that is of use to someone (*SIR v Hersamer (Pty) Ltd* 29 SATC 53 at 59)

Accordingly, the research will therefore try to differentiate between a process of manufacture and any other process by establishing what a process of manufacturing is, where manufacturing starts and where it ends. The research will also establish what allowances are available to the taxpayer regarding a manufacturing process as well as any other process.

The research methodology

The research methodology is to determine whether any or several or all of the processes within a business are processes of manufacture. How to distinguish between a process of manufacture and any other process and which capital allowances are available to the taxpayer regarding the different processes.

The "process of manufacture" is subject to the ITA as pertains to capital allowances available to the taxpayer and to the interpretation principles laid down by the South African as well as foreign courts as the ITA does not contain a definite definition of "process of manufacture".

Section 39(1) of the Constitution of the Republic of South Africa 1996 states that a court, tribunal or forum must consider international law and may consider foreign law.

In *Trustbank van Afrika v Eksteen* 1964 (3) SA 402 the court held however that principles laid down by foreign courts can and should be considered, but it should be used as a guideline and not as the deciding factor.

PROCESS OF MANUFACTURING

Introduction

On a few occasions the ITA refers to a "process of manufacture". Section 12C for example grants an allowance to a manufacturer when he uses plant or machinery which he has brought into use for the first time, for purposes of his trade, and is used directly in a process of manufacture.

Where the ITA "fails" us, is that it does not provide a clear cut definition of what constitutes a "process of manufacture".

> *"The concept 'process of manufacture' is not defined in the Act. The words and the phrase should therefore be interpreted according to their ordinary meaning."* (ITC 1479 (1989) 52 SATC 264 at 271)

Determining what a process of manufacture is

"Process" is defined in the Shorter Oxford Dictionary as:

> *"a continuous and regular action or succession of actions taking place or carried on in a definite manner; or*
> *a continuous operation or series of operations; or*
> *a particular method of operation in any manufacture"*

"Manufactured" is defined in the Merriam Webster Dictionary as:

> *"something made from raw materials by hand or by machinery; or*
> *the act or process of producing something"*

If we only take the above mentioned definitions into account, then almost every process that we come across in our daily lives can be classified as a "process of manufacture".

For example, a farmer that plants a seed (raw material) nurtures the seed through fertilisation and watering (particular method of operation) and produces a fruit (act of producing something) is involved in a process of manufacture. The same can be said for an accountant that receives a box of receipts and invoices (raw material), inputs the data into a computer (continuous operation done in a particular manner) and produces financial statements (process of producing something).

The question now is whether the farmer is farming or manufacturing. Is the accountant merely reflecting the receipts and invoices in a different manner or is he "producing / manufacturing" financial statements?

To stop the confusion, the courts have come up with certain interpretations over the years of what they think a process of manufacture should be defined as.

In *SIR v Safranmark (Pty) Ltd* 1982 (1) SA 113 (a), 43 SATC 235 at 240 Corbett JA summarises the term "process of manufacture" as:

1. Denotes an action or series of actions directed to the production of an object or thing which is essentially different from the materials or components which went into its making
2. The requirement of "essential difference" necessarily imports an element of degree; and there are no fixed criteria – nor is there any precise universal test – whereby it can be determined whether or not a change in the materials or components wrought by the process, be it as to the nature, form, shape or utility of the materials or components, has brought about an essential difference. This must be decided on the individual facts of each case.
3. When deciding whether a particular activity does or does not fall within the ambit of a "process of manufacture" the ordinary, natural meaning of that phrase in the English language must not be lost sight of, and in this connection analogies can be misleading. Thus to analyse and extract, from a process or operation which indubitably amounts to a process of manufacture, general criteria or attributes and to conclude that another

> process, to which the same general criteria apply or which exhibits similar general attributes is, therefore, also a process of manufacture may lead to results not intended by the legislature, particularly where it would be inaccurate or unrealistic in normal parlance to describe the latter process as a process of manufacture.

The requirement of "essential difference" between what is manufactured and from what it is manufactured has thus been heralded as the critical distinction (43 SATC 235; 29 SATC 53).

The man on the street will regard an "essential difference" as a difference that you can see or feel, whether it be colour, shape, texture or a combination.

In *MP Metals (Pty) Ltd v FCT* 117 CLR 631 at 638, 41 ALJR 297 the court interpreted "essential difference" as a difference in shape or colour or chemical composition or any other quality that makes it different.

In *COT v Processing Enterprises (Pty) Ltd* 1975 (2) SA 213 (RAD), 37 SATC 109 the court held:

> *"there need be no change in the actual substance of the raw material before the process of dealing with it is regarded as a manufacturing process provided skill has been applied in some way to that raw material and to such dealing, and its actual character, as opposed to its mere substance, is changed. Its physical substance may remain the same, but the process of handling may none the less be regarded as a manufacturing process if the raw material has been cleaned and broken up into its components."*

The above principle was also confirmed in *CIR v Stellenbosch Farmer's Winery Ltd* 1989 (4) SA 772 (C), 51 SATC 81 at 88 where the court held that raw wine purchased and purified into a refined marketable wine constitutes a process of manufacture.

Young J held in *ES & A Robinson (Rhodesia) (Pvt) Ltd v McIntyre*, 24 SATC 767 that the

wrapping paper which is converted into counter reels, constitutes the manufacture of wrappers used for packing goods.

In the well known Australian case of *McNicol v Pinch* (1906) 2 KB 352 Ridley J observed at 363

> *"To say that a person does not 'manufacture' a thing because it has the same name after the process has been passed upon it as it had before seems to me – but I suppose I am wrong – to be simply a question of words."*

In another Australian case (*Ready Mixed Concrete (W.A) Pty Ltd v FCT* (1971) 71 ATC 4107) the court held that aggregates or quantities of small pieces of stone formed by the breaking of large stones constituted manufactured goods. At 4109 Windemeyer J said

> *"The first question then is, is the crushing of large pieces of stone to make aggregates an operation by means of which manufactured goods is derived from other goods? When propounded, the answer might at first seem to be in the negative, as the Commissioner thought it was. I have, however, come to the conclusion that aggregate is, in a relevant sense, a new and different thing from blocks of stone. It is all very well to say that it is still stone and only in small pieces instead of in big pieces. That, I think, is too facile a solution of the problem."*

In *FCT v Hammersly Iron (Pty) Ltd* 80 ATC 4509 at 4519 the Australian court discussed whether stockpiling of iron ore and then "blending" the ore could be considered as the "treatment" of such soil (thus manufacturing) as opposed to the mere storage thereof. The court held that the subjection of something to an action or agent to effect a change in form, nature or condition with a realistic purpose constituted a "treatment" as envisaged in that definition of "aids to manufacture".

In ITC 1449 (1988) 51 SATC 65 (T) the court however held that even if the final product is essentially different from the starting product, not every difference brought about constitutes a

process of manufacture. The importance and the nature of the transformation of the product, from the raw material to the final product, and the final usefulness of the product has to be considered in each case.

In *SIR v Hersamer (Pty) Ltd* 29 SATC 53 at 58 the Appeal Court lists the following characteristics of a "process of manufacture" even though not all need to apply:

- Has physical or mechanical power been applied in making the article?
- Has material been worked up in a form suitable for use?
- Has the raw materials undergone a change of character or have they become something different to what they were?
- Has the material become substantially or essentially different?
- Has skill and experience been used in producing the article?
- Is expensive machinery used to produce the article?

A similar list was compiled in Safranmark case supra:

- that plant and machinery are used and which in some respects are specialised;
- that the method of using the plant and machinery is standardised;
- that human effort and labour are used;
- that the volume of production is based on anticipated demand;
- that the volume of the production is large;
- that the end product is different from the materials from which it is produced not only in nature but also in utility and value in that the ingredients of the milk and egg mixture and of the breading mixture have ceased to exist and the inedible raw chicken has become an edible product;
- that all of the above was done for Safranmark's trade."

Case law thus also supports, as one of the characteristics of manufacture, that the product's saleability is endowed or increased after the process (*CIR v Stellenbosch Farmers' Winery Ltd* 1989 (4) SA 772 (C), 51 SATC 81; *SIR v Safranmark (Pty) Ltd* 1982 (1) SA 113 (a), 43 SATC 235; *SIR v Hersamer (Pty) Ltd* 29 SATC 53; *FCT v Hammersly Iron (Pty) Ltd* 80 ATC 4509)

In Safranmark case supra at 248 the court held that if a standardised product is produced on a large scale by a continuous process utilising human effort and specialised equipment in an organised manner and to that is added the factor that the end product is, in terms of its nature, utility and value, essentially different from its main component, the process must be described as one of "manufacture".

In *FCT v Hammersly Iron (Pty) Ltd* 80 ATC 4509 the court approves the legal concept of other courts that the product which must be essentially different is the end product, which may be a collection of products packaged (Dictums approved of Samuel McCausland v Ministry of Commerce 1956 NI 36 at 40 and Henry Bull & Co Ltd v Holden 1912 12 CLR 569 at 573).

The courts in that instance dealing with when a taxpayer is manufacturing goods distinguished between goods which as final product are commercially sold in bulk such as seed and thus the bulk item and not the single seed is the final product and finished items which are for transport or sale bulked together.

The latter was held not to constitute the final product and thus did not form part of the process of manufacturing.

In *Queen Slide Fasteners of SA (Pty) Ltd v Commissioner of Customs* 19 SATC 73 it was held by the court that there has to be distinguished between operations of manufacture and operations of assembly.

At 78 the learned judge said:

> *"The manufacture of a commodity usually connotes operations which involve a change of the character of the raw materials. Linen cloth is manufactured from linen thread. Furniture is manufactured from timber. Motor-cars are manufactured from steel. There is, in all these cases, a very great change in the character of the raw materials. They become something different from what they were. When, however, the separate parts that combined together in a certain way make a motor-car, each part being a finished article of its own kind, are imported and assembled into a car – the necessary operations to produce this result are not operations of manufacture, but of assembly and each of the separate parts is an integral part of the car. This applies in my opinion to lengths of rubber radiator piping which have to be cut into shorter lengths for use. The mere fact that in assembling separate parts of an article in order to produce the finished product, some slight adjustment or alteration of some of those parts may be necessary, does not change the general character of the operations from assembly to manufacture."*

The above is confirmed by the observation of Phillimore J in *Gamble v Jordan,* (1913) 3 K.B. 149 at 152

> *"A man who picks to pieces a manufactured article and puts it together again does not make it…….I desire to confine myself to the case where a man takes flock out of a mattress and then simply replaces it without any addition whatever. If he were to add anything it would be quite another matter. But the mere act of removing the contents of a mattress and then replacing them is not making or manufacturing a mattress.*

From the above cases it can be seen that the assembly of manufactured parts still stay an assembly process and can not be said to be part of the manufacturing process.

Conclusion

In conclusion, taking into account all of the interpretations by the courts, it can be said that a "process of manufacture" is when human effort and labour is used with or without machinery,

be it specialised or not, to produce a product that is different in nature or shape or colour or form or chemical composition or has a different use than the product with which the process was started, but excludes the assembly of manufactured products

The above is made clear in the observation of J Darling in McNicol v Pinch (1906) 2 KB 352 at 361

> *"the essence of making or manufacturing is that what is made shall be a different thing from that out of which it is made".*

COMMENCEMENT AND END OF THE MANUFACTURING PROCESS

Introduction

Sections 12C and 12E(1) of the ITA provide allowances to the taxpayer if the plant and / or machinery of the taxpayer was used directly in a process of manufacturing.

A "process of manufacture" is in short, when the end product is essentially different from the starting product (raw material). What needs to be determined is when the process starts and ends and when can it be said that a machine or plant is used directly in the process of manufacture.

Commencement of manufacturing

In *SIR v Cape Lime Company Ltd* 1967 (4) SA 226 (A), 29 SATC 131 the taxpayer manufactured lime from raw materials which it quarried. As the plant where the actual lime was produced, was some distance away from where it was quarried, the court had to decide where the process of manufacture started. Was it at the quarry site, where the rock was blasted and reduced to manageable size for conveyance to the plant or was it at the plant itself where it was reduced in size even further before being fed into the kilns.

The court held that the blasting of the rock at the quarry site constituted the beginning of the manufacturing process (in that instance the dumping of the lime rock into crushers formed part of the process of manufacture).

In ITC 1591 57 SATC 212 at 221 it was similarly held that the processing of cattle at an abattoir started when the cattle arrived at the abattoir.

In the English case of *Lord Advocate v Reliant Tool Co* (1968) 1All ER 162 the court had to decide whether the designing of metal-working machine tools formed an integral part of the manufacturing of the said tools and therefore the designing of the tools could be seen as the

commencement of the manufacturing process.

It was held that each tool was made with a specific purpose in mind and without the specific design of each tool the tool could not be made for the specific use intended. Therefore, the court found that the designing of the specific tools formed an integral part of the manufacturing process and hence the designing can be regarded as the start of the manufacturing process.

The learned judge went further to say that if the designing and manufacturing took place in the same establishment and the designing was seen to be part of the manufacturing process, then the designing of the tool would form part of the process even if it was done in a different establishment.

In ITC 1114 30 SATC 14 Miller J referred to the Cape Lime case and said at 20

> *"Where it is necessary to decide at what stage the process of manufacture commences in an operation in which several objects are employed, the modus operandi and the degree of interdependence of the several objects will be important factors. It does not always follow that the process only commences at the stage when the raw material begins to be altered to the shape or form which it is ultimately to assume, although in the majority of cases this may be the true commencement of the process of manufacture. The process may commence at an earlier stage than that where, for example, several pieces of machinery, each connected with the other and all together forming an integrated whole, are used for the processing of the raw materials, it may truly be said in such case that the process commences at the first machine, although it is only at a later stage that the raw material begins to undergo a change."*

The preparation of the raw material (*Norton Harvesters (Pty) Ltd v FCT* 74 ATC 4080 approved on appeal in 74 ATC 4380) or obtaining of the raw material (Cape Lime case supra) does however not form part of the manufacturing process.

The above is supported in the Australian case of *Moreton Central Sugar Mill Co Ltd v FCT* (1964) 116 CLR 151 where Kitto J said

> *"No operation is within the neutral meaning of the words unless it occurs as a step in the actual derivation of the manufactured goods from the 'other goods' – as a step, that is to say, in the procedure which begins when the 'other goods' are put into the process of manufacture. The concept is a comparatively narrow one. It is true, as high authority lays down, that in order to derive a product from raw materials you must 'first catch your hare'. But hunting, even by the cook, is no part of the operations by means of which jugged hare is derived from hare. To go and get your raw materials is one thing; to derive the desired end product from them is another. Accordingly in my opinion it is only after the sugar cane has been brought to the mill that the appellant can be said to commence the operations by which it derives sugar from the cane."*

In direct contrast to the above, the learned judge said in ITC 1247 (1975) 38 SATC 27 at 34

> *"the process by which various ingredients are mixed and blended to form a suitable compound cannot be said to commence only when the ingredients have actually been fed into the mixing plant. The process of making the compound is carried out, usually, at or near the site of operations; some of the ingredients for blending and mixing have to be selected from the mass of material taken from the ground in the course of the appellant's general operations. There must, by the very nature of the operation, be constant availability in situ of the several ingredients for purposes of adding to the mixture one ingredient or another, in the very course of the mixing operation, in order to achieve the desired proportions and cohesion. In my view, the process as such commences with the selection of the necessary materials and therefore includes the transportation of such materials to the plant where mixing occurs"*

Used directly in the process of manufacturing

In ITC 1061, 26 SATC 317 it was held that the word "directly" means that there was no intervention between the process of manufacture and the plant and machinery used and in

ITC 1445 (1988) 51 SATC 40 (T) the learned judge went further by saying:

> *"The direct use must constitute, if not the sole use, at least the primary or dominant use of the plant or machinery."*

In *SIR v Cape Lime Company Ltd* 1967 (4) SA 226 (A), 29 SATC 131 at 143 it was held that once the process commenced the movement of one piece of plant to the next piece of plant and any plant or machinery used to effect such movement formed part of the process of manufacture and can thus be regarded as being directly part of the process of manufacture.

As the process of manufacture in the above case started at the quarry site where the rock was quarried, the court held that the trucks acquired for the conveyance of the rock from the quarry site to the actual plant was directly involved in the process of manufacture.

This principle was confirmed in ITC 1247 (1975) 38 SATC 27 where the court held that the process of manufacture started with the selection of the specific materials to be used and therefore the transportation of these specific materials was regarded to be directly part of the process of manufacture. It was, however, held that the excavation of the raw materials was not part of the manufacturing process, but part of the taxpayer's general operations.

> *"I do not accept that, because some of the materials extracted from the ground by means of the appellant's general operations are used in the process of manufacturing the mixture, the heavy machinery used for ripping up or excavating ground etc. is machinery used in the process of manufacture of the mixture. The overwhelmingly predominant use of such heavy machinery is for the purposes of and in connection with the road-building and other operations themselves and only to a minute extent contributory to the availability of materials for making the mixture of other substances or articles. Moreover, even to the minute extent of the use of such heavy machinery in relation to the manufacturing process, such use would be preparatory to, rather than part of, the process of manufacture of the mixture required for putting down layers for the foundations and surface of the roads or other structures"*

Depending on the facts of the case, it seems that the courts do not regard the preparation of the raw material as part of the manufacturing process (*Norton Harvesters (Pty) Ltd v FCT* 74 ATC 4080 approved on appeal in 74 ATC 4380), but in some cases the selection of specific materials are regarded as being directly involved in the process of manufacture (ITC 1247 (1975) 38 SATC 27).

There seems to be a disagreement about whether the transportation of raw materials can be seen as part of the manufacturing process or not. It would appear that the facts of each case are the deciding factor.

In *SIR v Cape Lime Company Ltd* 1967 (4) SA 226 (A), 29 SATC 131) and ITC 1247 (1975) 38 SATC 27 the vehicles used to transport the raw materials from one point to another were regarded as being directly involved in the process of manufacture, where in the case of *Moreton Central Sugar Mill Co Ltd v FCT* (1964) 116 CLR 151, the transportation of the raw materials was not regarded as being part of the manufacturing process.

The taxpayer in the last mentioned case was a sugar mill proprietor, who purchased a locomotive and trucks for the carriage of sugar cane from points at or near the field where the growers delivered the cane, to the mill. The locomotive and trucks were used on tramlines that were constructed and operated by the taxpayer. The taxpayer held that since the locomotive and trucks were used directly in the process of manufacture, he was entitled to a deduction of the purchase price.

The court held that the process of manufacture only started at the mill and therefore the locomotive and trucks were used to carriage the "raw materials" to the start of the manufacturing process, but was not part of the process themselves.

In *Carfax Waste Paper Co Ltd v Minister of Labour* (1968) 1 WLR 1166 Lord Parker CJ agrees with the Moreton Sugar case by saying at 1170

"Prima facie anything that takes place before by way of obtaining the raw material, is

something preliminary to or ancillary to the process of manufacture and is not part of it."

In direct contrast to the above the court held in *CIR v Stellenbosch Farmers Winery Ltd* (1988) CPD 51 SATC 81 that as the raw wine was aged at the supplier under the supervision of Stellenbosch Farmers Winery, the process of manufacture started at the suppliers' tanks. Therefore the tankers used to transport the raw wine from the farms that supplied Stellenbosch Farmers Winery were used directly in the process of manufacture.

In ITC 1421 (1986) 49 SATC 78 the court had to decide whether communication radios were used directly in the manufacturing process.

The taxpayer in the above case owned factories were a sawmill business was conducted. Products of timber were manufactured at the factories and the timber, being the raw material, was obtained from forests and plantations which were more often than not situated in remote areas.

The vehicles, used to transport the timbers from the plantations to the factories, had on several occasions broken down and subsequently the taxpayer installed communication radios in each vehicle so that help could be sent to the stranded vehicles as soon as possible.

The court held that the transportation of the timbers from the forests or plantations was part of the manufacturing process but that the radios were merely a medium of communication and that they were not directly involved in the transportation of the timbers. The judge did however feel that the communication radios were indirectly involved in the process of manufacture as they assisted in the transportation of the timbers in the sense that they are a means by which delays as a result of broken vehicles or wrong directions are minimised.

End of the manufacturing process

The "end of the manufacturing process" has not received as much attention by the courts as

the "commencement of the process". The man on the street assumes that a process has ended once the final product is made, but the term "end product" can have different meanings for different people.

In *FCT v Hammersly Iron (Pty) Ltd* 80 ATC 4509 the court approves the legal concept of other courts that the product, which must be essentially different, is the end product, which may be a collection of products packaged (Dictums approved of Samuel McCausland v Ministry of Commerce 1956 NI 36 at 40 and Henry Bull & Co Ltd v Holden 1912 12 CLR 569 at 573).

It was also held in *SIR v Hersamer (Pty) Ltd* 29 SATC 53 at 59 that the taxpayer does not have to be engaged in the production of the final product to be engaged in the process of manufacture and similarly a finished product would constitute anything which is of use to someone.

The above was also confirmed in ITC 1449 (1988) 51 SATC 65(T) were the learned judge said at 65:

> *"One may be a manufacturer even though that which is manufactured is not the final, finished end-product. The various processes involved in the manufacture of the final product, each of which is a link in the chain of manufacture, constitutes a process of manufacture."*
>
> *"A manufacturing process need not necessarily produce the end product provided it is an essential stage in the final production of that end product, or an important stage in the final production of that end product."* (*COT v Processing Enterprises (Pvt) Ltd* 1975 (2) SA 213 (RAD), 37 SATC 109

In the Stellenbosch Farmers Winery case supra the farmers that supplied the Stellenbosch Farmers winery with raw wine, was not part of the manufacturing of the purified wine (final product), but they were nonetheless part of the manufacturing process.

The process of manufacturing car batteries ends when the battery is ready to be sold, but the battery forms a vital part in the manufacturing of an engine for a motor vehicle.

Conclusion

It is clear from ITC 1114 30 SATC 14 that the process of manufacture does not always commence when the raw materials begin to alter to the shape or form that it is suppose to become. The process can begin earlier if the different machines used in the process form a whole.

When or where a process of manufacture starts and whether the transport of the raw materials are part of the manufacturing process or not, it will seem, depends entirely on the facts of the case.
It would also seem that to determine whether an item was used directly in the process of manufacture depends on when the process of manufacture commences.

In my opinion if the plant or machinery or transport equipment is an integral part of the process after commencement (which means that without the operation the manufacturing process can not proceed) then it can be said that the plant or machinery or transport equipment is directly involved in the process of manufacture.

The process of manufacture will end when a product can be produced that is essentially different from the materials used to produce it. It can be different in shape, form, size, chemical compound or any other quality that the man on the street will regard as being different.

The end product does not necessarily have to be the ultimate final product but it has to be a product that is of use to someone.

PROCESS OF MANUFACTURE V OTHER PROCESSES

Introduction

The process of farming, transport or construction must be distinguished from manufacturing for the purposes of the ITA (*National Co-operative Dairies Ltd v CIR* 1992 (1) SA 694 (A), 54 SATC 1; *Formscaff Investments (Pty) Ltd v CIR* 1993 (4) SA 76 (T), 55 SATC 251).

In order to be able to differentiate between the different processes within a business, one has to look at the whole process and then decide which portion can be seen as manufacturing and which portion is a process other than manufacturing.

In this chapter everyday examples of processes within different industries will be taken and dissected to determine whether a process of manufacture is present or not.

Differentiating between a process of manufacture and other processes

Motor car manufacturing

The basic man on the street knows that the process used to make a motor car is one of manufacture and the process ends when the car is driven of the floor. What the man on the street is not aware of is that the whole process consists of smaller processes of which only a few are manufacturing in nature.

In a very simplistic way, the manufacture of a motor car can be explained as follows:

1. Sheet metal, paint, rubber and plastic granules (the raw materials) are obtained.
2. The sheet metal is cut into the different shapes and doors, a roof, a bonnet, side panels etc. are made.
3. At the same time, the rubber is cut into the different lengths needed in the interior of the car as well as in the engine.
4. The plastic granules are melted and moulded into the correct shapes for use inside and outside of the car (e.g. air conditioning fans, bumpers etc.).

5. The products of (2) above are spray painted into different colours.
6. Leather and / or material is cut and stitched to form the seats of the car.
7. All the different parts are assembled to form the final product which is the motor car as we know it.

In today's business environment the manufacturing of for example the bumper of the motor vehicle, the dashboard and the seats are made by different entities. The final product being the bumper, dashboard and seats are sent to the ultimate manufacturer where all of the parts are assembled.

Most, if not all of the courts held that the most important characteristic of a process of manufacture is that the end product must be essentially different from the starting product.

Keeping the "essential difference" characteristic in mind, it can be said that the obtaining of the raw materials is not part of the manufacturing process.

> *"To go and get your raw materials is one thing; to derive the desired end product from them is another."* (*Moreton Central Sugar Mill Co Ltd v FCT* (1964) 116 CLR 151)

It can however be said that the process of producing the different parts of the car (doors, side panels etc.) from the sheet metal as well as the melting and moulding of the plastic granules into different parts, are processes of manufacture as the "raw products" are very different from the starting products.

In my opinion the cutting of the material or leather for the interior of the car, as well as the cutting of the rubber into different lengths does not constitute a process of manufacture, and in *Gamble v Jordan,* (1913) 3 K.B. 149 at 152 it was held that the assembly of different parts to make the final product is still an assembly process and not one of manufacture.

It can therefore be seen that if the car making process is dissected, only 2 steps in the process are manufacturing in nature, but if looked at the process as a whole there is 3 distinct

processes namely the obtaining of the "raw materials", the manufacture of the different parts of the motor car by the same or different entities, and the assembly of the parts to form the final product as we know it.

Oven bake potato chips

In every supermarket, "oven bake chips" are available from a variety of manufacturers e.g. McCains and Harvestime. What the everyday consumer does not know is that the making of this product is not just the mere peeling and cutting of the potatoes, but involves a variety of intricate processes on a large scale.

The process cab be described in a very basic manner, as follows:

1. Potatoes are either grown for the purpose of making potato chips or are bought. Either way, the potatoes are obtained and taken to the potato plant.
2. The potatoes are dumped into a water management system which washes the potatoes and serves as transport for the potatoes through the initial processes.
3. The potatoes are steam peeled and then transferred to conveyor belts where they are subjected to quality control tests.
4. If the potatoes pass the quality control tests, they are transported in hot water (which softens the potatoes) to the cutting machines.
5. The sliced potatoes are again subjected to a quality control process where they are scrutinised for imperfections and sorted accordingly.
6. Imperfections are mechanically removed.
7. The sliced potatoes are fried, subjected yet again to a quality control test and then frozen for packaging and dispatch.

Looking at the process as explained, it will be noted that the starting product and the end product is still a potato or part of a potato. However, a standardised potato product is produced on a large scale, using a continuous process, utilising human effort and specialised equipment in a controlled and organised manner. The potato chips (end product) are also essentially different in nature and value than the original potatoes.

> *"To say that a person does not 'manufacture' a thing because it has the same name after the process has been passed upon it as it had before seems to me – but I suppose I am wrong – to be simply a question of words."* (*McNicol v Pinch* (1906) 2 KB 352 at 363)

The process as explained is thus one of manufacture and starts when the potatoes are dumped into the water management system and ends when the packaged product has been produced.

Building of roads

The operations involved in the construction of a road will be very broadly and briefly described.

1. The first stage is the clearing and levelling of the site, for which purpose many heavy machines are used.
2. After the site has been cleared, the earth needs to be compacted in layers in order to achieve the required density.
3. Thereafter a layer consisting of a blend of coarse and fine stone is laid to which water is added by means of a mobile sprinkler-tank.
4. In due course a bituminous primer is laid, over which the final surface of pre-mixed asphalt is ultimately laid. The finishing layer is suitably compacted by use of a machine which serves as a roller.

The bare ground which is the "raw material" in the above process has, in the eyes of the man on the street deed, undergone a change in nature, shape and utility and I am very tempted to conclude that the process of laying a road is a process of manufacture.

However, the only change to the ground is that it was cleared and compacted. The characteristic of "essential change" is therefore not present. The ground was in essence only "prepared" to receive the road that was laid upon it. The surface of the ground has altered, but was not essentially transformed.

"In its ordinary usage the verb 'manufacture' is not used to describe productive and constructional activities resulting in new roads, bridges, dams, houses, playing-fields, airfield runways, or the preparation of a site for building. ...To call these activities a process of manufacture, is to wrest the word 'manufacture' from its ordinary and plain meaning..." (ITC 1101 (1966) 29 SATC 32(R) at 27).

"But I have difficulty in accepting that a process whereby something is laid or constructed upon or affixed to or embedded in the earth, is in itself, from beginning to end, a process of manufacture within the ordinary meaning of that phrase. The object or thing or substance so constructed upon or affixed to the earth might or might not have come into existence as a result of a process of manufacture but it does not appear to me that the preparation of the earth to receive such object or thing, or the performance of the actions required to lay down the substance or thing or to affix it to the earth, constitutes a process of manufacture." (ITC 1247 (1975) 38 SATC 27(N) at 32).

Taking the above 2 quotations into account, the laying of a road can not be seen as a process of manufacture as the "raw material" being the ground has in essence not undergone an essential change.

Potato tubers (seed potato)

Potatoes can be grown from seed or tubers. Potato seeds are planted to produce tubers for planting purposes. Tubers are also planted by farmers to cultivate more tubers.

Some farmers prefer to buy tubers instead of seed. The farmers also want the tubers that they buy to sprout at the same time. Therefore, an industry came to life where tubers are grown and treated to comply with the demand of the farmers.

Sprouting enhances the successful growth of the potato plant from the tuber and also reduces the period to harvest the crop. Planting the tubers before sprouting materially reduces the success rate of the tubers growing.

At the tuber plants, tubers that have usually not sprouted yet and may be in different stages of developing sprouts are treated with an anti bacterial chemical to ensure that any damage to the potatoes does not lead to rotting.
The potatoes are then put into cold storage for 7 to 8 months to put them in a stage of dormancy

The above is done to ensure the future sprouting process occurs simultaneously for all the tubers which would also enhance the characteristics of the tubers for the farmer as the crop will mature within the same time period, thus lessening the time for harvesting.

The process also enhances the chemical composition of the tuber to facilitate growing.

Once the potatoes are all dormant, they are crated and put in a sprouting plant whereby the temperature and humidity is controlled to ensure that sprouting occurs in a controlled manner.

Once the sprouting process is complete, the sprouted tubers are sold to farmers.
Even though a standardised sprouted tuber is produced on a large scale utilising human effort and specialised equipment in a continuous and controlled manner, the potato tuber still is a potato tuber after the whole process has been conducted.

The question now is whether there is an essential difference between the tuber before it was put through the process and the tuber after it was put through the process.

The answer to that will have to be "yes" as the seed tuber is different in nature (grows easier, quicker and in a more controlled manner) and value to the sprouted tuber.

Furthermore, by subjecting the seed tuber to the process the saleability of the "finished product" to the farmers has increased as the consumer purchases a product which it can grow on a more economical manner as opposed to the mere unsprouted tuber seed.

I am of the opinion that the final product does not have to be the end result of a single process as the courts have stated that each process is complete if a product of use is the end result.

Data capturing and processing

Most everybody captures and processes data on a daily basis, but in some cases people have actually made it there business to do so.
A typical data capturing and processing business will operate as follows:

1. The clients deliver their working papers, which are usually handwritten documents to be captured and processed.
2. The data is captured on computers using specific software and manipulated into the required format.
3. Finally, the information will be printed on blank paper.

Looking at the very simplistic explanation of the process above, one has to consider whether the end product is essentially different from the starting product and / or whether a standardised product is being produced on a large scale.

The "raw materials" are handwritten documents and the final product is printed documents, to which no additional information or data has been added.

The original data has thus just been reflected in a different manner and therefore it is clear that there is not a manufacturing process present.

Another point of view is that the final product is printed onto paper, which used to be blank. The blank paper, which has no value to the clients, is bought in bulk and rendered into printed documents which have a distinct value to the clients.

To say that a manufacturing process is present will be a gross mistake as data is supplied, manipulated by a computer and printed onto paper. Nothing is manufactured in the true sense

of the word and in my opinion there is not an essential difference between the starting handwritten document and the final printed document.

CAPITAL ALLOWANCES

Introduction

In order to claim any capital allowance, the taxpayer has to ensure that he is 100% certain as to what constitutes plant, machinery and buildings. The taxpayer will also have to confirm which of the above mentioned, forms part of the manufacturing process or a process similar to a manufacturing process.

Processes similar to a manufacturing process

The sections in the ITA dealing with the allowances regarding manufacturing processes state that an allowance may also be claimed if the process is one that is similar to a process of manufacture.

The Commissioner of the South Africa Revenue Services is the person that decides whether a process is one of manufacture or a similar process.

Practice Note 42, issued on the 27th of November 1995 lists processes which the Commissioner consider to be processes of manufacture as well as processes that are similar to manufacturing. The practice note also lists processes which in the opinion of the Commissioner is neither manufacturing nor similar to manufacturing in nature.

Processes similar to a manufacturing process are for example dry cleaning, shoe-repairing and panel-beating.

Buildings

The Collins Essential English Dictionary defines a building as inter alia *a structure with a roof and walls.*

The above definition is confirmed in *CIR v Le Sueur* 1960 (2) SA 709 (A), 23 SATC 261, where Botha AJA held:

> *"I think it is correct to say generally that a building is a substantial structure, more or less of a permanent nature, consisting of walls, a roof and the necessary appurtenances thereto."*

Section 13 of the ITA contains most of the building allowances available to a taxpayer. However, one has to distinguish between a building that is part of the manufacturing process and any other building.

Buildings that are part of the manufacturing process

For a building or improvements to a building, to qualify as a building for purposes of section 13 of the ITA the building needs to be:

- Erected or purchased by the taxpayer
- *Wholly* or *mainly* used by the taxpayer
- *In a process of manufacture* or a process which, in the opinion of the Commissioner, is similar to a process of manufacture
- Other than repairs and maintenance which has the effect of increasing the industrial capacity of the building
- Other than a building for farming or mining

In practice, SARS regards "wholly or mainly" to be more than 50% of the building, measured either by floor space or by volume of the building.

Based on either floor space or volume, if it can be seen that a building housing plant is used *wholly or mainly* in a process of manufacture, then the full building falls within the ambit of

Section 13 and would therefore qualify for a building allowance in terms of section 13 of the ITA.

Care should be taken in the allocation of costs during the erection of buildings housing plant as either being buildings that are part of the manufacturing process, structures relating to the plant or to adjacent buildings.

Any improvements to existing buildings which increases the current industrial capacity of the building will also be allowed the section 13 allowance, if brought into use for the first time and used in a process of manufacture.

Repairs and maintenance on existing buildings are claimable under section 11(e) of the ITA and not under section13.

Care should be taken not to claim allowances on costs incurred on site preparation when a new building is being erected, as SARS practice is not to allow any such expenditure as an allowance. In my view, the demolishing of old buildings would also fall within the "site preparation" category.

Overhead costs should be allocated on the basis of the costs either being "directly attributable" to either the building or the machinery or plant. If there are costs incurred which can not be directly attributed then it should be allocated to either the buildings, machinery, plant, site preparation or adjacent buildings on a pro rata basis. The pro-rata basis can be achieved by reference to the total costs of each of the different types of erected structures.

Engineering costs on building and site works are considered to be directly attributable to the building and site work and would therefore form part of the cost of the building to be claimed under section 13.

Other buildings

Silke on South African Income Tax 2008 states on page 167 that all buildings erected at the

same time as the manufacturing building and on the same site would qualify for the section 13 building allowance according to SARS practice.

In comparing *Silke on South African Income Tax 2008* with section 13 of the ITA, I am of the opinion that there is only limited merit in this view expressed above, if the section in the ITA is read.

Section 13*quinn* of the ITA allows for an annual allowance of 5% of any "commercial building" contracted for, on or after 1 April 2007 and erected on or after that date when:

- The commercial building is a *new and unused* building (or a portion of a building) owned by the taxpayer, and which is not used for residential purposes
- Which is *wholly or mainly* used by the taxpayer for the *production of income in the course of his trade* (e.g. not for production of exempt income)

In my view, taxpayers should rather claim the section 13*quinn* allowance on buildings adjacent to the plant if the above mentioned requirements are met.

Machinery

Machinery is, due to its nature, easily identifiable and classifiable as such. All machinery used in the process of manufacture by the taxpayer would fall within the ambit of section 12C and therefore allowances can be claimed on the preferential rates that are granted by this section.

Any engineering costs and other overhead costs that can be directly attributed to the installation or assembly of the machinery used in the process of manufacture by the taxpayer, would form part of the cost of the machinery on which a section 12C allowance is claimable. Overhead costs which can not be directly attributed to the machinery should be allocated on a pro-rata basis to each component that the costs relate to and claimed accordingly.

Section 12C provides for the write off of a machine over 4 years, at a rate of 40% in year 1 and 20% for the remaining 3 years for:

- *machinery or plant* owned by the taxpayer and
- which was or is brought into use *for the first time* by the taxpayer for the purposes of his trade (other than mining or farming) and
- is used by him *directly in a process of manufacture* carried on by him or any other process carried on by him which in the opinion of the Commissioner is of a similar nature.

Practice Note 16 of the Income Tax Act clarifies that section 12C allowances would include any foundations used for machinery and plant as well as some permanent structures as it is not specifically excluded by section 12C (as opposed to the case in section 11(e)). Plant includes "all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business".

Machinery that does not fall within the ambit of section 12C can claim an allowance in accordance with section 11(e).

Plant

Section 12C gives an allowance at a rate of 40% in year 1 and 20% for the remaining 3 years for:

- *machinery or plant* owned by the taxpayer and
- which was or is brought into use *for the first time* by the taxpayer for the purposes of his trade (other than mining or farming) and
- is used by him *directly in a process of manufacture* carried on by him or any other process carried on by him which in the opinion of the Commissioner is of a similar nature.

Practise Note 16 of the ITA clarifies that section 12C allowances would include any foundations used for machinery and plant as well as some permanent structures as it is not specifically excluded by section 12C (as opposed to the case in section 11(e)).

As stated above, machinery is due to its nature easily identifiable, but what constitutes plant?

The Shorter Oxford Dictionary defines plant as the "fixtures, implements, machinery, and apparatus used in carrying on any industrial process".

Due to the above definition being extremely wide it would be necessary to refer to case-law and SARS practice to establish if a narrower or wider application of this definition should be used.

Lindley LJ in *Yarmouth v France* (1887) 19 QBD 647 at 658 said the following:

> *"There is no definition of 'plant' in the Act: but, in its ordinary sense, it includes whatever apparatus is used by a businessman for carrying on his business – not his stock in trade which he buys or makes for sale, but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business…"*

In *Hinton (HM Inspector of Taxes) v Maden & Ireland Ltd* 38 Tax cases 391 Lord Jenkins made the following observation at 424 about the Yarmouth case:

> *"The reference to 'permanent employment" in the business demands some degree of durability."*

In the above case Lord Reid held at 417 that knives, although small in size and value, used in the shoe-making business of the taxpayer would be 'plant' (and not machinery as such).

The word "plant" refers to the items used in the "permanent employment in his business" and must be regarded as denoting no more than some degree of durability. Plant does not include

items that would be "quickly consumed or worn out in the course of a few operations".

After the Yarmouth case the courts tended to emphasis the use of the item alleged to be 'plant', and in this connection the functionality test was established.

The functionality test distinguishes between the setting in which a business is carried on and the apparatus with which a business is carried on. (*Blue Circle Cement Ltd v CIR* 46 SATC 21)

In ITC 1468 (1989) 52 SATC 32 it was laid down that a functional test needs to be passed in the sense that the items should be used in the manufacturing business and should be essential to the operation of the taxpayer's machines (the items should also pass the durability test noted above).

In *Blue Circle Cement Ltd v CIR* 1984 (2) SA 764 (A), 46 SATC 21 the following was laid down:

- Plant would not include a structure which merely housed or contained industrial equipment used in an industrial operation. It would also not constitute plant if the structure is "merely the place within which" industrial activities are carried on.
- On the other hand, in certain circumstances, buildings and fixtures can clearly constitute plant. It was laid down that "the structure is something by means of which the business activities are in part carried on".
- If the subject matter is the apparatus, or part of the apparatus, employed in carrying on the activities of the business then it does not matter that it consists of some structure attached to the soil. If it is not part of the apparatus so employed, it is not plant whatever its characteristics may be.

Taking the above into account it can be said that plant is everything that the taxpayer "keeps for permanent employment in his business" except for "stock in trade", subject to the durability and functionality tests.

It can therefore be seen that buildings merely housing machinery would not constitute "plant" and that items which may initially seem to be buildings or permanent structures can be essential to the operation of the taxpayer's machines, and would therefore qualify as "plant".

Conclusion

Practice Note 42 lists processes that the Commissioner feels are manufacturing processes, similar to manufacturing processes and processes which are neither manufacturing nor similar in nature.

Once the taxpayer is certain that they do have a process of manufacture or a process similar to that of manufacture and the taxpayer can prove that the building and / or machinery or the building(s) housing the machinery is part of this process, then the appropriate manufacturing allowances can be claimed.

Buildings are structures that have walls and a roof. The taxpayer will have to distinguish between a building that forms part of the manufacturing process and an administration / "commercial" building.

In our current tax environment plant and machinery are almost seen as one thing. Common practice is to regard machinery as the movable things and plant as the fixed machines or the factory.

As the plant and machinery allowances are exactly the same, the taxpayer will not have to distinguish between the two. The taxpayer will still however have to prove that the plant and machinery are used in the manufacturing process to be able to claim the said allowances.

CONCLUSION

In the last few years, the South African Income Tax Act has increased by leaps and bounds in volume and difficulty, but still it does not provide us with a definition of a "process of manufacture" and therefore to be able to differentiate between a process of manufacture and any other business process, is not as easy as originally thought.

Even though the ITA does not provide a definition of a "process of manufacture", it does however state in a few sections that the allowance claimable under the specific section is only claimable when the plant and / or machinery and / or buildings are used directly in a process of manufacture or in a process similar to a process of manufacture.

Interpretation principles as laid down by the courts were used to determine what a process of manufacture is, when it commences and ends and when it can be said that an article was used directly in the process of manufacture. In South Africa the Safranmark and Hersamer cases are seen as the landmark cases where a "process of manufacture" is concerned.

In summary, a "process of manufacture" is when human effort and labour is used with or without machinery, be it specialised or not, to produce a product that is different in nature or shape or colour or form or chemical composition or has a different use than the product with which the process was started.

One does not have to be involved in the manufacture of the ultimate product to have a process of manufacture, as long as the end product is of use to someone and care has to be taken not to confuse the assembly of a product with the manufacture of a product.

It would seem that to determine whether an item was used directly in the process of manufacture depends on when the process of manufacture commences.
Usually the process of manufacture starts when the "raw material" starts to change into the product that it is suppose to become. The process can be seen to begin earlier if the different machines used in the process form a whole.

There are different opinions on whether the transport of raw materials from one point to another from part of the manufacturing process. It would seem that whether transportation is included or excluded depends entirely on the facts of the case.

It is my opinion that if the plant or machinery or transport equipment forms an integral part of the process after commencement (which means that without the operation the manufacturing process can not proceed) then it can be said that the plant or machinery or transport equipment is directly involved in the manufacturing process.

The process of manufacture comes to an end when a product can be produced that is essentially different from the materials used to produce it. It can be different in shape, form, size, chemical composition or any other quality that the man on the street will regard as being different.

To be able to differentiate between a manufacturing process and another process within a business, you would have to look at the process as a whole. If the whole process adheres to the requirements and characteristics of a manufacturing process as explained by the courts, then the whole process can be classified as one of manufacture. If the process can not be so classified, then it will have to be dissected to establish if any portion of the process is not one of manufacture.

There are no set guidelines to use when deciding whether a process, or part of a process, is one of manufacture or not. Each case has to be evaluated on its own facts and merits.

In order to make the process of differentiating between processes easier, the Commissioner of the South African Revenue Services issued Practice Note 42 on the 27th of November 1995.

The above mentioned practice note lists processes which the Commissioner regards as manufacturing processes, processes similar to manufacturing processes and processes which are neither manufacturing nor similar to manufacturing.

Once a business has classified their processes, they will have to ensure that they know what constitutes plant, buildings and machinery and which of the afore mentioned forms part of the manufacturing process or to a process similar to a manufacturing process.

In short a building is a structure with a roof and walls. If the building is mainly or wholly used in the process of manufacture then the section 13 allowance can be claimed. If the building is an administration or "commercial" building, I would suggest that the section 13*quinn* allowance be claimed

The word "machinery" speaks for itself. Machinery is easily identifiable and classifiable and if it is used in the manufacturing process a section 12C allowance can be claimed, otherwise a wear and tear allowance in accordance with section 11(e) will be claimable.

To attempt to provide a definition of "plant" would be a futile exercise as the courts do not even agree on what "plant" means.

The general consensus is however that "plant" refers to everything that the taxpayer keeps for permanent employment in his business. The items kept do not include "stock in trade" and will have to comply with the durability and functionality tests.

In our current tax environment plant and machinery are seen as one and the same thing. Common practice is to regard plant as the big, unmovable machines or a factory and machinery refers to the smaller movable machines.

In conclusion, to differentiate between a process of manufacturing and any other business process, each case will have to be judged by comparing the specific facts of the case with the general criteria as laid down by the courts.

"The hardest thing in the world to understand is the income tax."

– Albert Einstein

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