

**THE TAX TREATMENT OF REHABILITATION LIABILITIES
ASSUMED BY THE PURCHASER AS PART OF THE
CONSIDERATION GIVEN ON THE SALE OF MINING PROPERTY
IN TERMS OF SECTION 37 OF THE INCOME TAX ACT
58 OF 1962**

by

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**A dissertation submitted in part fulfilment of the requirements of the
degree**

LLM TAX LAW

In the

FACULTY OF LAW

at the

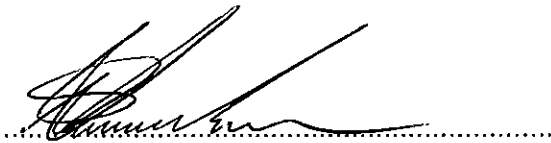
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February 2015

DECLARATION

I, André Vermeulen, hereby declare that this dissertation is my own, unaided work. It is being submitted in partial fulfilment of the prerequisites for the degree of Master's in Tax Law at the University of Pretoria. It has not been submitted before for any degree or examination in any other University.



André Vermeulen

3 February 2015

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LIST OF ABBREVIATIONS

In this document the following abbreviations shall have the meanings as described in the table below.

<u>Definition</u>	<u>Description</u>
“Daishowa”	Daishowa-Marubeni International Ltd;
“DMR”	The Department of Mineral Resources;
“SARS”	The South African Revenue Service;
“the Canadian Income Tax Act”	The Income Tax Act, Canada R.S.C., 1985, c. 1 (5th Supp.);
“the Commissioner”	The Commissioner for the South African Revenue Service;
“the Discussion Document”	The discussion paper released by the South African Revenue Service during December 2013 titled: <i>“Discussion Paper on the Tax Implications for the Seller and Purchaser in relation to the Assumption of Contingent Liabilities in Part settlement of the Purchase Price of Assets Acquired as part of a Going Concern.”</i> ;

- “the Eighth Schedule”** The Eighth Schedule to the Income Tax Act 58 of 1962;
- “the Income Tax Act”** The Income Tax Act, 58 of 1962;
- “the MPRDA”** Mineral and Petroleum Resources Development Act, 28 of 2002;
- “the SCC”** The Supreme Court of Canada;
- “the Transfer Duty Act”** The Transfer Duty Act, 40 of 1949;

ABSTRACT

THE TAX TREATMENT OF REHABILITATION LIABILITIES ASSUMED BY THE PURCHASER AS PART OF THE CONSIDERATION GIVEN ON THE SALE OF MINING PROPERTY IN TERMS OF SECTION 37 OF THE INCOME TAX ACT 58 OF 1962

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The tax treatment of contingent liabilities assumed by a purchaser as part settlement of the purchase price for the acquisition of a business as a going concern has at the best of times been a contentious issue. During December 2013, SARS released a Discussion Document in which it set out its views in respect of the tax treatment of both the seller and the purchaser, where contingent liabilities are assumed as part settlement of the purchase consideration to be paid by the purchaser. The Discussion Document introduced two concepts in respect of contingent liabilities which are currently not recognised in South African tax law i.e. an embedded contingent liability and a free-standing contingent liability.

These concepts were derived from the judgment delivered by the Supreme Court of Canada in the matter of *Daishowa-Marubeni International Ltd v Canada*, wherein the court found that the reforestation obligation attaching to a forest tenure is a future cost embedded in the forest tenure and as such cannot be assumed as a separate liability by a purchaser, but in fact, reduces the value of the forest tenure to which it relates i.e. the reforestation obligation is embedded in the forest tenure.

In the same manner that the holder of a forest tenure in Canada is obligated to conduct reforestation activities in order to rehabilitate the land from which it had cut timber, the holder of a mining right in South Africa is obligated to rehabilitate the land on which it conducted its mining activities. The question that arises in this regard, is whether or not

the mining rehabilitation obligation attaching to a mining right is, similarly to the reforestation obligation attaching to a forest tenure, so inextricably linked to the mining right that it becomes embedded in the mining right and as such reduces the value of the mining right.

Should this be the case, the assumption of the mining rehabilitation obligation attaching to a mining right by a purchaser, when acquiring mining property and capital assets as part of a going concern, will not constitute consideration given for that property by the purchaser. This will in turn affect the application of section 37 of the Income Tax Act which determines the deemed capital expenditure incurred by the purchaser upon acquisition of the capital assets which will have an impact on the mining capital expenditure allowance the purchaser can claim in terms of section 15(a), read with section 36 of the Income Tax Act.

The purpose of this paper is to determine whether the concept of an embedded liability applies in a South African mining tax context and will consider the specific provisions contained in the Income Tax Act which deal with the taxation of mining companies, the nature of a mining right as opposed to that of a forest tenure, the factors impacting the value of a mining right as well as the application of the reasoning used and principles established in *Daishowa-Marubeni International Ltd v Canada* to a mining right and its corresponding mining rehabilitation obligation.

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CHAPTER 1

INTRODUCTION AND RESEARCH PROPOSAL

1.1. INTRODUCTION

During December 2013, SARS released the Discussion Document in which it set out its application of the relevant tax law, in relation to the tax treatment of the purchaser and seller, with regard to the assumption of contingent liabilities as part settlement of the purchase price of assets acquired as part of a going concern.

SARS states that the document was prepared in light of the recent judgments delivered by local and foreign courts as well as numerous requests for clarity regarding the income tax treatment, of both the seller and the purchaser, in respect of the assumption of contingent liabilities as part settlement of the purchase price of assets disposed of and acquired.

A particular point of interest in the Discussion Document is the fact that SARS distinguishes between, what it calls, 'embedded' and 'free-standing' contingent liabilities. This distinction appears to be based on the judgment delivered by the Supreme Court of Canada ("SCC") in the matter of *Daishowa-Marubeni International Ltd v Canada*¹ in which the court distinguished between:

- (i) a contingent liability which, in its view, is a future cost which depresses the value of the asset (i.e. embedded contingent liability); and
- (ii) an obligation which is a distinct existing liability which does not impact the market value of the asset (i.e. a free-standing contingent liability).

¹2013 SCC 29.

Although the Discussion Document only considers the tax treatment of the seller and purchaser with regard to the assumption of 'free-standing contingent liabilities',² SARS does state that it "accepts that a distinction must be drawn between an embedded statutory obligation that depresses the value of an asset and a separately identifiable contingent liability".³ In SARS' view an 'embedded contingent liability' is so inextricably linked to the asset that should the asset be transferred, the contingent liability will have an impact on the market value of the asset and the assumption of the contingent liability by the purchaser will not qualify as consideration given by the purchaser.⁴

The application of the principles enunciated in *Daishowa-Marubeni International Ltd v Canada* could potentially have far-reaching consequences in the South African mining sector to the extent that it is applied to the transfer of mining rights and the assumption of the corresponding mining rehabilitation obligation by the purchaser. In the matter of *Daishowa-Marubeni International Ltd v Canada* the court had to determine the tax treatment of the seller in respect of a right to harvest timber (i.e. forest tenure) which it had disposed of and whether or not the value of the reforestation liability assumed by the purchaser, that attaches to that forest tenure, should be included in the seller's 'proceeds of disposition'.

There are thus various similarities to the facts as they occurred in *Daishowa-Marubeni International Ltd v Canada* and the instance where a mining right is transferred in South Africa.

As with the reforestation liability which attached to the forest tenure, a mining rehabilitation obligation attaches to each mining right issued in South Africa with the effect that the DMR will not transfer such a mining right unless the corresponding mining rehabilitation obligation is also transferred to and assumed by the purchaser. A direct application of the decision in *Daishowa-Marubeni International Ltd v Canada* will result in the market value of the mining right decreasing and the assumption of the rehabilitation liability not constituting consideration given by the purchaser. From the purchasers perspective this will affect the amount of capital expenditure the purchaser will incur and as such will affect the amount of capital expenditure it will be able to

² The Discussion Document, page 3.

³ The Discussion Document, page 2.

⁴ The Discussion Document, page 3.

deduct in terms of section 15(a) read with section 36(7) of the Income Tax Act, in determining its taxable income from mining activities.

However, the South African Income Tax Act makes specific provision for the allocation of cost and as such the amount of expenditure incurred in the situation where mining property and capital assets are disposed of. In this regard section 37 of the Income Tax Act makes provision for the manner in which the capital expenditure incurred by the purchaser, upon acquisition of mining property and assets, should be determined.

The basis upon which the application of section 37 is premised is the effective valuation of the mining assets by the Director-General of the DMR. The effective valuation serves to determine the value of the capital assets acquired by the purchaser on the effective date of the transaction. This value, as determined by the Director-General of the DMR, is deemed to be the amount of expenditure incurred by the purchaser in acquiring each of the respective mining assets and as such is deductible in determining the purchaser's taxable income from mining.

Should the values attributed to the respective assets by the Director-General of the DMR, in its effective valuation, exceed the consideration given by the purchaser in acquiring the assets, the deemed cost and deemed capital expenditure incurred by the purchaser are to be determined by apportioning the consideration given by the purchaser for each asset to hold the same ratio to the total consideration given by the purchaser as the effective value of that asset, as per the effective valuation, holds to the total effective valuation of all the assets acquired.

From the above it is clear that the meaning of the term 'consideration given' is of vital importance with regard to the interpretation and application of section 37 of the Income Tax Act. The amounts included and the amounts excluded from the meaning of the term will have a substantial impact on the amount of capital expenditure the purchaser will be deemed to have incurred upon acquisition of the mining property and assets.

The direct application of the judgment in *Daishowa-Marubeni International Ltd v Canada* to the transfer of mining rights and the corresponding mining rehabilitation obligation in South Africa will undoubtedly impact the application of section 37 as the 'consideration given' by the purchaser will, according to SARS, not include the value of any mining rehabilitation obligations assumed by the purchaser.

The Income Tax Act currently does not make provision for the separate treatment of contingent liabilities in the form of 'embedded liabilities' and 'free-standing liabilities' nor are these concepts currently recognised in South African tax law.

It must thus be determined if these concepts are in fact applicable in South African tax law and if so, what the impact thereof is in respect of the transfer of mining rights and the corresponding mining rehabilitation obligation as well as the consideration that the purchaser gives in return for the assets it acquires.

1.2. PROBLEM STATEMENT

Are the mining rehabilitation obligations assumed by the purchaser, upon the acquisition of mining property, of such a nature that it does not constitute 'consideration given' for purposes of determining the purchaser's capital expenditure as provided for under section 37 of the Income Tax Act?

In other words, are the mining rehabilitation obligations of such a nature that it does not exist separately from the mining right to which it attaches and as such cannot be transferred as a contingent liability but in fact reduces the value of the mining right to which it attaches?

1.3. OBJECTIVES

The objectives of the research paper will be to determine whether or not the assumption of contingent liabilities, in the form of a mining rehabilitation liability, will indeed form part of the 'consideration given' by the purchaser in return for the mining property it acquires.

The research paper will amongst other things consider the general tax principles in respect of the assumption of contingent liabilities, the application of the deeming provisions of section 37 of the Income Tax Act and the applicability of the judgment delivered in *Daishowa-Marubeni International Ltd v Canada* in the context of the transfer of mining rights.

1.4. SIGNIFICANCE

The assumption of contingent liabilities as part settlement of the purchase price for assets and the tax treatment thereof in the hands of both the seller and purchaser has always been a contentious issue clouded with uncertainty. The introduction of the terms 'embedded contingent liability' and 'free-standing contingent liability' as derived from the judgment delivered in *Daishowa-Marubeni International Ltd v Canada* is sure to only increase this uncertainty.

Furthermore, the direct application of judgement in *Daishowa-Marubeni International Ltd v Canada* to the transfer of mining rights and the corresponding mining rehabilitation obligation attaching to such rights will have a significant impact on both the seller as well as the purchaser. From the seller's perspective the argument that the assumption of the mining rehabilitation obligation attaching to the mining right does not constitute 'consideration given' will arguably be preferred as it will exclude the value of that liability (which can be quite substantial) from the proceeds that the seller receives upon disposal of the mining right. From the purchaser's perspective the opposite argument would be preferred as the inclusion of the value of the mining rehabilitation obligation it assumes as part of the consideration that it gives for the mining property and assets, will result in a larger amount of capital expenditure which it can claim in determining its taxable income.

The assumption of mining rehabilitation obligations as part settlement of the purchase price for assets acquired and the tax treatment thereof have never been considered by a South African court. It is an issue that will become more and more relevant in the near future as an increasing number of mines and as such the mining rights, are being disposed of as and when the mines near the end of its viable production period (i.e. Life of Mine). Not only is the correct treatment of the assumption of mining rehabilitation obligations relevant for future sales transactions, it could potentially also impact transactions which have already been concluded but have not been subject to audit by SARS.

The research paper will aim to provide guidance as to the tax treatment of mining rehabilitation obligations which are assumed by the purchaser as part settlement of the purchase price for the acquisition of mining assets and mining property.

1.5. RESEARCH METHODOLOGY

The research will be conducted as a non-empirical comparative study and will include an analysis of the tax treatment of contingent liabilities assumed by a purchaser as consideration for the acquisition of assets, the development and purpose of section 37 of the Income Tax Act, as well as a comparison between South African and Canadian tax law, as applied in *Daishowa-Marubeni International Ltd v Canada* and the extent to which it applies to the transfer of mining rights.

1.6. DATA COLLECTION

The data to be collected will consist of the following:

- (a) South African and Canadian Income Tax legislation;
- (b) Case law (South African and Canadian);
- (c) Journals and Articles; and
- (d) All other relevant literature in the form of discussion documents, interpretation notes etc.

1.7. DATA ANALYSIS

The data will be analysed by way of a literature study of the relevant legislation, commentary thereon, case law, journals, articles and other literature relating to the assumption of contingent liabilities, the nature of mining rights and the meaning of the term 'consideration given'. Upon completion of the literature review, the conclusion and deductions made will be used and applied in a comparative analysis to the principles established in *Daishowa-Marubeni International Ltd v Canada* in order to determine the applicability thereof in the context of South African tax law, specifically relating to the assumption of mining rehabilitation obligations as consideration for mining assets acquired in terms of section 37 of the Income Tax Act.

1.8. CONCLUSION

Upon completion of the literature review and the analysis of the principles established in *Daishowa-Marubeni International Ltd v Canada* a conclusion or inference will be made as to the applicability of the term 'embedded liability' in a South African tax law context to the extent that it relates to the transfer of mining rights and the assumption of the corresponding mining rehabilitation obligation as part of the consideration given by the purchaser.

The aim of the research study will be to determine whether or not the assumption of the mining rehabilitation obligation does in fact have an effect on the market value of a mining right and if so, what the impact thereof is with regard to the application of the provisions of section 37 of the Income Tax Act.

1.9. CHAPTER OVERVIEW

Chapter 1 – Provides a general discussion and introduction relating to the identified research areas, as well as an overview of the specific objectives of the document. The chapter furthermore highlights the practical importance of the issues considered in the document, as well as a summary of the research methodology employed.

Chapter 2 – Provides a summary of the views expressed by SARS in the Discussion Document as well as the conclusions reached therein.

Chapter 3 – Sets out the background facts to the matter of *Daishowa-Marubeni International Ltd v Canada* as well as a summary of the judgments delivered in the Tax Court of Canada, the Canadian Federal Court of Appeal and the SCC.

Chapter 4 – Provides a brief background to the tax treatment of taxpayers involved in mining and mining operations in South Africa as well as the tax consequences upon the disposal of mining property. It will furthermore illustrate the impact of the judgment delivered in *Daishowa-Marubeni*

International Ltd v Canada, should it be applied directly in a South African mining tax context.

Chapter 5 – Considers and discusses the content of the provisions contained in section 37 as well as the application thereof to the acquisition of mining property and assets.

Chapter 6 – Will consider the meaning of the term ‘consideration given’, as used in section 37 as well as the concept of an embedded liability as derived from the judgment delivered in the matter of *Daishowa-Marubeni International Ltd v Canada*.

Chapter 7 – Applies the reasoning followed by the SCC, in delivering the judgment in *Daishowa-Marubeni International Ltd v Canada*, to a mining right and its corresponding mining rehabilitation obligation. It will furthermore consider whether the judgment delivered in *Daishowa-Marubeni International Ltd v Canada* does in fact find application in a South African mining tax context.

Chapter 8 – Conclusion.

CHAPTER 2

VIEWS EXPRESSED BY SARS IN THE DISCUSSION DOCUMENT AND GENERAL INCOME TAX PRINCIPLES TO THE ASSUMPTION OF LIABILITIES

2.1. INTRODUCTION

The Discussion Document considers the application of general income tax principles to the assumption of contingent liabilities upon the disposal and acquisition of a business as a going concern. It does, however, not specifically deal with the assumption of contingent liabilities, in the form of mining rehabilitation obligations, in relation to the disposal and acquisition of mining property in terms of section 37 of the Income Tax Act⁵. Nonetheless, it offers valuable insight as to the approach taken by SARS in considering the tax treatment of contingent liabilities assumed by a taxpayer a part consideration for the acquisition of assets.

It must be noted that the Discussion Document, from the outset, distinguishes between and accepts the notion of (i) embedded contingent liabilities which would reduce the market value of the asset to which it attaches and (ii) free-standing contingent liabilities which do not impact the market value of any asset. Other than a brief reference to the judgment delivered in the matter of *Daishowa-Marubeni International Ltd v Canada*⁶ (as discussed in further detail in Chapter 3) no further authority is provided as to why the concept of an 'embedded liability' should be recognised and applied in South African Income Tax law.

The Discussion Document considers the position of both the seller and the purchaser in the instance where 'free-standing' contingent liabilities are assumed as part of the purchase consideration which is given by the purchaser in acquiring a business as going concern and provides a basis from which to consider the interpretation and application of the provisions of section 37 of the Income Tax Act.

⁵ Act 58 of 1962.

⁶ 2013 SCC 29.

2.2. THE CLASSIFICATION OF CONTINGENT LIABILITIES

As this paper considers the tax treatment of contingent liabilities, where such contingent liabilities are assumed as part of the payment of the purchase consideration, it is prudent to first understand exactly what constitutes a contingent liability and how it differs from what can be called an actual or absolute liability.

The term 'contingent' is not defined in the Income Tax Act and as such its meaning falls to be determined with regard to its ordinary dictionary meaning. In this regard the Concise Oxford Dictionary⁷ defines the term 'contingent' as:

"dependent on; that can be anticipated or arise if a particular event occurs."

The Collins Dictionary⁸ defines the term 'contingent' when used as an adjective to mean:

"... dependant on events, conditions etc. not yet known; conditional."

From the above definitions it is clear that the term 'contingent' connotes something that is uncertain, conditional or dependent upon the occurrence of certain events. Support for the above can be found in the judgments delivered in the matters of *Nasionale Pers BPK v KBI*⁹, *Edgars Stores Ltd v CIR*¹⁰ and *CIR v Golden Dumps*¹¹ which considered the deductibility of certain expenditure items on the grounds of whether these expenditure items had actually been incurred during the respective years of assessment.

In the matter of *Nasionale Pers BPK v KBI*, the taxpayer had a financial year end and as such a year of assessment ending on 31 March. In submitting its tax return, it claimed expenditure for bonuses payable to its employees should they still be in its employ on 31 October of that year. The bonus provisions contained in each employee's service agreement provided for a bonus to be paid to that employee, should he or she still be in the taxpayer's employ on 31 October of each year. The court found that the taxpayer's liability to pay these bonuses were contingent upon the employee still being

⁷ Twelfth Edition (2011).

⁸ Sixth Edition (2003), at 364.

⁹ [1986] 2 All SA 397 (A), at page 402.

¹⁰ 1988 (3) SA 876 (A), 50 SATC 81, [at page 93 of 50 SATC 81].

¹¹ [1993] 2 All SA 496 (A), 55 SATC 198, [at page 510 of [1993] 2 All SA 496 (A)].

in its employ on 31 October, which was an uncertain event, and as such there was no liability to pay these bonuses on 31 March when the deduction was claimed. Accordingly the taxpayer had not incurred an expense in respect of bonuses payable to its employees and could not deduct such expenditure in determining its taxable income.

Similarly in *Edgars Stores Ltd v CIR*, the court found that the final amount of rent payable by the taxpayer was determined with reference to a period which ended subsequent to the closing of the taxpayer's year of assessment and was furthermore dependent upon the taxpayer's turnover at that future date. Therefore, as the turnover upon which the final amount of rent was to be determined was not yet fixed or known at the end of taxpayer's year of assessment, the taxpayer could only claim the rental expenditure actually incurred up to the end of that year of assessment as the remaining amount was subject to the occurrence of uncertain future events. The liability for rent was therefore contingent.

In the matter of *CIR v Golden Dumps* the court found that the taxpayer could not deduct expenditure relating to a claim that a former employee had instituted against the taxpayer, which the taxpayer was in the process of defending. The court stated that the taxpayer's liability towards the former employee only arose and was actually incurred in the year of assessment in which the former employee's claim against the taxpayer was upheld by the Appellate Division.

It is thus clear that a contingent liability will be present where the taxpayer's obligation to make payment in respect of the liability is conditional upon the occurrence of uncertain future events and when such liability becomes unconditional it will result in expenditure being incurred by the taxpayer.

In contrast to the above an actual or absolute liability represents a liability that is unconditional in terms of which the taxpayer has a definite obligation to make payment.¹²

¹² The Discussion Document, page 3.

2.3. ALLOCATION OF THE PURCHASE PRICE

It is trite that when a business is sold as a going concern, the business as a whole does not represent an asset for income tax purposes. The going concern is in fact a collection of assets for which the purchase price is paid and as such the purchase price must be allocated to each respective asset.¹³ In the instance where liabilities are assumed as part of the purchase consideration of the going concern, the values of these liabilities are to be allocated to the assets being acquired.

In this regard the Discussion Document states that the purchase price allocation as agreed upon by the seller and the purchaser will generally be accepted by SARS, unless there is evidence that the allocation does not represent the actual facts and the true intention of the parties.¹⁴

For income tax purposes both the seller and the purchaser must use the same purchase price allocation.

2.4. THE TAX TREATMENT OF THE SELLER

In the event that the purchase price of the assets acquired by the purchaser is settled through the assumption of contingent liabilities, the following must be considered when determining the tax treatment of the seller:

- (a) The amount to be included in the seller's gross income for income tax purposes or proceeds for capital gains tax purposes; and
- (b) Can the seller claim a deduction for the value of the contingent liability assumed by the purchaser?

¹³ The Discussion Document, page 4.

¹⁴ The Discussion Document, page 4.

2.4.1. Inclusion in gross income and/or proceeds

The inclusion of any amount in a taxpayer's gross income depends on whether the requirements set in section 1 of the Income Tax Act are met. In this regard, in respect of a South African tax resident, gross income is defined as:

"...the total amount in cash or otherwise, received or accrued to or in favour of such resident."

Similarly for any amount to qualify as proceeds for capital gains tax purposes, the amount must fall within the definition of 'proceeds from disposal' as contained in paragraph 35 of the Eighth Schedule.

In this regard, paragraph 35 of the Eighth Schedule determines that an amount will qualify to be included as proceeds where it *"is received or accrued, or is treated as having been received by or accrued to or in favour of a person"* in respect of the disposal of an asset.

According to the Discussion Document, the seller is entitled to the following when the purchase price of the assets acquired as part of a going concern is settled through the payment of a cash amount and the assumption of 'free-standing' contingent liabilities by the purchaser:¹⁵

- (a) the cash amount; and
- (b) the benefit of being relieved from the obligation to settle the 'free-standing' contingent liability, if and when it becomes unconditional. The value of this benefit would normally be equal to the value as agreed to by the seller and purchaser in the sales agreement.¹⁶

Both of these amounts must be accounted for and included in the taxpayer's 'gross income' or 'proceeds from disposal' in determining the seller's tax liability upon the disposal of the business as a going concern.

¹⁵ The Discussion Document, page 5.

¹⁶ The Discussion Document, page 6.

2.4.2. Deductibility of the contingent liability amount

As with the inclusion of the amounts in the taxpayer's gross income or proceeds from disposal, the value of the contingent liability will only qualify for deduction should it satisfy the requirements of section 11(a) and 23(g) of the Income Tax Act (i.e. the general deduction formula).

In this regard the general deduction formula provides for the deduction of expenditure or losses, actually incurred in the production of the taxpayer's income provided that such expenditure is not of a capital nature and was incurred for the purposes of the taxpayer's trade.

The question as to whether or not the value of the contingent liabilities assumed by the purchaser qualifies for deduction in the hands of the seller came before the Supreme Court of Appeal in the matter of *Ackermans Ltd v C:SARS*.¹⁷

In this case the taxpayer (i.e. Ackermans) sold its clothing retail business as a going concern. The purchase price was defined in the sale agreement to be an amount of R800 million plus the value of the liabilities to be assumed by the purchaser of R329 440 402. Included in the liabilities to be assumed by the purchaser were contingent liabilities in the form of the taxpayer's contractual obligation to fund post-retirement medical aid benefits for its employees, an obligation to employees under a long-term bonus scheme and obligations in respect of repairs to be undertaken by the taxpayer under property leases. The combined value of these contingent liabilities came to an amount of R17 174 777. The taxpayer claimed this amount as a deduction in terms of section 11(a) of the Income Tax Act on the basis that it had incurred expenditure due to the fact that it had to relinquish a portion of the purchase price which it would have been entitled to had it not been for the contingent liabilities. The taxpayer was thus of the view that the reduction in the purchase price, caused by the contingent liabilities assumed by the purchaser, represented expenditure which it could deduct in terms of the general deduction formula when determining its taxable income for that particular year of assessment.

¹⁷ 2011 (1) SA 1 (SCA), 73 SATC 1.

In dismissing the taxpayer's appeal the court stated that the taxpayer, at the effective date of the sale agreement, had not incurred any expenditure as required in terms of section 11(a) of the Income Tax Act. As such the taxpayer could not claim the amount relating to the contingent liabilities as a deduction in determining its taxable income for that year. The reasons given for the judgment were as follows:

- (a) The term 'expenditure incurred', contained in section 11(a) of the Income Tax Act, requires an actual incurral of a liability or the undertaking of an obligation to make payment in terms of a liability.¹⁸
- (b) The fact that the taxpayer accepted a smaller purchase price than it could have, had the purchaser not assumed these liabilities, did not in fact or in law mean that the taxpayer incurred expenditure in the form of a reduction in the purchase price of the business.¹⁹

Based on the judgment delivered in the matter of *Ackermans v C:SARS*, the amount of any contingent liability assumed by the purchaser as part settlement of the purchase price of a business acquired as a going concern, would not qualify as expenditure to be deducted in determining the taxable income of the seller.

2.5. THE TAX TREATMENT OF THE PURCHASER

The purchaser assumes the 'free-standing' contingent liabilities as part settlement of the purchase price for the assets it acquires. Therefore, it has to be determined to what extent the purchaser would qualify for a deduction of the purchase price of the asset acquired as well as when the purchaser may claim such deduction, if any.²⁰

Since the contingent liabilities are assumed by the purchaser as a method of settling the purchase price of specific assets, the deductibility of this amount must be determined with reference to the asset acquired by the purchaser through the assumption of the contingent liabilities.²¹ The nature of the asset acquired will

¹⁸ See discussion under 2.2 above for additional authority as to the meaning of the term 'expenditure incurred'.

¹⁹ [2011] 2 All SA 125 (SCA), at page 131.

²⁰ The Discussion Document, page 10.

²¹ The Discussion Document, page 11.

determine the specific section of the Income Tax Act which will regulate the deductibility of the amount.²²

According to the Discussion Document, the key consideration as to whether or not an amount qualifies to be deducted in terms of any of the various allowance provisions contained in the Income Tax Act, is whether the taxpayer incurred expenditure in relation to that specific asset for which the deduction or allowance is sought.²³

In this regard the Discussion Document states the following:

"The purchaser does not incur expenditure as at the date of sale to the extent the purchase price is settled or partially settled by the purchaser assuming a free-standing contingent liability. In order to constitute expenditure, the purchaser must outlay or expend cash or assets in a form other than cash, or must have an unconditional legal liability to outlay or expend cash or assets in a form other than cash. A purchaser who assumes a free-standing contingent liability has an unconditional obligation to settle it if and when the free-standing contingent liability becomes unconditional in the future. However, as at the date of the sale it is not yet known whether the free-standing contingent liability will become unconditional and the purchaser could not therefore have undertaken to unconditionally outlay cash or assets at that time. The purchaser has merely undertaken to incur expenditure in the future if the free-standing contingent liability materialises but has not incurred the expenditure as at the date of sale."²⁴

From the above, it is thus clear that as the liability is still contingent (i.e. conditional) at the time the sale is concluded, no expenditure will be incurred by the taxpayer in respect of the contingent liability and as such no allowance or deduction will be available to the purchaser in relation to the asset acquired through the assumption of the contingent liability.

²² In the case of trading stock section 11(a) would apply, whereas in the case of certain capital assets the section 11(e) would apply.

²³ The Discussion Document, page 11.

²⁴ The Discussion Document, page 11.

The next point to be considered is whether the purchaser would qualify for a deduction or allowance as and when the contingent liability becomes unconditional and as a consequence thereof the purchaser incurs expenditure. As stated previously, the deductibility of the value of the contingent liability will be determined with reference to the asset in relation to which it was assumed. In this regard the factors which would impact the deductibility of the amount are:²⁵

- (a) whether the amount is capital or revenue in nature;
- (b) if the expenditure has been incurred in the production of the purchaser's income; and
- (c) if the expenditure has been incurred for purposes of the purchaser's trade.

2.5.1. Capital or revenue nature of the expense

The capital or revenue nature of the amount will determine whether a deduction in terms of section 11(a) or a capital allowance will be available to the purchaser.²⁶

In determining the nature of the expenditure amount, the nature of the asset which was acquired through the assumption of the contingent liability must be considered and not the nature of the expense to which the contingent liability relates.²⁷ Thus, where a purchaser acquired trading stock in return for which it assumed contingent liabilities relating to the seller's employee bonus provisions, which subsequently became unconditional, the nature of the expense must be determined with reference to the trading stock and not the fact that the liability related to the seller's obligations towards its employees. In this regard the Discussion Documents states the following:

"The expenditure has arisen as a direct result of the purchaser's assumption of the free-standing contingent liability which was assumed as a means of settling the purchase price payable for the assets acquired. It was an undertaking between the purchaser and the seller. Accordingly, in determining the capital or

²⁵ The Discussion Document, page 12.

²⁶ The Discussion Document, page 12.

²⁷ The Discussion Document, page 13.

revenue nature of the expense, the nature of the particular asset acquired must be ascertained.”²⁸

2.5.2. In the production of income and for purposes of the purchaser’s trade

In order to determine if the expense was incurred for purposes of the purchaser’s trade, it must be determined if the activities conducted by the purchaser constitute a trade as defined in section 1 of the Income Tax Act²⁹ and if the expenditure is sufficiently closely connected to the income earning activities of the purchaser to be said to have been incurred for the purposes of producing income.³⁰

Due to the wide interpretation afforded to the term ‘trade’,³¹ this requirement will likely be satisfied where a business is acquired as a going concern by the purchaser.³²

In determining whether the expenditure was incurred for the purposes of producing income, the court in the matter of *PE Electric Tramway Co Ltd v CIR*³³ stated that the following must be considered:

- (a) what action resulted in the expenditure being incurred; and
- (b) is this action so closely related to the trade (i.e. income earning activities) of the taxpayer that it can be considered as part of the cost of performing it.

The court stated that an action will be regarded as being performed in the production of income if it is performed with the *bona fide* purpose of carrying on the taxpayer’s trade which produces income.

²⁸ The Discussion Document, page 13.

²⁹ Section 1 of the Income Tax Act defines the term ‘Trade’ to include “every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act, 1978 (Act No. 57 of 1978), or any design as defined in the Designs Act, 1993 (Act No. 195 of 1993), or any trade mark as defined in the Trade Marks Act, 1993 (Act No. 194 of 1993), or any copyright as defined in the Copyright Act, 1978 (Act No. 98 of 1978), or any other property which is of a similar nature.”

³⁰ See *PE Electric Tramway Co Ltd v CIR*, 1936 CPD 241, 8 SATC 13, [at page 17 - 18 of 8 SATC 13]; *Sub Nigel Ltd v CIR*, 1948 (4) SA (A), 15 SATC 381 [at page 397 of 15 SATC 381] and *CIR v Nemojim (Pty) Ltd* [1983] 2 All SA 485 (A), 45 SATC 241, at page 492.

³¹ *Burgers v CIR*, [1993] 2 All SA 496 (A), at page 519.

³² The Discussion Document, page 15.

³³ 1936 CPD 241, 8 SATC 13.

The purchaser will thus be able to deduct or claim an allowance in respect a 'free-standing' contingent liability which it assumed as part of the purchase consideration to acquire a specific asset. This deduction or allowance will, however, only be available once the liability becomes unconditional and the purchaser incurs an expense in relation thereto.

2.6. CONCLUSION

In summary, according to the Discussion Document, where a 'free-standing' contingent liability is assumed as part settlement of the purchase price for assets acquired as part of a going concern, the seller and purchaser should be treated as follows:³⁴

- (a) the seller must include the value of the contingent liabilities assumed by the purchaser in its gross income;
- (b) the seller does not incur any expenditure in relation to the assumption of the contingent liabilities and is therefore not entitled to a deduction or allowance in respect of that amount;
- (c) the purchaser will only incur expenditure, and as such will only be entitled to a deduction or allowance if and when the contingent liability materialises; and
- (d) the assumption of the contingent liability, in the hands of the purchaser, relates to the assets acquired and as such any possible deduction or allowance must be determined with reference to the nature of the assets of which the purchase price was settled through the assumption of the contingent liability.

With regard to the purchaser, it appears from the Discussion Document that the assumption of a contingent liability in part settlement of the purchase price of a business does not constitute 'expenditure incurred' until the liability materialises and as such will not qualify to be deducted in calculating the purchaser's taxable income. The purchaser must allocate the assumption of the contingent liability to specific assets assumed and, until the liability materialises, the purchaser may only claim allowances

³⁴ The Discussion Document, page 17.

or deductions to the extent that it actually incurred expenditure in acquiring those assets.

The Discussion Document, however, distinguishes between 'free-standing' contingent liabilities and 'embedded' contingent liabilities. The views expressed in the Discussion Document relates solely to 'free-standing' contingent liabilities which is defined as "*distinct existing obligations which are separately identifiable and are not embedded in an asset that is separately recognised for tax purposes.*"³⁵

An embedded contingent liability is defined as a liability that is "*embedded in the asset such that they are inextricably linked to the asset and, should the asset be transferred, must be transferred by the seller to the purchaser under law or government regulation.*"³⁶ According to the Discussion Document an 'embedded liability' has an impact on the market value of the relevant asset in that it reduces the market value of the asset to which it relates. The assumption thereof would, according to the Discussion Document, not represent consideration for the acquisition of the asset.³⁷

The view in respect of 'embedded' contingent liabilities appears to be based on the judgment delivered by the SCC in the matter of *Daishowa Marubeni International Ltd v Canada*³⁸ which is discussed in further detail in Chapter 3.

The Discussion Document considers the tax treatment of both the seller and the purchaser from a perspective where general income tax principles are applied. It does, however, remain to be determined if these principles find application in the instance where mining property is transferred in terms of the provisions of section 37 of the Income Tax Act, which contains specific provisions relating to the tax treatment of the seller and the purchaser. The provisions, interpretation and application of section 37 are discussed in further detail in Chapter 5.

³⁵ The Discussion Document, page 3.

³⁶ The Discussion Document, page 3.

³⁷ The Discussion Document, page 17.

³⁸ 2013 SCC 29.

CHAPTER 3

THE JUDGMENTS DELIVERED IN THE MATTER OF *DAISHOWA-MARUBENI INTERNATIONAL LTD V CANADA*

3.1. INTRODUCTION

As mentioned in Chapters 1 and 2, the Discussion Document introduces the concepts of 'free-freestanding' and 'embedded' contingent liabilities, the former being a separate and distinct liability which does not impact on the value of an asset and the latter being a liability which is inextricably linked to an asset to such an extent that it reduces the value of the asset to which it attaches (i.e. it becomes embedded in the asset).³⁹

The notion of 'free-standing' and 'embedded' contingent liabilities stems from the judgment delivered by the SCC in the matter of *Daishowa-Marubeni International Ltd v Canada*⁴⁰ where the court had to decide if the value of the contingent liabilities, in the form of reforestation liabilities, assumed by the purchaser had to be included in the taxpayer's (i.e. Daishowa-Marubeni International Ltd ("Daishowa")) 'proceeds of disposition' upon the disposal of its business as a going concern.

This chapter sets out the background facts to the matter as well as a summary of the judgments delivered in the Tax Court of Canada, the Canadian Federal Court of Appeal and the SCC.

3.2. THE FACTS

Daishowa owned two timber divisions (i) the High Level Division and (ii) the Brewster Division, located in the province of Alberta, which it respectively disposed of during 1999 and 2000. Both these divisions had a right or licence ("**right**" and/or "**forest tenure**") to cut and remove timber from the property over which the forest tenure extended. As the holder of this forest tenure, Daishowa was also obliged to reforest all the land from which it had cut and removed timber (i.e. a reforestation obligation/liability). The holder of such a forest tenure would only be absolved from the reforestation obligation once

³⁹ The Discussion Document, page 3.

⁴⁰ 2013 SCC 29.

the area which it had reforested entered into what is referred to as a 'free-to-grow period' or if natural processes made it impossible for the area to enter into such a period. The 'free-to-grow period' generally took between eight to 14 years to be achieved.

Sale of the High Level Division

The High Level division, including the forest tenure, was sold to Toklo Industries Ltd during 1999. The sale agreement provided for the purchase price of the division to be determined as follows:

- (a) A cash amount of \$169 000 000 for certain assets; plus or minus
- (b) The net purchased working capital which was estimated at \$16 628 400, plus or minus any difference between the estimated amount and the effective date amount; and
- (c) The assumption of Daishowa's reforestation liabilities, estimated at \$11 000 000 plus or minus any difference between the estimated amount and the effective date amount.

The purchase price of R169 000 000 was allocated to the acquired assets, as follows:

<u>Asset</u>	<u>Allocated Amount</u>
Land	\$1 000 000
Mill Buildings	\$18 000 000
Mill Machinery and Equipment	\$127 300 000
Logging Equipment, Roads and Rights	\$199 000
Mobile Equipment	\$1 000 000
Lot Storage Area and Similar Surface Construction	\$1 500 000
Forest Tenures	\$20 000 000
Other Assets	\$1 000 000
Total	\$169 000 000

The value of \$20 000 000 allocated to the forest tenure represented the net value and was calculated by deducting the value of \$11 000 000 allocated to the reforestation liability from the gross value of the forest tenure of \$31 000 000.

Sale of the Brewster Division

The Brewster division was sold to Seehta Forest Products during 2000 and as in the case of the disposal of the High Level division, also included the disposal of the forest tenure held by the Brewster division.

The purchase price of the Brewster division was determined as follows:

- (a) A cash amount of \$6 100 000 for certain assets; plus or minus
- (b) The net purchased working capital which was estimated at \$4 919 000, plus or minus any difference between the estimated amount and the effective date amount; and
- (c) The assumption of Daishowa's reforestation liabilities, estimated at \$2 996 380.

The purchase price of \$6 100 000 was allocated to the acquired assets, as follows:

<u>Asset</u>	<u>Allocated Amount</u>
Improvements	\$435 000
Equipment, Furniture and Fixtures	\$5 315 000
Forest Tenure	\$350 000
Total	\$6 100 000

In completing its tax returns for the 1999 and 2000 years of assessments, Daishowa did not include in its 'proceeds of disposition' the amounts allocated to the reforestation liabilities, assumed by the purchasers. Daishowa was reassessed, in respect of both the 1999 and 2000 years of assessment, by the Minister of National Revenue on the grounds that these amounts should have been included in Daishowa's 'proceeds from disposal' in determining its taxable income for the respective years of assessment.

It is against the inclusion of these amounts in Daishowa's 'proceeds of disposal', to which Daishowa' lodged an appeal to the Canadian Tax Court.

Additional Facts

The following facts are also relevant to the issues considered by the court.

The Canadian Tax Court, Federal Court of Appeal as well as the SCC had to decide whether the value of the reforestation liabilities assumed by the purchasers had to be included in Daishowa's 'proceeds for disposition' for purposes of section 13(21) of the Canadian Income Tax Act.⁴¹ The term 'proceeds of disposition' is defined in section 13(21) of the Canadian Income Tax Act to mean:

- “(a) the sale price of property that has been sold,*
- (b) compensation for property unlawfully taken,*
- (c) compensation for property destroyed and any amount payable under a policy of insurance in respect of loss or destruction of property,*
- (d) compensation for property taken under statutory authority or the sale price of property sold to a person by whom notice of an intention to take it under statutory authority was given,*
- (e) compensation for property injuriously affected, whether lawfully or unlawfully or under statutory authority or otherwise,*
- (f) compensation for property damaged and any amount payable under a policy of insurance in respect of damage to property, except to the extent that the compensation or amount, as the case may be, has within a reasonable time after the damage been expended on repairing the damage,*
- (g) an amount by which the liability of a taxpayer to a mortgagee or hypothecary creditor is reduced as a result of the sale of mortgaged or hypothecated property under a provision of the mortgage or hypothec, plus any amount received by the taxpayer out of the proceeds of the sale, and*
- (h) any amount included because of section 79 in computing a taxpayer's proceeds of disposition of the property”*

⁴¹ The Income Tax Act, Canada R.S.C., 1985, c. 1 (5th Supp.).

The matter related to the disposal of forest tenures by Daishowa which constituted 'timber resource properties' as defined in section 13(21) of the Canadian Income Tax Act. The definition of a 'timber resource property' reads as follows:

"timber resource property of a taxpayer means

(a) a right or license to cut or remove timber from a limit or area in Canada (in this definition referred to as an "original right") if

(i) that original right was acquired by the taxpayer (other than in the manner referred to in paragraph 13(21) "timber resource property" (b)) after May 6, 1974, and

(ii) at the time of the acquisition of the original right

(A) the taxpayer may reasonably be regarded as having acquired, directly or indirectly, the right to extend or renew that original right or to acquire another such right or license in substitution therefor, or

(B) in the ordinary course of events, the taxpayer may reasonably expect to be able to extend or renew that original right or to acquire another such right or license in substitution therefor, or

(b) any right or license owned by the taxpayer to cut or remove timber from a limit or area in Canada if that right or license may reasonably be regarded

(i) as an extension or renewal of or as one of a series of extensions or renewals of an original right of the taxpayer, or

(ii) as having been acquired in substitution for or as one of a series of substitutions for an original right of the taxpayer or any renewal or extension thereof."

With regard to the transfer of a forest tenure, it is the policy of the Alberta Department of Sustainable Resource Development that a forest tenure cannot be transferred to a purchaser unless that purchaser also assumes the reforestation obligation associated

with that forest tenure.⁴² It is furthermore the view of the Alberta Department of Sustainable Resource Development that once the forest tenure has been transferred to the purchaser, the purchaser also assumes the reforestation obligations associated with the forest tenure and that the seller is no longer liable for the reforestation obligation. A forest tenure will thus not be transferred by the Alberta Department of Sustainable Resource Development unless the purchaser undertakes to assume the reforestation obligation associated with that forest tenure and subsequent to the transfer of that forest tenure, the seller will not be pursued for the recovery of the reforestation liability.

3.3. JUDGMENT DELIVERED IN THE TAX COURT OF CANADA⁴³

On appeal to the Tax Court of Canada, Daishowa presented the following arguments as to why the amounts of the reforestation obligations assumed by the purchasers should not be included in its proceeds of disposition:⁴⁴

- (a) Although it received a benefit through the assumption of the of the reforestation obligations by the purchasers, the fair market value of these obligations were not determinable at the time the sale agreement closed and as such no amount can be included in its proceeds of disposition;
- (b) Alternatively, should it be found that the fair market values of the reforestation obligations were determinable at closing, the fair market values would be less than the estimated amounts used in the sale agreements as it represent an estimation of the amounts to be incurred over a period of 14 years and were not discounted to reflect a present value; and
- (c) Should it be found that the estimates used in the sale agreements are equal to the fair market values of the reforestation obligations, Daishowa

⁴² This policy is based on the content of section 163 of the Alberta Timber Management Regulation 60/1973, in terms of which "*Every assignment made shall be an unconditional assignment of the entire interest therein of the assignor, but the assignor may also be one of the assignees.*"

⁴³ *Daishowa-Marubeni International Ltd v Her Majesty the Queen*, 2010 TCC 317, 2010 DTC. 1216.

⁴⁴ At paragraph 20.

would be entitled to a corresponding deduction from its income on the grounds that it had paid the purchasers with assets to assume the reforestation obligation.

The Minister of National Revenue, represented by the Canadian Revenue Authority, in turn argued that the sales price of the respective agreements consisted of the cash payments as well as consideration in the form the assumption of the reforestation obligations and that if it was found that Daishowa had incurred any expenditure such expenditure would not be deductible as it represented a capital outlay.⁴⁵

Accordingly, the following issues had to be decided by the Canadian Tax Court:⁴⁶

- (a) Whether the values of the reforestation obligations assumed by the purchasers should be included in the proceeds of disposition of Daishowa;
- (b) Whether these amounts were properly allocated to the timber resource properties; and
- (c) Whether Daishowa was entitled to a deduction from its income equal to the value of the reforestation obligations assumed by the purchasers.

Although the court passed judgment in respect of all three of the above-mentioned issues, the questions relating to the allocation of the amounts and the deductibility thereof will not receive any further detailed consideration as the main issue for consideration is whether or not the assumption of the reforestation obligations by the purchaser would constitute consideration received by Daishowa and as such stands to be included in its proceeds of disposition.

Due to the similarities between the disposal of the High Level division and the Brewster division, the court delivered its judgment with reference to the facts relating to the disposal of the High Level division.

As to the question of whether or not the value of the reforestation liabilities assumed by the purchaser constituted consideration and therefore should be included in Daishowa's proceeds from disposition, the court found as follows:⁴⁷

⁴⁵ At paragraph 21.

⁴⁶ At paragraph 19.

- (a) Daishowa acknowledged that it received a benefit from the purchasers through the assumption of the reforestation obligations.
- (b) It furthermore acknowledged that had the purchasers not assumed the reforestation obligations the portion of the purchase price which was paid in cash would have increased.
- (c) The definition of proceeds of disposal in section 13(21) included the sale price of a property. The 'price' of an item is commonly defined to include 'consideration', which is in turn defined as "*some right, interest, profit, or benefit accruing to one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other*".

Based on the above the court concluded that the assumption of the reforestation liabilities did in fact form part of the consideration given by the purchasers and as such should be included in Daishowa's proceed of disposition. The court further found that the fact that Alberta's regulatory scheme did not allow for a forest tenure to be transferred without the reforestation obligation associated with that tenure being assumed by the purchaser, did not detract from its nature as consideration.⁴⁸

Daishowa's appeal against the inclusion of the reforestation obligations was accordingly dismissed.

3.4. JUDGMENT DELIVERED IN THE CANADIAN FEDERAL COURT OF APPEAL⁴⁹

Both Daishowa and the Canadian Revenue Authority respectively lodged an appeal and cross-appeal to the Canadian Federal Court of Appeal against the judgment delivered in the Tax Court.

In this regard, Daishowa appealed against the inclusion of the value of the reforestation obligations assumed by the purchasers in its proceeds of disposition, whereas the Canadian Revenue Authority appealed against the value determination, set by the Tax

⁴⁷ At paragraph 24 - 25.

⁴⁸ At paragraph 19.

⁴⁹ *Daishowa-Marubeni International Ltd v Her Majesty the Queen*, 2011 FCA 267, 422 NR 188.

Court, of the reforestation obligations to be included in Daishowa's proceeds of disposition. As with the discussion under 3.3, the discussion of the judgment delivered by the Canadian Federal Court of Appeal will only relate to the inclusion of the reforestation liabilities in Daishowa's proceeds of disposition.

In the majority judgment the court agreed with the conclusions reached by the Canadian Tax Court as to the fact that the reforestation liabilities assumed by the purchasers constituted consideration and as such should be included in Daishowa's proceeds of disposition.

The court stated that with regard to the meaning of the term 'proceeds of disposition' as contained in section 13(21) of the Canadian Income Tax Act, the focus was on whether the seller received value i.e. consideration for the assumption of the liability and that the nature of the liability (i.e. contingent or absolute) was irrelevant.⁵⁰

In delivering the dissenting judgment, Mainville J.A, stated that in his view the Tax Court had erred in assuming that that the assumption of the reforestation obligations by the purchasers constituted separate and distinct consideration for the sale of the forest tenures. In this regard, the judge was of the view that although the reforestation obligations affect the value of the forest tenures, it forms such an integral part of the forest tenures that the assumption thereof by the purchasers did not constitute separate consideration.⁵¹

The judge stated as follows:⁵²

"The proper approach in these proceedings is to recognise that the reforestation liabilities at issue depress the value of the timber resources [forest tenure] to which they are inextricably linked, and that consequently the vendor [Daishowa] received a lower price on the sale of these properties than it might have otherwise received."

Mainville J.A, concluded that as the reforestation obligations are inextricably linked to the forest tenures, they do not exist separately from the forest tenures and as such depress the value of the forest tenures. Therefore, the value of the reforestation

⁵⁰ At paragraph 82.

⁵¹ At paragraph 128.

⁵² At paragraph 130.

obligations does not form part of the proceeds of disposition resulting from the sale of the forest tenures.⁵³

The judge was furthermore of the view that the above would apply irrespective of whether the reforestation obligations are transferred to the purchasers by operation of law or as a result of conditions set by a regulating authority for the transfer of a forest tenure.⁵⁴

3.5. JUDGMENT DELIVERED IN THE SUPREME COURT OF CANADA⁵⁵

Following the judgment delivered in the Canadian Federal Court of Appeal, Daishowa took the matter on appeal to the SCC where the following issues had to be decided:⁵⁶

- (a) Whether the reforestation obligations assumed by the purchasers were to be included in Daishowa's proceeds of disposition on the basis that Daishowa was relieved of a distinct liability or are the reforestation obligations so inextricably linked to the forest tenures to the extent that it reduces the market value of the forest tenures; and
- (b) Whether the fact that the parties allocated a specific value to the reforestation obligations makes any difference.

The court stated that it is beyond dispute that the assumption of liabilities by a purchaser may constitute part of the sales price of the assets acquired by the purchaser and therefore would form part of the seller's proceeds of disposition. To illustrate this, the court used the example of the sale and purchase of a property which is encumbered by a mortgage bond. Should the property be acquired by the purchaser through the payment of a cash amount and the assumption of the mortgage, the purchase price of the property would include both the cash amount and the amount of

⁵³ At paragraph 138.

⁵⁴ At paragraph 136.

⁵⁵ 2013 SCC 29.

⁵⁶ At paragraph 22.

the mortgage assumed by the purchaser and as such both these amounts fall to be included in the seller's proceeds of disposal.⁵⁷

The Canadian Revenue Authority advanced the argument that a forest tenure with reforestation obligations attaching to it was similar to that of a property encumbered by a mortgage bond. As such the assumption of the reforestation obligations by the purchaser would form part of the purchase price, in the same manner that the assumption of the mortgage would, and therefore should be included in the seller's proceeds of disposition.⁵⁸

Daishowa, however, did not agree with the above analogy as advanced by the Canadian Revenue Authority. In its view, a forest tenure with a reforestation obligation attaching to it is more akin to a property in need of repair. The assumption by the purchaser of the cost of repairs would not form part of the sales price for the property but would in fact depress the value of the property and as such would not form part of the seller's proceeds of disposition.⁵⁹

It was acknowledged by the Canadian Revenue Authority that in the instance where property in need of repair is disposed of, the seller would not be required to include the value of the repair costs, assumed by the purchaser in its proceeds of disposition. The court confirmed that this would be the position even if the parties attributed a value to the cost of repairs in the sale agreement or if the repairs were required by law.⁶⁰

In this regard the SCC agreed with the judgment delivered by Mainville J.A in the Canadian Federal Court of Appeal and the arguments advanced by Daishowa. The court found the reforestation obligations attaching to a forest tenure are not a distinct existing debt, the assumption of which would form part of the sales price of the forest tenure. Instead the SCC was of the view that the reforestation obligations are a future cost embedded in the forest tenure which serves to depress the value of the forest tenure.⁶¹

⁵⁷ At paragraph 26.

⁵⁸ At paragraph 27.

⁵⁹ At paragraph 28.

⁶⁰ At paragraph 28.

⁶¹ At paragraph 29.

In the case of the High Level division, the parties had determined the value of the forest tenure to be \$20 000 000. This amount was determined by subtracting the estimated value of the reforestation obligations of \$11 000 000 from the estimated value of the forest tenure of \$31 000 000. The court found that to include the full amount of \$31 000 000 in Daishowa's proceed of disposition would be to disregard the fact that Daishowa never had \$31 000 000 in value to sell to the purchaser.⁶² The existence of the reforestation obligation would reduce the value of the forest tenure and as such reduce the amount which a purchaser would pay for the forest tenure.

According to the SCC, this results in a forest tenure with reforestation obligations attaching to it, being more akin to a property in need of repair rather than a property encumbered by a mortgage. In the case of property in need of repair, the cost of the repairs would reduce the value of the property whereas the existence of a mortgage bond would not affect the value of the property.⁶³

Daishowa's appeal was thus upheld by the SCC on the grounds that the reforestation obligations attaching to a forest tenure are embedded in the forest tenure and as such are future expenses associated with the ownership of the forest tenure. The reforestation obligations are not separate liabilities which can be assumed by a purchaser and as such do not fall to be included in the seller's proceeds of disposition.⁶⁴

As the reforestation obligations are embedded in the forest tenure and therefore reduce the value of the forest tenure, the court found that any value attached the reforestation obligations by the parties serve no purpose other than to assist in determining the fair market value of the forest tenure.⁶⁵

As is evident from paragraphs [41] – [43] of the judgment a major consideration in delivering the judgment was the avoidance of the asymmetrical tax treatment of the seller and the purchaser.

⁶² At paragraph 31.

⁶³ At paragraph 32.

⁶⁴ At paragraph 37.

⁶⁵ At paragraph 45.

The position as argued by the Canadian Revenue Authority would have resulted in the amount of the reforestation obligations being included in Daishowa's proceeds of disposition but the purchaser would not have received a corresponding increase in its base cost in respect of the forest tenure it acquired. This would effectively have resulted in Daishowa being taxed as if the reforestation obligations formed part of the purchase price of the forest tenure, whereas the purchaser would have been taxed as if the reforestation obligations it assumed were not part of the purchase price of the forest tenure.⁶⁶

The judgment delivered by the SCC, however, avoided the asymmetrical tax treatment of the seller and the purchaser.

3.6. CONCLUSION

In terms of the judgment delivered in the matter of *Daishowa-Marubeni International Ltd v Canada* the value of a forest tenure is reduced by the value of the reforestation obligation that attaches to it. Since the reforestation obligation reduces the value of the forest tenure, the assumption thereof would not constitute part of the purchase price paid by the purchaser for the acquisition of the forest tenure.

The question to be determined is how this judgment will impact in a South African mining tax context with specific reference to the transfer of mining rights and the corresponding mining rehabilitation obligation associated with mining rights.

⁶⁶ At paragraph 41.

CHAPTER 4

IMPACT OF THE JUDGMENT IN *DAISHOWA-MARUBENI INTERNATIONAL LTD v CANADA* ON THE TRANSFER OF MINING RIGHTS IN SOUTH AFRICA

4.1. INTRODUCTION

In terms of the judgment delivered in the matter of *Daishowa-Marubeni International Ltd v Canada*⁶⁷ the assumption of the seller's reforestation obligation will not constitute part of the purchase price paid by the purchaser for the acquisition of the forest tenure. This follows as the reforestation obligation is future cost embedded in the forest tenure which reduces the value of the forest tenure and does not exist separately from the forest tenure.

Should this judgment be directly applied in a South African mining tax context, specifically with regard to the transfer of mining rights and property as a going concern and the assumption of the mining rehabilitation liabilities associated with these mining rights, what would the impact be?

This chapter will provide a brief background to the tax treatment of taxpayers involved in mining and mining operations⁶⁸ in South Africa as well as the tax consequences upon the disposal of mining property. It will furthermore illustrate the impact of the judgment delivered in *Daishowa-Marubeni International Ltd v Canada*, should it be applied directly in a South African mining tax context. The question as to whether the judgment actually applies to the transfer of mining rights and assets in South Africa, in light of the specific provisions contained in section 37 of the Income Tax Act,⁶⁹ will be discussed in the subsequent chapters.

4.2. THE SOUTH AFRICAN MINING TAX REGIME

As with all other resident taxpayers, taxpayers conducting mining or mining operations are taxed on their taxable income as determined in terms of the Income Tax Act.

⁶⁷ 2013 SCC 29, at paragraphs 29 and 37.

⁶⁸ 'Mining' and 'Mining Operations' are defined in section 1 of the Income Tax Act to include "every method or process by which any mineral is won from the soil or from any substance or constituent thereof".

⁶⁹ Act 58 of 1962.

However, the Income Tax Act contains specific provisions in terms of which the taxable income of taxpayers, conducting mining or mining operations, is determined.

4.2.1. The mining capital expenditure allowance

Of particular significance in the current circumstances is the capital expenditure allowance afforded to taxpayers, conducting mining and mining operations, in terms of section 15(a) read with section 36 of the Income Tax Act.

Section 15(a) provides a taxpayer conducting mining or mining operations, with a capital expenditure⁷⁰ allowance which it can claim against the income it derives from mining operations.⁷¹ This allowance is given to the taxpayer *in lieu* of the capital expenditure allowances normally claimed in terms of sections 11(e), (f), (gA), (gC), (o), 12D, 12DA, 12F and 13*quin*. The amount to be claimed in terms of section 15(a) is determined in terms of the provisions contained in section 36 of the Income Tax Act.

Section 36(7C) determines that the amount to be deducted from the taxpayer's mining income, in terms of section 15(a), is the amount of 'capital expenditure incurred'. The provisions of section 36(7C) are, however, subject to the ring-fencing provisions contained in sections 36(7E), (7F) and (7G). The ring-fencing provisions essentially and in very simplified terms, serve to determine and limit the total amount of capital expenditure that can be claimed during a year of assessment and provides for any excess amounts to be carried forward to the subsequent year of assessment and to be claimed against mining income in that year. Although the content, interpretation and application of the ring-fencing provisions have been the topic of significant discussion

⁷⁰ As defined in section 36(11) of the Income Tax Act. It must be noted that the cost of a mining right is not included under the definition of 'capital expenditure' in section 36(11) and therefore does not qualify to be deducted in terms of the capital expenditure allowance provided for under section 15(a) read with section 36.

⁷¹ The capital expenditure allowance afforded to a taxpayer in terms of section 15(a) is only available for set-off against income derived from mining operations as defined in section 1 of the Income Tax Act (see footnote 2 above). For a detailed discussion as to when income will be considered to be mining income (i.e. derived from mining or mining operations) see the judgment delivered in the matter of *Western Platinum Ltd v C:SARS*, [2004] JOL 12997 (SCA) where it was found that there must be a direct link between the mining activities of the taxpayer and the income in order for to constitute mining income.

in recent years,⁷² of greater importance to the current discussion is the definition of the term 'capital expenditure incurred' as contained in section 36 of the Income Tax Act.

As mentioned above, in terms of section 36(7C), the amount of the capital expenditure allowance a taxpayer conducting mining and mining operations is allowed to claim against its mining income, is the amount of 'capital expenditure incurred'. In this regard section 36(11) defines the term 'capital expenditure incurred' as follows:

*“**capital expenditure incurred**”, for the purpose of determining the amount of capital expenditure incurred during any period in respect of any mine, means the amount (if any) by which the expenditure that is incurred during such period in respect of such mine and is capital expenditure, exceeds the sum of the amounts received or accrued during the said period from disposals of assets the cost of which has in whole or in part been included in capital expenditure taken into account (whether under this Act or any previous Income Tax Act) for the purposes of any deduction in respect of such mine under section 15(a) of this Act or the corresponding provisions of any previous Income Tax Act”*

The amount that a taxpayer conducting mining and mining operations, will be allowed to claim against its mining income (subject to the ring-fencing provisions) in terms of section 15(a) is thus, the net amount after the amount of capital expenditure (as defined in section 36(11)) incurred during that year has been reduced by any amounts received during that year in respect of the disposal of capital assets, the cost of which constituted and was included in the taxpayer's capital expenditure as defined in section 36(11).

The effect of the above provisions is that a taxpayer, conducting mining and mining operations, can set-off in one year as much of the capital expenditure it incurred against its mining income as the provisions of section 15(a) read with section 36 will allow. Any excess amount that does not qualify to be deducted will be carried forward to the subsequent year of assessment for deduction. In contrast to this, the capital allowance provisions as contained in section 11(e), (f), (gA), (gC), (o), 12D, 12DA, 12F and 13quin provide for the cost of the capital asset to be claimed over a specified period and effectively spreads the allowance over a number of years.

⁷² See the judgment delivered in the matter of *Armgold/Harmony Freegold Joint Venture (Pty) Ltd v C:SARS*, 2013 (1) SA 353 (SCA).

4.2.2. Paragraph (j) gross income inclusion and capital gains tax

A further difference in the manner in which taxpayers, conducting mining and mining operations are taxed, is the inclusion of the amount to be determined in terms of paragraph (j) of the 'gross income' definition,⁷³ in the taxpayer's gross income during the year in which capital assets are disposed of. In this regard paragraph (j) of the gross income definition provides for the following amount to be included in a taxpayer's gross income:

"so much of any amounts received or accrued during any year of assessment in respect of the disposal of assets the cost of which has in whole or in part been included in capital expenditure taken into account (whether under this Act or any previous Income Tax Act) for the purposes of any deductions in respect of any mine under section 15(a) of this Act or the corresponding provisions of any previous Income Tax Act, as exceeds the sum of so much of any capital expenditure as in the case of such mine is unredeemed at the commencement of the said year of assessment and the capital expenditure that is incurred during that year in respect of such mine, as determined before applying the definition of "capital expenditure incurred" in section 36(11)."

Thus, where a taxpayer conducting mining and mining operations, disposes of a capital asset (i.e. an asset, the cost of which qualified as capital expenditure for the purposes of the section 15(a) capital expenditure allowance) and the amount it receives in respect of the disposal of that capital asset exceeds the capital expenditure incurred by the taxpayer during the year in which the asset was disposed, prior to the application of the definition of 'capital expenditure incurred' in section 36(11), the excess amount is to be included in the taxpayer's gross income.⁷⁴

The effect of the above is that upon disposal of a capital asset by a taxpayer conducting mining and mining operations, the taxpayer will not be liable for capital gains tax. This follows as the amount received by the taxpayer in respect of the disposal will first be applied against the capital expenditure incurred by the taxpayer during that year where after any excess amount will be included in the taxpayer's gross income.

⁷³ Section 1 of the Income Tax Act, 58 of 1962.

⁷⁴ SILKE on South African Income Tax, Vol 2 at 16.4, page 16 – 14.

The inclusion of this amount in the taxpayer's gross income will result in the amount not being recognised as 'proceeds' for capital gains tax purposes as paragraph 35(3)(a) of the Eighth Schedule provides that the proceeds from the disposal of an asset must be reduced by any amount that must be included or was included in the gross income of the taxpayer or was taken into account in determining the taxable income of the taxpayer.

The South African Income Tax Act thus provides for a specific regime which applies to taxpayers conducting mining and mining operations. This regime provides such a taxpayer with the benefit of an accelerated capital expenditure allowance but also includes the amount received in respect of the disposal of capital assets (should the requirements of paragraph (j) of the gross income definition be met) as an amount under gross income instead of subjecting the taxpayer to capital gains tax.

A similar position seems to apply in Canada in respect of a timber resource property as defined in section 13(21) Canadian Income Tax Act.⁷⁵ In essence, a timber resource property is treated as a hybrid for tax purposes in that the taxpayer can claim an annual capital allowance in respect of the cost of the timber resources equal to a percentage of the undepreciated capital cost of the timber resource property but upon disposal of the timber resource property, the proceeds received by the taxpayer are treated as income to the extent that it exceeds the capital cost of the property.⁷⁶

4.3. APPLICATION OF THE *DAISHOWA-MARUBENI INTERNATIONAL LTD v CANADA* JUDGMENT TO THE DISPOSAL OF MINING CAPITAL ASSETS AND PROPERTY

4.3.1. Disposal and acquisition of capital assets only

In the instance where a taxpayer, conducting mining and mining operations, acquires only capital assets⁷⁷ the judgment as delivered in *Daishowa-Marubeni International Ltd v Canada* (on the assumption that the judgment applies in a South African mining tax

⁷⁵ The Income Tax Act, Canada R.S.C., 1985, c. 1 (5th Supp.).

⁷⁶ *Daishowa-Marubeni International Ltd v Canada*, 2013 SCC 29 at paragraph 24.

⁷⁷ Assets, the cost of which would constitute capital expenditure as defined in section 36(11) of the Income Tax Act.

context) will not have any impact in respect of the amount of capital expenditure the taxpayer incurs in acquiring the capital assets. This follows as the taxpayer will not acquire a mining right, the value of which will be reduced by the mining rehabilitation obligation embedded therein.

The consideration given by the taxpayer for the capital assets, whether in the form of a cash payment, the assumption of liabilities or a combination thereof, will constitute capital expenditure incurred for purposes of 36(11) and as such would qualify to be claimed as part of the capital expenditure allowance in terms of section 15(a) read with section 36. It is noted that, should the taxpayer assume contingent liabilities, the position as set out in the Discussion Document and discussed under 2.5 above will apply and the taxpayer will only be able to claim the expenditure once the liability has become unconditional.

The total value of the consideration given by the purchaser will be included in the seller's proceeds received from the disposal of the capital assets and where the requirements of paragraph (j) of the gross income definition are satisfied the relevant amount will be included in the seller's gross income in respect of the year of assessment during which the capital assets were disposed of.

4.3.2. Disposal and acquisition of mining capital assets and mining property

In the event that a taxpayer acquires capital assets as well as mining property (including a mining right) the provisions of section 37 of the Income Tax Act will apply. Section 37 contains specific provisions for the calculation of the amount of capital expenditure that a taxpayer will be deemed to have incurred when it acquires mining property as well as capital assets. The content and application of section 37 of the Income Tax Act is considered in detail in Chapter 5 and as such for purposes of this section, only a brief overview will be provided.

When a taxpayer acquires capital assets as well as mining property, it is deemed to have acquired the capital assets for a cost equal to the effective value of the capital assets on the effective date of the transaction.⁷⁸ The effective value of the capital assets as well as the mining property is determined and set by the Director-General for

⁷⁸ SILKE on South African Income Tax, Vol 2 at 16.6, page 16 – 16.

the DMR.⁷⁹ Should the effective value for all the assets acquired by the taxpayer exceed the value of the consideration given by the taxpayer for these assets, section 37(1A) provides a formula in terms of which the consideration given is to be apportioned to the respective assets acquired by the purchaser.

The deemed cost at which the taxpayer acquires the capital assets is then also deemed to be the capital expenditure incurred by the taxpayer in acquiring these assets for purposes of the definition of capital expenditure incurred in section 36(11).⁸⁰ It thus follows that this deemed amount will be the amount that qualifies to be deducted in terms of section 15(a) in determining the taxpayer's taxable income.

In terms of section 37(2) the seller will be deemed to have disposed of the capital assets for a consideration equal to the deemed capital expenditure incurred by the purchaser as determined in terms of section 37(1) and (1A). This will then be the amount used for purposes of determining the paragraph (j) gross income inclusions to be accounted for by the seller.

The impact of the judgment in *Daishowa-Marubeni International Ltd v Canada* in the circumstances where both capital assets and mining property are acquired by a taxpayer can be best illustrated through the following, simplified example.

A seller disposes of its mining right as well as mining capital assets to the purchaser for purchase price of R110 000 000. The Director-General for the DMR has set the effective value of the capital assets at R60 000 000 and the value of the mining right at R40 000 000. The purchaser, in return for the mining right and capital assets, settles the purchase price through a cash payment of R40 000 000 and the assumption of the seller's mining rehabilitation obligation valued at R70 000 000.

Should it be accepted that the assumption of the mining rehabilitation obligation constitutes a separate and distinct liability, the assumption of which constitutes consideration, the purchaser's tax position would be as follows:

- (a) The purchaser will recognise capital expenditure incurred, for purposes of section 36(11), on the acquisition of the capital assets to the value of

⁷⁹ Section 37(4).

⁸⁰ Section 37(1).

R60 000 000 which is equal to the effective value of the assets as set by the Director-General of the DMR.

- (b) The remaining R50 000 000 of the consideration given by the purchaser will be allocated to the value of the mining right.

The seller will be deemed to have disposed of the capital assets for an amount of R60 000 000, which amount will be used to determine the amount to be included in its gross income in terms of paragraph (j) of the gross income definition. The seller will furthermore recognise proceeds upon the disposal of the mining right to the value of R50 000 000 which amount will constitute proceeds for capital gains tax purposes.

Should the judgment in *Daishowa-Marubeni International Ltd v Canada* be applied to the above set of facts the following would result:

- (a) The assumption of the R70 000 000 mining rehabilitation obligation will not constitute consideration given by the purchaser for the acquisition of the mining right and capital assets.
- (b) The purchaser would effectively have acquired the mining right and capital assets, which have a combined value of R100 000 000 as determined by the Director-General for the DMR, for a consideration of R40 000 000 (i.e. the value of the cash payment).
- (c) As the effective value of all the assets (i.e. the mining right and the capital assets) exceeds the cash consideration of R40 000 000, this amount will be apportioned between the mining right and capital assets on a 40/60 basis⁸¹ in terms of section 37(1A). The purchaser will thus be deemed to have incurred capital expenditure for purposes of section 36(11) on the acquisition of the capital assets in the amount of R24 000 000.
- (d) The seller will, in turn, be deemed to have disposed of the capital assets for an amount of R24 000 000, which amount will be used to determine its paragraph (j) gross income inclusion.

⁸¹ The ratio that the mining right (i.e. R40 000 000) and capital assets (i.e. R60 000 000) in terms of the effective valuation held against the total value of all the assets as per the effective valuation (i.e. R100 000 000).

4.4. CONCLUSION

The direct application of the judgment in *Daishowa-Marubeni International Ltd v Canada* will clearly have a significant impact on both the seller and the purchaser in the instance where mining property and capital assets are acquired by the purchaser through the assumption of the seller's mining rehabilitation obligations.

The question, however, is whether the view that mining rehabilitation obligations are inextricably linked to a mining right and therefore embedded in the mining right to such an extent that it reduces the value of the mining right, does in fact find application in the context of the South African mining tax regime? In this regard, the fact that the concept of an 'embedded liability' has been adopted from foreign case law as well as the fact that the Income Tax Act contains specific provisions, in the form of section 37, which regulate the transfer of mining property and capital assets, are of great significance.

These considerations will be discussed in further detail in the chapters below.

CHAPTER 5

INTERPRETATION AND APPLICATION OF SECTION 37 OF THE INCOME TAX ACT

5.1. INTRODUCTION

As mentioned in Chapter 4, the South African Income Tax Act⁸² contains very specific provisions relating to the tax treatment of taxpayers conducting mining and mining operations. These provisions create a very distinct tax regime which differs significantly from the manner in which a taxpayer which does not conduct mining or mining operations will be taxed.

One of the sections in the Income Tax Act, forming part of the mining tax regime is section 37. This section contains very specific provisions in terms of which the capital expenditure incurred by a taxpayer, for purposes of section 36(11) of the Income Tax Act, is determined upon the acquisition of mining property and capital assets.

This chapter will consider and discuss the content of the provisions contained in section 37 of the Income Tax Act as well as the application thereof to the acquisition of mining property and assets.

5.2. THE PROVISIONS OF SECTION 37 OF THE INCOME TAX ACT

The discussion below sets out and considers each of the provisions contained in section 37(1) to 37(5) of the Income Tax Act on an individual basis. It must be noted that section 37 will only apply in the instance where both mining property as well as capital assets are acquired by a taxpayer as part of the same transaction. Should it only be mining property or capital assets which are acquired by the taxpayer, the normal principles in respect of cost, expenditure, capital expenditure, proceeds and gross income will apply to the respective transactions.

⁸² Act 58 of 1962.

5.2.1. Section 37(1)

Section 37(1) of the Income Tax Act, reads as follows:

"For the purposes of this Act, but subject to subsection (1A), whenever a taxpayer [seller] -

- a) sells, transfers, leases or cedes any mining property; and*
- b) disposes of any assets contemplated in section 36(11) (hereinafter referred to as 'the capital assets') in consequence of the sale, transfer, lease or cession contemplated in paragraph (a),*

the person acquiring those capital assets shall be deemed to have acquired such capital assets at a cost equal to the effective value of those capital assets to that person on the effective date of that agreement of sale, transfer, lease or cession of the mining property, and the said cost shall be deemed to be expenditure that is incurred by that person during the period of assessment during which that agreement takes effect and to be capital expenditure which is in respect of such period required to be taken into account for the purposes of the definition of "capital expenditure incurred" in section 36(11)."

From the wording of section 37(1) it is evident that when a taxpayer acquires capital assets, as contemplated in section 37(1)(b), the taxpayer is deemed to have acquired those assets at a cost equal to the effective value of those capital assets as at the effective date of the transaction. The effective value of the capital assets and mining property is determined by the Director-General of the DMR through an effective valuation. This deemed cost of acquisition is then also deemed to be expenditure incurred by the taxpayer in acquiring the capital assets as well as 'capital expenditure incurred', as defined in section 36(11).

Therefore, a taxpayer that is a purchaser and falls within the provisions of section 37(1), is deemed to have incurred capital expenditure, for purposes of section 36(11). This deemed capital expenditure is equal to the amount determined by the Director-General of the DMR through an effective valuation done on the mining property and capital assets. Section 37(1) is therefore the starting point in determining the deemed capital expenditure (for purposes of section 36(11)) of a taxpayer upon the acquisition of mining property and capital assets.

5.2.2. Section 37(1A)

The wording of section 37(1), however, makes it clear that the application of section 37(1) is subject to the provisions of section 37(1A). In this regard, section 37(1A) determines the following:

“Where any consideration is given by the person acquiring the assets disposed of by the taxpayer [seller], as contemplated in subsection (1), and the effective value of all those assets (including any mining property) so acquired, exceeds that consideration, the amount of the cost and expenditure in respect of the capital assets shall, for the purposes of subsection (1), be deemed to be an amount which bears to the total amount of such consideration the same ratio as such effective value of those capital assets bears to the effective value to that person of all the assets (including any mining property) so disposed of to that person.”

Section 37(1A) thus provides for the apportionment of the deemed cost and as such deemed capital expenditure at which the taxpayer acquires the capital assets in the event that the value allocated to the assets (i.e. capital assets and mining property), through the effective valuation conducted by the Director-General of the DMR, exceeds the 'consideration given' by the taxpayer for these assets. In the instance where section 37(1A) applies the 'consideration given' by the taxpayer must be compared to and apportioned in relation to the effective valuation of the assets as provided by the Director-General of the DMR.

In terms of section 37(1A), in order to determine the deemed capital expenditure incurred by the taxpayer in respect of the capital assets it acquired, the portion of the consideration given, which is allocated to the capital assets, must hold the same ratio to the total consideration given by the taxpayer as the effective value of the capital assets, as per the Director-General of the DMR's valuation, holds to the total effective valuation of all the assets acquired.⁸³

⁸³ SILKE on South African Income Tax, Vol 2 at 16.6, page 16 – 17.

5.2.3. Section 37(2)

Section 37(2) determines the tax treatment of the seller and determines the following:

"For the purposes of paragraph (j) of the definition of "gross income" in section 1 and section 36, the taxpayer [seller] who disposes of any capital assets contemplated in subsection (1), shall be deemed to have disposed of such capital assets for a consideration equal in value to the cost of those capital assets to the person acquiring such capital assets, as determined under subsection (1) and 1(A), and such consideration shall be deemed to have been received by or to have accrued to the said taxpayer [seller] on the effective date of the agreement of sale, transfer, lease or cession."

Section 37(2) sets out the position of the seller in respect of the amount that is to be included in its gross income (for purposes of paragraph (j) of the definition of gross income) in respect of the capital assets that it disposed of. In this regard, the seller is deemed to have disposed of the capital assets for a consideration equal to the cost (and capital expenditure), as determined under section 37(1) and 37(1A), at which the purchaser acquired the capital assets. This deemed amount will then be used to determine the amount to be included in the seller's gross income, if any, in terms of paragraph (j) of the gross income definition.

It is thus not the cash amount, purchase price or actual proceeds which are to be considered when determining the position of the seller upon the disposal of the capital assets, but the amount as determined in terms of section 37(2), which is equal to the deemed capital expenditure incurred by the purchaser.

5.2.4. Section 37(3)

Should the value of the consideration given or the value of the property disposed of be in dispute, section 37(3) provides the Commissioner for the South African Revenue Service ("the Commissioner") with the authority to settle the dispute as well as a mechanism through which to settle the dispute. Section 37(3) reads as follows:

"If the value of the consideration given or the value of the property disposed of is in dispute, the value may be fixed by the Commissioner and shall be determined-

- a) *in the case of any mining property, in the same manner as if transfer duty were payable; or*
- b) *in the case of any capital asset, at the market value of such capital asset.”*

From the use of the word 'may' in the proviso to section 37(3) it would seem that the Commissioner is provided with a discretion to determine the value of the 'consideration given' or the value of the property where a dispute exists. However, the remainder of the proviso and more specifically the use of the word '*shall*', makes it clear that should the Commissioner choose to exercise this discretion the value of the 'consideration given' or property must be determined in terms of the provisions of section 37(3)(a) and (b).

An alternative and preferred interpretation to the use of the word 'may' is however, that the use of the word 'may' in the context of section 37 does not only provide the Commissioner with a discretion but also a duty to set the value of the capital assets or consideration given, whichever is in dispute. This follows as it could surely not have been the intention of the legislature to provide the Commissioner with the power to settle a dispute, as contemplated in section 37(3), in one instance and not do the same in another,⁸⁴ purely on the basis of exercising a discretion as it would be severely prejudicial to the rights of the taxpayers.

Thus, where the provisions of section 37 apply and a dispute exists with regard to the value of the 'consideration given' or the value of the property disposed of, the Commissioner has to determine the value of the 'consideration given' or property disposed of and when he does so, he must determine the respective values in terms of the parameters specified in the provisions of section 37(3)(a) and (b).

The application of the mechanism prescribed in section 37(3)(a) and (b), for determining the value of the consideration given or property disposed of will be discussed in further detail below.

⁸⁴ *CIR v King*, 1947 (2) SA 196 (A), 14 SATC 184, [at page 193 of 14 SATC 184].

5.2.5. Section 37(4)

Section 37(4) determines that the effective value of the assets being disposed of shall be set by the Director-General of the DMR and furthermore determines the powers that Director-General will have in determining the effective value of the assets that are being disposed of. Section 37(4) reads as follows:

"The effective value on the effective date of the agreement of sale, transfer, lease or cession of all the assets disposed of, shall be determined by the Director General for Minerals and Energy who shall, notwithstanding the repeal of the Second Schedule to the Transvaal Mining Leases and Mineral Law Amendment Act, 1918 (Act No.30 of 1918), for the purposes of such determination have all the powers which were conferred upon him by the provisions of that Schedule."

As with the use of the word 'shall' in section 37(3), the use thereof in the text of section 37(4) makes it clear that the Director-General of the DMR is the only person with the authority to set the effective value of the assets being disposed of. Once the effective value of the respective assets has been set by the Director-General, no party to the transaction nor the Commissioner can change the values allocated to the assets.

In the matter of *Pering Mine (Pty) Ltd v Director-General, Mineral and Energy Affairs and others*⁸⁵ the court found that not even the Director-General could re-open and amend an evaluation done in terms of section 37(4). In this matter the taxpayer had acquired mining assets the values of which were determined through an effective valuation conducted by the then Director-General of Mineral and Energy Affairs in terms of s 37(4) of the Income Tax. The taxpayer had been assessed for tax on the basis of the values attributed to the assets through the effective valuation. Four years after the original determination was done the Director-General amended his original value determination of the mining assets which resulted in the taxpayer being re-assessed for tax on the new values. This resulted in a substantial increase in the taxpayer's tax liability. The taxpayer took the decision to re-determine the value of the assets on review and sought an order setting the re-determination as well as the additional assessment raised by the Commissioner aside.

⁸⁵ [2005] 4 All SA 641 (T), at page 647.

The court found that the Director-General was *functus officio* in re-valuing the assets after it had already done so and that where an administrative official has made a decision that affects a private individual's interests, that decision is final and unless the enabling statute expressly or impliedly gives him authority to do so, he may not re-open the decision which he has taken.

With regard to the powers that the Director-General has in determining the effective value of the assets the Second Schedule to the Transvaal Mining Leases and Mineral Law Amendment Act gives the Director-General free access to all plans and records relating to the assets, the power to request all information which he deems relevant in determining the value of the assets, as well as the authority to inspect or examine the assets.

5.2.6. Section 37(5)

Section 37(5) provides a definition for the term 'mining property' for the purposes of applying the provisions of section 37. The section reads as follows:

"For the purpose of this section "mining property" means –

- a) any land on which mining is carried on; or*
- b) any right to minerals (including any right to mine for minerals) and a lease or sub-lease of such a right."*

From the above definition it is clear that not only the land on which mining is conducted but also any right to minerals, including the right to mine for minerals (i.e. a mining right), or a lease or sub-lease of such a right will be considered to be 'mining property' for the purposes of applying the provisions of section 37.

5.3. THE APPLICATION OF SECTION 37(1), (1A) and (2)

Section 37 of the Income Tax Act contains specific provisions that will apply to a taxpayer in the circumstances as specified in the proviso to section 37(1).⁸⁶ These provisions provide for the purchaser and seller of mining property and capital assets to be taxed in a certain manner. The taxation of the purchaser and seller is achieved through the use of the deeming provisions contained in section 37(1), (1A) and (2) which 'deems' the purchaser (and the seller) to have acquired (or disposed of) the capital assets for a certain value. With regard to the use and functioning of a deeming provision the SCA explained in *S v Rosenthal*⁸⁷ that:

"The words 'shall be deemed' ... are a familiar and useful expression often used in legislation in order to predicate that a certain subject-matter, e.g. a person, thing, situation or matter, shall be regarded or accepted for the purpose of the statute in question as being of a particular, specified kind whether or not the subject-matter is ordinarily of that kind." In other words, "... when it is said that a thing is to be deemed to be something, it is not meant to say that it is that which it is deemed to be. It is rather an admission that it is not that which it is deemed to be, and that notwithstanding that it is not that particular thing, nevertheless, for the purposes of the Act, it is deemed to be that thing."

The resultant effect of a deeming provision is thus that, in spite of the general principles that would normally apply, the deeming provision overrides these principles and by doing so, provides for a specific situation or treatment of a 'thing' which may in terms of general principles not have applied.

Section 37 specifically serves to determine what amount will be deemed to be the cost and expenditure incurred by the purchaser in acquiring the capital assets. This amount will also be deemed to be the amount of expenditure incurred upon the acquisition of the capital assets by the purchaser for purposes of section 36(11).

In this regard section 37(1) deems the cost or expenditure incurred in respect of the capital assets to be an amount equal to the effective value of the assets as determined by the Director-General of the DMR. Section 37(1), thus recognises that the

⁸⁶ The transfer, sale, leasing or cession of mining property and the disposal of capital assets as contemplated in section 36(11) of the Income Tax Act.

⁸⁷ [1980] 1 All SA 103 (A), at page 105.

purchaser's actual expenditure incurred in acquiring the capital assets could possibly be more than the value thereof as determined by the Director-General of the DMR and therefore, for purposes of establishing the capital expenditure for purposes of section 36(11), deems it to be equal to the value of capital assets as determined by the Director-General through the effective valuation conducted in terms of section 37(4).

Section 37, through subsection (1A), also recognises that the 'consideration given' by the purchaser for the capital assets could be less than that of the value established by the Director-General of the DMR and therefore provides for a mechanism to apportion the consideration given by the purchaser between the value of the capital assets and mining property in relation to the values attributed thereto in terms of the effective valuation. Section 37(1A), however, refers to the instance where the 'consideration given' by the purchaser (and not the expenditure incurred by the purchaser or purchase price received by the seller) is less than that of the effective value as determined by the Director-General.

By using the phrase 'any consideration given' section 37(1A) recognises and makes provision for the fact that what the purchaser gives in return for the assets acquired could be or is something different to its expenditure incurred. Furthermore, when read with section 37(2), it is also clear that the provisions of section 37 foresees the possibility that the purchase price or proceeds received by the seller is also not necessarily equal to the consideration given by the purchaser.

Section 37(2) makes it clear that the position of the seller is to be determined with regard to the position of the purchaser. Thus, irrespective of the actual purchase price received by the seller, the amount to be recognised as consideration received by the seller for the capital assets disposed of is the same as the deemed capital expenditure recognised by the purchaser in terms of the provisions of section 37(1) and (1A).

As a result of applying the deeming provisions of section 37, an enquiry as to what constitutes 'expenditure actually incurred' for the purchaser or 'proceeds' or 'gross income' for the seller (i.e. the general principles which would normally apply upon a sale of business assets) is not required as the deeming provisions, which, *inter alia*, are premised on the term 'consideration given', override such general principles.

5.4. THE APPLICATION OF SECTION 37(3)

Section 37(3) determines that in the event of a dispute in respect of either the 'consideration given' or the 'value' of the property, the Commissioner may fix the value of the 'consideration given' or the 'value' of the property disposed of. The use of the term 'may' necessarily implies that the Commissioner has a discretion as to whether or not he wishes to set the value of the 'consideration given' or the 'value' of the property disposed of. However, as discussed in 5.2.4. the use of the word 'may' in the context of section 37, should be interpreted to confer an obligation on the Commissioner to set the values and not a discretion.

Section 37(3) also provides a specific formula in terms of which the Commissioner must determine the value of the either the consideration given or the value of the property disposed of.⁸⁸ Thus, when the Commissioner is called upon to exercise this authority and to fix the value of the consideration given or the value of the property disposed of, he is only entitled to determine the respective values in terms of the parameters specified in the provisions of section 37(3). In this regard the Commissioner shall (i.e. there is no discretion as to the method to be used by the Commissioner) determine the value of mining property as if transfer duty were payable and in the case of capital assets the value is to be determined with reference to the market value thereof as at the time of disposal.

The question that arises in respect of the authority given to the Commissioner to fix the value of the consideration given or the property being disposed of, is when is the Commissioner entitled to exercise this authority? Neither section 37 nor section 1 of the Income Tax Act provides a definition for the term 'dispute', nor is it evident from the wording of section 37(3) if the term refers to a dispute between the purchaser and seller or a dispute between the Commissioner and one or both of the parties to the transaction. In this regard, a view that the Commissioner can only exercise his power, to set the value of the consideration given or property disposed of, in the instance where a dispute exists between the purchaser and the seller should be preferred. This follows, as the alternative would result in a situation where the Commissioner can create a dispute regarding the value of the consideration given or the property and then settle the dispute, which he created, through the application of section 37(3).

⁸⁸ Section 37(3)(a) and (b).

A further aspect to be considered in this regard is at which point in time the dispute should exist in order for the Commissioner to be able to exercise the power to set the value of the consideration given or property disposed of. More specifically, is the authority given to the Commissioner in order to settle a dispute between the seller and the purchaser, prior to the effective value of the assets being set by the Director-General of the DMR or after the values have been set through the effective valuation?

Considering the fact that in terms of section 37(3) the Commissioner can set the value of the property disposed of and that in terms of section 37(4), the Director-General of the DMR is the only person competent to determine the effective value of the capital assets and mining property and that after the effective value of the assets has been set, not even the Director-General has the authority to re-determine the effective value of the assets,⁸⁹ it would appear as though the power given to the Commissioner in terms of section 37(3) only relates to the instance where a dispute exists between the seller and the purchaser regarding the value of the consideration given or the property disposed of, prior to the effective valuation being completed and finalised by the Director-General of the DMR.

Thus, section 37(3) will apply in the event that there is a dispute between the purchaser and the seller in respect of the 'consideration given' by the purchaser or the value of the property disposed of by the seller prior, to the effective value of the assets being set by the Director-General of the DMR. In these circumstances the Commissioner can determine the value of the consideration given or the assets disposed of but only within the parameters as set by section 37(3).

5.5. RELEVANCE OF THE *DAISHOWA-MARUBENI INTERNATIONAL LTD V CANADA* JUDGMENT TO THE APPLICATION OF SECTION 37

The judgment in the matter of *Daishowa-Marubeni International Ltd v Canada*⁹⁰ essentially determined that the reforestation obligation attaching to a forest tenure cannot be assumed by the purchaser as part of the purchaser consideration it pays for the acquisition of a timber resource property. This is owing to the fact that the

⁸⁹ *Pering Mine (Pty) Ltd v Director-General, Mineral and Energy Affairs and Others*, [2005] 4 All SA 641 (T), 67 SATC 317.

⁹⁰ 2013 SCC 29.

reforestation obligation is inextricably linked to the forest tenure and as such reduces the value of the forest tenure.

The question to be determined is whether or not this situation applies in a South African mining tax context in respect of the transfer of mining rights and the assumption of the associated mining rehabilitation obligation. More specifically, if the assumption of the mining rehabilitation obligation by the purchaser will form part of the consideration it gives in return for the assets, including the mining right, it acquires.

5.6. CONCLUSION

The South African Income Tax Act, through section 37, makes specific provision for the manner in which the purchaser's capital expenditure incurred, on the acquisition of mining property and capital assets, is to be determined as well the manner in which the seller's proceeds from the disposal of these assets are to be determined. The values to be recognised, for income tax purposes, by the purchaser and seller are determined through the effective value of these assets as well as the consideration given by the purchaser.

Following the judgment delivered in the matter of *Daishowa-Marubeni International Ltd v Canada* the question to be determined is whether or not the assumption of mining rehabilitation obligations by a purchaser would constitute 'consideration given' for purposes of applying the provisions of section 37. This question as well as the applicability of the *Daishowa-Marubeni International Ltd v Canada* judgment, in light of the specific provisions of section 37, is discussed in Chapter 6.

CHAPTER 6

THE MEANING OF CONSIDERATION GIVEN AND THE CONCEPT OF AN EMBEDDED LIABILITY

6.1. INTRODUCTION

As mentioned in Chapter 5 the determination of the purchaser's capital expenditure incurred for purposes of section 36(11) of the Income Tax Act as well as the consideration received by the seller, in terms of section 37, is dependent on the effective value attributed to the assets by the Director-General of the DMR.

As section 37 applies in the instance where both capital assets as well as mining property⁹¹ are transferred, the issue to be determined is whether or not the assumption of the mining rehabilitation obligations associated with the mining right acquired by the purchaser will form part of the consideration given by the purchaser for the assets. This question arises following the judgment delivered by the SCC in the matter of *Daishowa-Marubeni International Ltd v Canada*⁹² where it was found that the reforestation obligation that attaches to a forest tenure is embedded in the forest tenure and as such reduces the value of the forest tenure. Therefore, the assumption of the reforestation obligations by a purchaser does not constitute part of the seller's proceeds of disposition.

This chapter considers the meaning of the term 'consideration given', as used in section 37, as well as the concept of an embedded liability as derived from the judgment delivered in the matter of *Daishowa-Marubeni International Ltd v Canada*.

6.2. CONSIDERATION GIVEN

The term 'consideration' is not defined in the Income Tax Act and as such, when interpreting the meaning of the term, it must be given its ordinary dictionary meaning. In this regard, the Concise Oxford Dictionary⁹³ defines it as:

⁹¹ As defined in section 37(5), which includes mining rights.

⁹² 2013 SCC 29, at paragraphs 29 and 37.

⁹³ Twelfth Edition (2011).

"anything given or promised or forborne by one party in exchange for the promise or undertaking of another"

Black's Law Dictionary⁹⁴ defines the term consideration to mean:

"Something (such as an act, a forbearance or a return promise) bargained for and received by a promisor from a promisee; that which motivates a person to do something."

"A consideration in its widest sense is the reason, motive or inducement, by which a man is moved to himself by an agreement."

The use of the words 'anything' and 'something' in the above definitions result in the term 'consideration' having a very wide application which would include more than just monetary compensation given by the purchaser. The fact that the term 'consideration' should be given a wide interpretation, for purposes of applying the provisions of section 37, is furthermore supported by the use of the word 'any' in the wording of section 37(1A).

Support for the above can be found in the matter of *Eveready (Pty) Ltd v CSARS*.⁹⁵ Paragraph [9] of the judgment states that the question before the court was "*whether Eveready [the taxpayer] acquired the trading stock from Gillette 'for no consideration', for purposes of the 'deemed cost' provisions contained in section 22(4) of the Income Tax Act. Section 22(4) of the Income Tax Act determines that where a taxpayer acquires trading stock for no consideration or consideration not measurable in money, such a taxpayer will be deemed to have acquired the trading stock at its market value as on the day of acquisition.*

In this case the taxpayer acquired the business of the seller for a purchase price of R80 000 000 which was determined as follows:

Land and Buildings	R30 000 000
Plant and Equipment	R25 000 000
Trade Marks	R25 000 000

⁹⁴ Tenth Edition (2014).

⁹⁵ (2012) 74 SATC 185 at page 191 - 192.

Inventory	R21 562 918
Debtors	R193 287
Sundry Debtors	R9 115 977
Cash	R9 500
Accounts Payable	(R20 182 371)
Provisions	(R10 699 313)
Net Total	R80 000 000

From the above it is clear that the net asset value of the company equalled the cash component of the purchase price that the taxpayer paid to the seller for the business. The taxpayer had, however, not allocated any value to the trading stock it acquired in completing its financial statements and income tax returns in respect of the year during which it acquired the business on the grounds that it had acquired it for 'no consideration'.

The Commissioner argued that the liabilities assumed by the purchaser constituted the consideration the purchaser had given for the trading stock and as such it was not acquired for 'no consideration'. The court, through interpreting the sale of business agreement, found that the liabilities assumed by the purchaser did in fact constitute consideration given for the trading stock acquired by the taxpayer, as argued by the Commissioner, and as such the trading stock was not acquired for 'no consideration'. Thus, the purchase price paid by the taxpayer (i.e. R80 000 000) did not constitute the consideration given by the taxpayer in acquiring the business. Whether such consideration constitutes 'expenditure incurred' is a different enquiry and is not relevant for purposes of the application of section 37.

The fact that 'consideration given' can (in some instances) refer to something wider or more than the concept of "expenditure" or "expenditure actually incurred" by a taxpayer was also confirmed in the matter of *CSARS v Labat Africa Limited*.⁹⁶ The Supreme Court of Appeal in this matter found that although the purchaser had issued shares as consideration for the acquisition of intellectual property rights, it did not incur any expenditure in issuing the shares as consideration for the rights it acquired.

⁹⁶ [2012] 1 All SA 613 (SCA), at page 618 - 619.

SARS also appears to agree with the above in the Discussion Document where it states that a “*free-standing contingent liability comprises consideration for the sale of the asset which forms part of the seller’s gross income or proceeds, whilst, initially at least, the same amount is not considered to be expenditure in the hands of the purchaser*”.⁹⁷

Based on the above, the principles of ‘consideration given’, ‘expenditure’ or ‘expenditure actually incurred’ by a purchaser and the principle of “proceeds” in the hands of the seller should not be confused with one another and can be different in certain instances. The issue in the current circumstances is the meaning of the term ‘consideration given’ and whether the assumption of mining rehabilitation obligations by a purchaser will be included under the term ‘consideration given’ for purposes of applying the provisions of section 37 of the Income Tax Act.

Based on the South African case law discussed above as well as the ordinary meaning of the term ‘consideration’, a wide meaning is afforded to the term ‘consideration given’ which includes the assumption of liabilities (whether actual or contingent). Whether or not the assumption of mining rehabilitation obligations will constitute ‘consideration given’ will depend on whether the concept of an ‘embedded liability’ as introduced by the *Daishowa-Marubeni International Ltd v Canada* judgment and accepted by SARS in the Discussion Document⁹⁸, actually applies in a South African mining tax context.

6.3. THE CONCEPT OF AN EMBEDDED LIABILITY

The concept of an ‘embedded liability’ is derived from the judgment handed down by the SCC in the matter of *Daishowa-Marubeni International Ltd v Canada* where the court found that the reforestation obligation attaching to a forest tenure is so inextricably linked to that forest tenure that it represents a future cost embedded in the forest tenure and as such reduces the value of the forest tenure. The conclusion that the reforestation obligation is inextricably linked to and as such embedded in the forest tenure was reached on the basis that it was the practice and policy of the province of Alberta to not give consent to the transfer of a forest tenure, unless the purchaser also

⁹⁷ The Discussion Document, page 11.

⁹⁸ The Discussion Document, page 2.

assumes the reforestation obligation of the seller.⁹⁹ The purchaser was thus effectively forced to assume the reforestation obligation of the seller if it wished to acquire the forest tenure.

SARS, in the Discussion Document accepts this concept when it is states that:

"Accordingly, in the context of transferring a business, from an income tax perspective a distinction must be drawn between contingent liabilities which are –

- embedded in the asset such that they are inextricably linked to the asset and, should the asset be transferred, must be transferred by the seller to the purchaser under law or government regulation. This type of contingent liability has an impact on the market value of the asset and does not represent consideration for the asset. This is referred to as an "embedded obligation" in this discussion paper; and*
- distinct existing obligations which are separately identifiable and are not embedded in an asset that is separately recognised for tax purposes. The transfer of these free-standing obligations is not required by law or may be required but can be contracted out of. This type of contingent liability does not have an impact on the market value of an asset recognised for tax purposes and is referred to as a "free-standing contingent liability" in this discussion paper."¹⁰⁰*

and

"In appropriate circumstances the principle enunciated in this case [Daishowa-Marubeni International Ltd v Canada] may find application in a South African context. SARS accepts that a distinction must be drawn between an embedded statutory obligation that depresses the value of an asset and a separately identifiable contingent liability."¹⁰¹

Thus, it must be determined if the nature of the mining rehabilitation obligation associated with a mining right is of such a nature that it becomes embedded in the mining right itself.

⁹⁹ 2013 SCC 29, at paragraph 30 and 31.

¹⁰⁰ The Discussion Document, at page 3.

¹⁰¹ The Discussion Document, at page 2.

6.3.1. The existence of the mining rehabilitation obligation

In terms of the now repealed section 41 of the MPRDA,¹⁰² the applicant for a mining or prospecting right had to make financial provision for the rehabilitation of the land on which it conducted its mining activities. The rehabilitation liability had to be assessed on an annual basis and the mining right holder had to adjust its financial provision accordingly, to the satisfaction of the Minister of Mineral Resources. Section 41 of the MPRDA was repealed by section 33 of the Mineral and Petroleum Resources Development Amendment Act¹⁰³ and replaced by section 24P of the National Environmental Management Act ("NEMA")¹⁰⁴ which contains essentially the same provisions as section 41 of the MPRDA.

(i) Liability in terms of the MPRDA

In terms of section 43(1) of the MPRDA the holder of the mining right will remain liable for the rehabilitation to be done in respect of the land on which the mining activities, relating to that mining right, were conducted. This liability will remain until such a point in time that the Minister of Mineral Resources issues a mine closure certificate in terms of section 43. From the provisions of the MPRDA it is clear that it is the holder of the mining right that will be held liable for the rehabilitation of the land on which the mining activities were conducted.

The term 'holder' is defined in section 1 of the MPRDA as:

"...in relation to a prospecting right, mining right, mining permit, retention permit, exploration right, production right, reconnaissance permit or technical co-operation permit, means the person to whom such right or permit has been granted or such person's successor in title."

Thus, upon the transfer of a mining right, in terms of the provisions of the MPRDA, it will be the purchaser, as the new holder of the mining right, who is liable for the rehabilitation of the mined land. It is, furthermore, also the practice of the DMR to

¹⁰² Act 28 of 2002.

¹⁰³ Act 49 of 2008.

¹⁰⁴ Act 107 of 1998.

require that sufficient financial provision for rehabilitation is made by a purchaser before section 11 consent¹⁰⁵ for the transfer of the mining right will be granted.

However, it is also worth noting that section 43(2) of the MPRDA specifically makes provision for the transfer of the "environmental liabilities and responsibilities" as set out in the environmental management plan or environmental management programme, upon application by the holder of a mining right, to a person with the qualifications as prescribed. Neither the MPRDA nor Regulations 58 and 59 (as published in Government Gazette No 26275 on 23 April 2004), which set out the requirements for the transfer of the environmental liabilities, requires the mining right to be transferred with the rehabilitation liabilities nor does it require the person who assumes the liabilities to be the holder of a mining right.

Although section 43(2) arguably deals with the situation upon closure of the mine, there is nothing in the section or the regulations that would suggest that the rehabilitation obligation cannot be transferred separately from the mining right.

(ii) *Liability in terms of NEMA*

The enactment of the National Environmental Management Amendment Act 62 of 2008 and the Mineral and Petroleum Resources Development Amendment Act 49 of 2008 will, however, eventually result in the environmental aspects of mining being dealt with under the provisions of, *inter alia*, the MPRDA as well as NEMA.

In this regard section 2(4)(p) of NEMA states that one of the principles that apply to sustainable development is that "*the costs of remedying pollution, environmental degradation and its consequent adverse health effects and of preventing, controlling or minimising further pollution, environmental damage or adverse health effects must be paid for by those responsible for harming the environment.*"

Section 28 of NEMA, which deals with the duty of care to be applied when dealing with the environment and the remediation of environmental damage, states under subsection (1) that:

"Every person who causes, has caused or may cause significant pollution or degradation of the environment must take reasonable measures to prevent

¹⁰⁵ Consent in terms of section 11 of the MPRDA for the transfer of a mining right.

such pollution or degradation from occurring, continuing or recurring, or, in so far as such harm to the environment is authorised by law or cannot reasonably be avoided or stopped, to minimise and rectify such pollution or degradation of the environment."

This liability to minimise and rectify such pollution or degradation, in terms of section 28(1A) of NEMA applies retrospectively in the event of significant pollution or degradation that -

- "(a) occurred before the commencement of this Act;*
- (b) arises or is likely to arise at a different time from the actual activity that caused the contamination; or*
- (c) arises through an act or activity of a person that results in a change to pre-existing contamination."*

This retrospective application could thus result in the previous owner of a mining right also being held liable for the rehabilitation of the mined land.

Section 28(8) of NEMA creates what can be referred to as a secondary liability in terms of which any person, as listed in section 28(8) can potentially be held liable for rehabilitation costs where the State incurred expenditure on remedial measures due to the failure of the person primarily liable for such rehabilitation. In terms of section 28(8), the cost of remedial measure employed by the state can be recovered from the following people:

- "(a) any person who is or was responsible for, or who directly or indirectly contributed to, the pollution or degradation or the potential pollution or degradation;*
- (b) the owner of the land at the time when the pollution or degradation or the potential for pollution or degradation occurred, or that owner's successor in title;*
- (c) the person in control of the land or any person who has or had a right to use the land at the time when—*
 - (i) the activity or the process is or was performed or undertaken; or*

- (ii) *the situation came about; or*
- (d) *any person who negligently failed to prevent—*
 - (i) *the activity or the process being performed or undertaken; or*
 - (ii) *the situation from coming about.”*

These persons will, however, only be held liable in the instance where it can be shown that they did not take reasonable measures, as required in terms of section 28(1) of NEMA, to avoid such damage, pollution or degradation.

Section 28(9) of NEMA furthermore provides that when costs are recovered, as envisioned in terms of section 28(8), such costs can be recovered proportionally from any person that benefitted from the remedial measures taken by the state.

It is clear from the above that NEMA deals with the concept of liability in a much broader manner than the MPRDA. Therefore, although the holder of the mining right is liable for the rehabilitation of the mined land, the situation can arise where the provisions of NEMA are relied upon by the state where uncertainty exists as to which person is liable for the rehabilitation of the mined land or where the person primarily liable for the rehabilitation defaults on that obligation.

6.3.2. Comparison with the situation in *Daishowa-Marubeni International Ltd v Canada*

When looking at the liability for the rehabilitation of mining property purely from the perspective of the provisions of the MPRDA, it appears that a similar situation to that in the matter of *Daishowa-Marubeni International Ltd v Canada* exists in that the purchaser is obligated to assume the mining rehabilitation obligations upon acquisition of the mining right. There furthermore does not seem to be any liability that remains with the seller once the mining right has been transferred to the purchaser.

However, when factoring in the provisions of NEMA which creates a 'secondary liability', there is a possibility that the former holder of a mining right can be held liable for the rehabilitation of the land to which the mining right it disposed of relates and on which it conducted its mining activities.

6.4. CONCLUSION

The facts in the matter of *Daishowa-Marubeni International Ltd v Canada* which led to the reforestation obligations being embedded in the forest tenure do not appear to be present in the case of mining rehabilitation obligations. Although the purchaser of the mining right is obligated to assume the rehabilitation obligation of the seller, the seller is not necessarily absolved from being held liable for the rehabilitation of the land to which the rehabilitation obligation relates.

The SCC, in delivering the judgment, did not specify or provide any further guidance as to when a liability will be considered to be 'embedded' in the asset to which it relates. The question is thus whether the fact that there are similarities between the South African mining tax regime, the manner in which timber resource properties are taxed in terms of the Canadian Income Tax Act as well as the fact that both the holders of a mining right and forest tenure are liable for the rehabilitation or reforestation of land is sufficient to apply the concept of an 'embedded liability' in a South African income tax context.

CHAPTER 7

APPLICABILITY OF THE *DAISHOWA-MARUBENI INTERNATIONAL LTD v CANADA* JUDGMENT

7.1. INTRODUCTION

Although there are similarities between a forest tenure (and the accompanying reforestation obligation attaching thereto) and a mining right (and the mining rehabilitation obligation associated with that mining right), such similarities are not sufficient to justify the outright application of the principles established in the *Daishowa-Marubeni International Ltd v Canada*¹⁰⁶ judgment to the transfer of a mining right and the assumption of the corresponding mining rehabilitation obligation in South Africa.

As the judgment delivered by the SCC would impact the value of a mining right, if applied directly in a South African mining context, it would be prudent to consider the nature of a mining right in contrast to that of a forest tenure as well as the factors impacting the value of a mining right.

This chapter will apply the reasoning followed by the SCC, in delivering the judgment in *Daishowa-Marubeni International Ltd v Canada*, to a mining right and its corresponding rehabilitation obligation. It will furthermore consider whether the judgment delivered in *Daishowa-Marubeni International Ltd v Canada* does in fact find application in a South African mining tax context with specific regard to the provisions of section 37 of the Income Tax Act.¹⁰⁷

7.2. THE ANALOGY OF A PROPERTY IN NEED OF REPAIR

In *Daishowa-Marubeni International Ltd v Canada*, which considered the tax treatment of the reforestation obligation that attaches to a forest tenure, the SCC compared the effect of the reforestation obligation on the value of the forest tenure to that of a property that is in need of repair. According to the SCC the reforestation obligation,

¹⁰⁶ 2013 SCC 29.

¹⁰⁷ Act 58 of 1962.

serves to reduce the value of the forest tenure in the same manner that damage to property reduces the value of the property.

Considering the fact that a forest tenure allows the holder thereof to cut and remove timber from the land to which the tenure relates, the value of the forest tenure can arguably be said to be in the timber growing on the land and the condition of that land. Therefore, it follows that as and when timber is cut and removed from the land (i.e. damage is caused to the property), the value of the forest tenure would be reduced. However, the process does not conclude with the timber being cut and removed from the land to which the tenure relates, as the holder of a forest tenure has an obligation to reforest the land from which it has cut timber.

The reforestation obligation requires the holder of a forest tenure to conduct activities that include brush disposal, scarification, mounding, planting, seeding, applying herbicides, brush-weeding and manual or chemical tending. The holder of a forest tenure is relieved of its obligation to reforest when it satisfies the relevant authority that the reforested area has reached a threshold level of growth, referred to as a “free-to-grow” status.¹⁰⁸ The holder of a forest tenure essentially has to repair the ground and replant that which it has taken from the ground. In essence the holder of the forest tenure returns value to the forest tenure through repairing the property.

Similarly in the case of a property in need of repair, although there is no obligation on the owner of the property to actually repair the property, the value of the property will arguably increase as and when the repairs have been made to the property.

Thus, when comparing a forest tenure to that of a property in need of repair the following similarities are evident:

- (a) In the same way that the value of the property is reduced by the damage caused to it, the cutting of the trees from the forest area to which the forest tenure relates, will reduce the value of the tenure in the form of the reforestation obligation.
- (b) As and when repairs are made to the property, the value of the property will increase. The reforestation activities of the forest tenure holder will also

¹⁰⁸ *Daishowa-Marubeni International Ltd v Canada*, 2013 SCC 29 at paragraph 5.

return that which has been taken from the area to which the forest tenure relates and the value of the forest tenure will arguably increase.

The SCC, in using the analogy of a house in need of repair to illustrate the effect of the reforestation obligation on the value of a forest tenure, appears to have correctly assessed the factors from which a forest tenure derives its value as well as those factors which would reduce the value thereof. The question, however, is whether this analogy can be applied to a mining right and the effect of the mining rehabilitation obligation on the value of such a mining right.

A mining right is defined in section 1 of the MPRDA¹⁰⁹ as a right which allows the holder thereof the right to 'mine'. The term 'mine' when used as a verb is defined in section 1 of the MPRDA to be any operation or activity conducted for the purpose or with the aim of winning a mineral on, in or under the earth. These activities include the underground or open cast working of the area to which the right relates as well as any activity or operation incidental thereto.¹¹⁰

In terms of section 5(3) of the MPRDA a mining right entitles the holder thereof to the following. The holder of the mining right may:

- "(a) enter the land to which such right relates together with his or her employees, and bring onto that land any plant, machinery or equipment and build, construct or lay down any surface, underground or under sea infrastructure which may be required for the purpose of prospecting, mining, exploration or production, as the case may be;*
- (b) prospect, mine, explore or produce, as the case may be, for his or her own account on or under that land for the mineral or petroleum for which such right has been granted;*
- (c) remove and dispose of any such mineral found during the course of prospecting, mining, exploration or production, as the case may be;*

¹⁰⁹ Act 28 of 2002.

¹¹⁰ The definition of the term 'mine' furthermore includes the winning of a mineral from water or any residue stockpile.

- (cA) *subject to section 59B of the Diamonds Act, 1986 (Act No. 56 of 1986), (in the case of diamonds) remove and dispose of any diamond found during the course of mining operations;*
- (d) *subject to the National Water Act, 1998 (Act No. 36 of 1998), use water from any natural spring, lake, river or stream, situated on, or flowing through, such land or from any excavation previously made and used for prospecting, mining, exploration or production purposes, or sink a well or borehole required for use relating to prospecting, mining, exploration or production on such land; and*
- (e) *carry out any other activity incidental to prospecting, mining, exploration or production operations, which activity does not contravene the provisions of this Act."*

In simple terms, the holder of a mining right is entitled to mine for and extract minerals from the area to which the mining right relates, much like the holder of a forest tenure is entitled to cut and remove timber from the land to which the forest tenure relates. As in the case of a forest tenure, the value of a mining right can be said to be derived from that which the mining right entitles the holder thereof to do. A forest tenure allows the holder to cut and remove timber and as such the value is derived from the timber on the land and the condition of the land. A mining right allows the holder to mine for and extract minerals from the ground and as such it can be said that the value of a mining right is derived from the minerals in the ground to which the mining right relates.

As and when the holder of the mining right mines and extracts the minerals, the value of the mining right will arguably decrease as the minerals from which it derives its value are depleted. Furthermore, the area to which the mining right relates is disturbed (i.e. damaged) and the holder of the mining right is liable for the rehabilitation (i.e. repair) of the mined land.

However, does the rehabilitation of the mined land have an impact on the value of the mining right? As mentioned above, the value of a forest tenure is affected by both the timber located on the land as well as the condition of the land. The timber on the land can be said to be similar to the minerals which the holder of a mining right mines for and extracts. The condition of the land is also relevant from a forest tenure perspective as the treatment and repair thereof will allow the forest tenure holder to return value, in

the form of replanting trees in the place of the ones it had cut down. In the case of a mining right the condition of the ground does not affect the value of the mining right as the value attaches to the minerals located in the ground and these minerals cannot be replenished through rehabilitation of the ground. Contrary to that of a forest tenure, where the value is dependent on, amongst other things, the condition of the property, the value of a mining right attaches to the minerals located within the ground and not the condition of the ground.

A forest tenure relates to a renewable resource (i.e. the timber which can be cut down and replanted) whereas a mining right relates to a wasting resource (i.e. the minerals can be extracted from the ground but not returned). It makes no difference how extensive the rehabilitation is in the context of mining, the rehabilitation does not give rise to new resources (i.e. minerals). The minerals are a natural resource and a wasting asset and once extracted, can never be re-created, replaced or regenerated.

Therefore, when comparing a mining right and the associated mining rehabilitation obligation to that of a house in need of repair the following is evident:

- (a) The mining activities conducted by the mining right holder, which creates the mining rehabilitation obligation, result in the mineral resources in the ground being depleted and as such will impact the value of the mining right. This can be said to be similar to the damage to the property which reduces the value of the property.
- (b) However, contrary to repairs being done to a property, the mining rehabilitation activities conducted by the mining right holder will not restore any value to the mining right. This follows as the value of a mining right is not affected by the condition of the area to which the mining right relates and as such the rehabilitation of this area does not impact the value of the mining right.

Although there are parallels that can be drawn between the requirements for the transfer of a forest tenure, as in the matter of *Daishowa-Marubeni International Ltd v Canada*, and the transfer of a mining right, the direct application of the judgment reached by the SCC to a mining right, fails to take into account that a forest tenure and mining right are very distinct and separate rights, the values of which are determined and influenced by different factors.

7.3. THE POSITION OF THE SELLER v THE POSITION OF THE PURCHASER AND TAX SYMMETRY

The judgment delivered in *Daishowa-Marubeni International Ltd v Canada* was given with the specific goal of avoiding the asymmetrical tax treatment of the parties involved (see paragraphs 41 – 43 of the judgment).

The position as argued by the Canadian Revenue Authority would have resulted in the amount of the reforestation obligations being included in Daishowa's proceeds of disposition but the purchaser would not have received a corresponding increase in its base cost in respect of the forest tenure it acquired. This would effectively have resulted in Daishowa being taxed as if the reforestation obligations formed part of the purchase price of the forest tenure, whereas the purchaser would have been taxed as if the reforestation obligations it assumed were not part of the purchase price of the forest tenure. In deciding that the value of the reforestation obligation reduced the value of the forest tenure and could therefore not be assumed by the purchaser as part of the consideration it gives, the SCC achieved symmetry between the tax treatment of Daishowa as well as the purchaser.

Symmetry as achieved in *Daishowa-Marubeni International Ltd v Canada* is provided for in section 37(2) of the Income Tax Act, in that the consideration received by the seller is also to be determined with reference to the effective valuation conducted by the DMR. In this regard section 37(2) specifically determines that for purposes of determining the paragraph (j) gross income inclusion of the seller, the seller will be deemed to have received consideration equal to the deemed capital expenditure of the purchaser as determined under section 37(1) and 37(1A).

Section 37 is a section specific to South African Income Tax Law and provides for the specific circumstances where mining property is disposed of. Not only does it specify how the capital expenditure incurred by the purchaser must be determined, it also states that the consideration received by the purchaser is to be equal to the deemed capital expenditure incurred by the purchaser. The resultant effect of this section is that both the purchaser and the seller recognise the same amounts in relation to their capital expenditure and proceeds received from the acquisition and disposal of mining property and capital assets for income tax purposes.

It must furthermore be noted that in *Daishowa-Marubeni International Ltd v Canada*, the SCC considered the position of the seller (i.e. the proceeds received by the seller) which in turn determined the capital expenditure incurred by the purchaser. This approach is in direct conflict with the approach prescribed by the deeming provisions of section 37 of the Income Tax Act. The Income Tax Act, through section 37, provides specific provisions in terms of which the deemed capital expenditure incurred by the purchaser is to be determined and it is only once the position of the purchaser has been determined that the provisions of section 37(2), which determines the position of the seller, will find application.

7.4. CONCLUSION

The use and application of the judgment delivered in *Daishowa-Marubeni International Ltd v Canada* to interpret a section of the Income Tax Act, more specifically a deeming provision of the Income Tax Act (i.e. which specifically prescribes the manner in which the disposal of mining property should be dealt with), should be approached with caution.

The SCC in *Daishowa-Marubeni International Ltd v Canada*, considered concepts specific to the Canadian Income Tax Act. It furthermore considered the tax treatment of the seller in relation to these concepts. In this regard the Income Tax Act, contains specific provisions in terms of which the tax position of the seller is to be determined upon the disposal of mining property and capital assets, which cannot be ignored in favour of the application of the judgment in *Daishowa-Marubeni International Ltd v Canada*.

In addition to the above, the nature of mining right and the underlying factors which impact on its value are separate and distinct from that of a forest tenure. The judgment delivered by the SCC in *Daishowa-Marubeni International Ltd v Canada* was to a great extent influenced by the value that was transferred from Daishowa to the purchaser.¹¹¹ In the case of a mining right the value attaches to the minerals located in the ground to which the mining right relates and where the mining right is transferred that value is also transferred to the purchaser. The mining rehabilitation obligation, associated with

¹¹¹ 2013 SCC 29, at paragraph 31.

that mining right, does not impact on the value of the minerals transferred as it relates to the condition of the ground on which the mining activities were conducted and therefore does not impact on the value of the mining right.

CHAPTER 8

CONCLUSION

8.1. INTRODUCTION

The assumption of contingent liabilities as part settlement of the purchase price for assets and the tax treatment thereof in the hands of both the seller and purchaser has always been a contentious issue clouded in uncertainty. The introduction of the terms 'embedded contingent liability' and 'free-standing contingent liability' as derived from the judgment delivered in *Daishowa-Marubeni International Ltd v Canada* is sure to increase this uncertainty.

The direct application of the judgment in *Daishowa-Marubeni International Ltd v Canada* to the transfer of mining rights and the corresponding mining rehabilitation obligation attaching to such right, will have a significant impact on both the seller as well as the purchaser. From the seller's perspective the argument that the assumption of the mining rehabilitation obligation attaching to the mining right does not constitute 'consideration given' will arguably be preferred as it will exclude the value of that liability (which can be quite substantial) from the proceeds that the seller receives upon disposal of the mining right. From the purchaser's perspective the opposite argument would be preferred as the inclusion of the value of the mining rehabilitation obligation it assumes as part of the consideration that it gives for the mining property and assets will result in a larger amount of capital expenditure which it can claim in determining its taxable income.

Not only is the correct treatment of the assumption of mining rehabilitation obligations relevant for future sales transactions, it could potentially also impact transactions which have already been concluded but have not been subject to audit by SARS.

8.2. FINDINGS FROM REVIEW

The concept of an embedded liability has to date not been applied or recognised in South African Tax law. Although it is not inconceivable that a liability may be so closely linked to an asset that it reduces the market value of such an asset, there are also no

clear guidelines or indicators as what would be required for a liability to be so inextricably linked to an asset in order to reduce the market value of that asset.

Although there are numerous similarities between the reforestation obligation attaching to a forest tenure and that of a mining rehabilitation obligation attaching to a mining right, as well as the requirements for the transfer of a forest tenure and a mining right, these similarities do not justify the direct application of the judgment in *Daishowa-Marubeni International Ltd v Canada* to the transfer of a mining right and the assumption of the corresponding mining rehabilitation obligation.

Firstly, the Income Tax Act, through section 37, makes specific provision for the manner in which both the seller and the purchaser should be treated in the event that mining property and capital assets are disposed of and acquired. In this regard the purchaser will be deemed to have incurred capital expenditure, for purposes of section 36(11) of the Income Tax Act, equal to an amount determined through the effective valuation of the capital assets by the Director-General of the DMR.¹¹² It is only once the amount of capital expenditure incurred by the purchaser has been determined that the deemed proceeds to be included in the seller's gross income in terms of paragraph (j) to the gross income definition is determined. These are specific deeming provisions which override the general principles of expenditure incurred or proceeds received for purposes of establishing a base cost and proceeds received.

Secondly, while both the holder of a forest tenure and a mining right are liable for the reforestation or rehabilitation of the land to which the forest tenure and mining right respectively relates, such a liability in the case of a forest tenure is ultimate and no third party can be held liable for the reforestation. In South Africa, the current legislative framework in respect of environmental rehabilitation provides for a primary as well as secondary liability for the rehabilitation obligations attaching to a mining right and as such it is not solely the holder of the mining right which could be held liable for the rehabilitation of the mined land. Thus, contrary to the regulatory scheme in Alberta which causes the reforestation obligation to become inextricably linked to the forest tenure, the fact that the mining reforestation obligation attaches to and must be transferred with the mining right does not result in the mining rehabilitation obligation becoming embedded in the mining right as parties, other than the purchaser, could be held liable for the rehabilitation of the mined land.

¹¹² Section 37(1) and 37(1A).

Thirdly, a mining right is distinctly different in nature to that of a forest tenure and the value of these respective rights are impacted by different factors. A forest tenure derives its value from the timber located on the ground to which the forest tenure relates as well as the condition of the ground. The timber is, however, a renewable resource which is returned or replenished through the reforestation activities which the holder of the forest tenure is obligated to conduct. In the case of a mining right, its value is derived from the minerals located in the ground to which the mining right relates. The minerals are, however, a wasting resource and cannot be replenished through the mining rehabilitation activities of the mining right holder.

The SCC, in delivering the judgment in *Daishowa-Marubeni International Ltd v Canada*, specifically considered the value of the forest tenure being transferred from the seller to the purchaser. In this regard, the SCC found that the value of the forest tenure had to be determined inclusive of the value of the reforestation liability and that there was no additional value to be transferred to the purchaser. It was thus not a case of an asset with a gross value which is reduced by the value of the liability assumed by the purchaser to derive a net purchase price. In the instance of a mining right, the value attaches to the minerals and that is also the value that is transferred to the purchaser. As such the value of the mining right is not affected by the mining rehabilitation obligation.

8.3. CONCLUSION

As the value of a mining right is not reduced by the value of the mining rehabilitation obligation, the mining rehabilitation obligation clearly exists separately from the mining right. The fact that mining rehabilitation obligations exist separately from the mining right is furthermore clearly illustrated in the case where a person disposes of mining assets in the form of equipment, infrastructure and property rights (i.e. no mining right) and the purchaser settles the purchase price through a cash payment and the assumption of the seller's mining rehabilitation obligations. This would occur in the instance where the seller's mining right has lapsed or where the mine has reached the end of its productive cycle. In this situation there would not be a mining right, the value of which could be reduced by the value of the mining rehabilitation obligation and the assumption thereof would constitute consideration given for the assets acquired by the purchaser. The fact that the disposal will not be a transfer of a going concern should

not impact the assumption of the mining rehabilitation obligation qualifying as consideration given for the assets.

The tax treatment of mining rehabilitation obligations assumed as part of the purchase consideration given by the purchaser remains a contentious issue. The judgment delivered in *Daishowa-Marubeni International Ltd v Canada* does not appear to have provided any further clarity in respect of the issue. Although there may be instances where the judgment may find application in a South African tax context, the direct application of the principles does not appear to apply to the transfer of mining rights.

Word Count: 24 856

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