



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
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A CRITICAL EVALUATION OF SECTION 15A OF THE INCOME TAX ACT

by

WINIA JANSE VAN RENSBURG

Student number 99282552

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Study leader: Theuns Steyn

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ABSTRACT

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WINIA JANSE VAN RENSBURG

SUPERVISOR : THEUNS STEYN
DEPARTMENT : TAXATION
DEGREE : MAGISTER COMMERCII

The purpose of the study was to perform a critical evaluation of section 15A of the Income Tax Act No. 58 of 1962 (hereafter referred to as the “ITA”). The hypothesis statement that guided the study was that the addition of this section into the ITA provides certainty on what will constitute trading stock for the taxpayer conducting mining operations, as well as clarity and guidance on the treatment of such classified trading stock.

The research objectives formulated in order to support and prove the hypothesis formulation were firstly, to critically analyse the position of the taxpayer involved in mining operations prior to the introduction of section 15A of the ITA on the classification and treatment of trading stock. The second objective was to perform a critical grammatical analysis of section 15A of the ITA. The final objective was to evaluate the clarity, effectiveness and guidance for the classification and consequent treatment of trading stock prescribed by section 15A of the ITA for the taxpayer conducting mining operations.

The first objective was analysed in chapter 2 of the study. It was concluded that prior to section 15A being introduced, the available sections for the classification and treatment of trading stock could only be applied with difficulty to the specialised mining industry due to its unique nature. This was confirmed through an analysis of the litigation between the *Commissioner of South African Revenue Services v Foskor, 2010 (375/09) ZASCA 45 (72 SATC 174)*.

The second and third objectives of the study were evaluated in chapter 3 by critically evaluating section 15A of the ITA. This evaluation involved a grammatical analysis of



the provisions of section 15A. It was concluded that the formulation of the definition of trading stock in section 15A of the ITA, provides for a broad, inclusive definition of what would constitute trading stock for a taxpayer who conducts mining operations. It was further concluded that the section provides guidance on the process of classification of the subject matter as trading stock or not. This guidance is mainly achieved by reference made in the section to the accounting treatment that is to be followed and reflected in the taxation treatment of the subject matter by the taxpayer.

The study finally concluded that the introduction of section 15A into the ITA provided both clarity and guidance on the classification as well as subsequent treatment of trading stock for normal tax purposes for taxpayers involved in the mining industry in South Africa.



OPSOMMING

’N KRITIESE EVALUASIE VAN ARTIKEL 15A VAN DIE INKOMSTEBELASTINGWET

deur

WINIA JANSE VAN RENSBURG

STUDIE LEIER : THEUNS STEYN
DEPARTEMENT : BELASTING
GRAAD : MAGISTER COMMERCII

Die doel van die studie was om ’n kritiese evaluering van artikel 15A van die Inkomstebelastingwet No. 58 van 1962 (hierna verwys na as “die Inkomstebelastingwet”) te doen. Die hipotese stelling wat as onderliggende dryfveer vir die studie geformuleer is, was dat die toevoeging van artikel 15A tot die Inkomstebelastingwet duidelikheid en sekerheid verskaf rondom die klassifikasie van ’n item as handelsvoorraad of nie, asook die gevolglike hantering en verantwoordingdoening van die geklassifiseerde handelsvoorraad vir belastingpligtiges wat mynboubedrywighede in Suid-Afrika beoefen.

Drie navorsingsdoelwitte is geformuleer ter ondersteuning en bewys van die hipoteseformulering. Die eerste doelwit was die kritiese analise van die posisie van die belastingpligtige betrokke in mynboubedrywighede voor die toevoeging van artikel 15A as deel van die Inkomstebelastingwet rakende die klassifikasie en hantering van handelsvoorraad. Die tweede doelwit was om ’n kritiese grammatiese evaluering van artikel 15A van die Inkomstebelastingwet te doen. Die laaste doelwit was die evaluering van die duidelikheid, doeltreffendheid en leiding vervat in artikel 15A vir die klassifikasie van asook gevolglike verantwoordingdoening vir die handelsvoorraad vir belastingpligtiges betrokke in die mynboubedrywighede.

Die eerste doelwit is aangespreek in hoofstuk 2 van die studie. Die gevolgtrekking is bereik dat voor die toevoeging van artikel 15A, die artikels beskikbaar vir die klassifikasie en verantwoordingdoening van handelsvoorraad, moeilik toegepas kon word op die gespesialiseerde mynboubedryf. weens die unieke aard daarvan. Hierdie gevolgtrekking is bevestig deur ’n analise van die geding *Commissioner of South African Revenue Services v Foskor*, 2010 ,(375/09) ZASCA 45 (72 SATC 174).



Die tweede en derde navorsingsdoelwit is in hoofstuk 3 ondersoek deur die kritiese evaluering van artikel 15A van die Inkomstebelastingwet. Dit het 'n grammatiese ontleding van die bepalings van artikel 15A behels. Die gevolgtrekking is bereik dat die formulering van die woordskrywings van handelsvoorraad soos voorgestel en vervat in artikel 15A van die Inkomstebelastingwet voorsiening maak vir 'n breë en omvattende begrip van wat handelsvoorraad sal wees vir die belastingpligtige betrokke in mynboubedryghede. Daar is ook tot die gevolgtrekking gekom dat die artikel duidelike riglyne verskaf rondom die klassifikasie van wanneer 'n item as handelsvoorraad geklassifiseer sal word of nie vir doeleindes van belasting. Hierdie riglyne word hoofsaaklik bereik deur die voorsiening in die artikel vir die inagneming van die hantering van die betrokke item vir doeleindes van rekeningkundige verantwoordingdoening. Die artikel stipuleer dat die hantering wat vir rekeningkundige doeleindes aanvaar is deur die belastingpligtige gereflekteer moet wees in die belastinghantering van die betrokke item.

Die studie kom tot die finale slotsom dat artikel 15A van die Inkomstebelastingwet duidelikheid en sekerheid verskaf rondom die klassifikasie en verantwoordingdoening van handelsvoorraad vir doeleindes van die mynboubedryf in Suid-Afrika.



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CHAPTER 1

INTRODUCTION AND PROBLEM STATEMENT

1.1 BACKGROUND

South Africa is a country known for its natural abundance of minerals, in particular gold and platinum. Mining represents a large portion of the South African economy with thirty-two percent of the South African exports in the last decade having been related to the mining sector. (Department of Minerals and Energy 2007:5.) Otto (2000:3) suggests that:

“[t]he key tax policy question in terms of meeting the objective of raising revenues is, how great a tax burden should be placed on a mine? Given that a high tax burden means lower investor profit, governments are placed in a position of balancing their fiscal take with a firm's willingness to invest. If taxes are too high, investors may invest elsewhere, but if taxes are too low, government may needlessly forgo fiscal revenue.”

As can be gathered from this introductory paragraph, the importance of the mining sector as part of South Africa's economy needs to be balanced with fiscal take in order to prevent a negative impact on the success of the mining sector of South Africa.

1.2 OVERVIEW OF TAX IMPOSED ON MINING OPERATIONS IN SA

1.2.1 Background on vesting and ownership of mineral rights in SA

South Africa has always had a dual ownership model for mineral rights. This means that the mineral wealth of the country has partly been held in private hands and partly by the state. (Magwenya, 2010:1.) Private ownership of mineral rights has been based on the law of property and is intended to provide long-term security of tenure for those involved in mining.



With the introduction of the White Paper on Minerals in 1998, this view of dual ownership started to change. (Magwenya, 2010:1.) The South African regulatory environment of mines was brought more in line with international mining industry norms, which provide custodianship of mineral rights to the state. The Mineral and Petroleum Resources Development Act 28 of 2002 (MPRDA), as promulgated in May 2004, gives effect to this notion of state custodianship of mineral rights. (Magwenya, 2010:1.)

The foreword of the MPRDA recognises the mineral wealth as a national asset, a common heritage that belongs to all in South Africa and pronounces the state as the custodian thereof. Section 2(a) of the Mineral and Petroleum Resources Development Act acknowledges the right of the state to exercise sovereignty over the entire mineral and petroleum resources within the Republic. (Magwenya, 2010:1.)

1.2.2 Overview of taxes imposed on mining operations

Taxation of income from mining operations is not a new phenomenon. Minerals have been mined for thousands of years and rulers and governments throughout history have taxed mines to share in the created wealth (Otto 2000:1).

Otto (2000:4) suggests that most nations provide the mining sector with some sort of special taxation treatment. This varies from instances where a special type of tax such as a royalty tax is levied on the sector to the offering of special incentives such as special rates for capital allowances. Cloete (2009:11) suggests the ideal balance of any tax regime would entail creating an environment in which sufficient tax revenue is secured for the benefit of the people of the country but which is still competitive enough to attract foreign investment.

The generic components of mining taxes and tax incentives in the mining industry are tabled below in order to provide a basic framework and overview of the different taxes that may be applicable to taxpayers conducting mining operations (Cloete 2009:9-11).



Table 1: List of mining tax and mining tax incentives

Tax Type	Description
Income tax	“Income Tax is a profit based tax with key factors being the tax rate at which income tax is levied and the tax base to which the rate is applied”(Cloete 2009:9.)
Mining royalty	“Royalty taxes are usually levied where the state owns the minerals. Effectively the state receives a reward in return for its minerals, irrespective of whether or not the company is generating profits.” (Cloete 2009:9).
Import and export duty	“Import Duties are levied on goods imported for use in the mining operation. In the mining industry this often entails expensive specialised equipment and has a major impact on the company as mines are usually capital intensive. Export duties on the other hand are levied on the goods and materials produced that are exported.” (Cloete 2009:9).
Registration fees	“Registration Fees levied for the administration of application for exploration or mining. These administration costs are usually minimal.” (Cloete 2009:10).
Surface rentals	“These rentals are calculated according to the land usage, whether for mining or exploration activities. Rates per unit area is often prescribed, depending on specific land usage.”(Cloete 2009:10).
Value-added tax (“VAT”)	“A consumer tax is levied on most purchases and revenues. There is a trend world wide to zero exports, but the capital-intensive mining industry carries the burden of large input taxes on capital expenditure.” (Cloete 2009:10).
Accelerated depreciation	“Tax deductions are claimed based on capital asset depreciation which is accelerated in the early years of production” (Cloete 2009:11.)



The current study focus mainly on the evaluation of section 15A of the Income Tax Act 58 of 1962 (hereafter referred to as the “ITA”). The summary provided in the table above was merely to assist in the creation of a framework, in order to illustrate that the income tax liability of mines cannot be viewed in isolation.

1.3 RESEARCH PROBLEM STATEMENT

Discrepancies in classification, as well as the consequent treatment of assets in the mining industry, may have been the result of a generic definition applicable to all industries (provided in section 1 of the ITA) that has been applied on the mining industry as well, without taking into account certain unique features of the mining industry. The application of this generic definition and treatment of trading stock for purposes of the ITA (provided in section 1 and section 22 of the ITA until 2010) resulted in increasing strain on the mining industry as was demonstrated in *Commissioner of South African Revenue Services v Foskor*, 2010 (375/09) ZASCA 45 (72 SATC 174).

In March 2010, section 15A was introduced into the ITA, a section that provided for the classification and treatment of trading stock specifically applicable to the mining industry. The main purpose of this study was consequently to evaluate the clarity and guidance provided by section 15A of the ITA on both the classification and consequent treatment of an asset as trading stock, specifically applicable to taxpayers conducting mining operations.

1.4 RESEARCH HYPOTHESIS FORMULATION

The hypothesis statement that guided the study is if the addition of section 15A to the ITA is justified on the grounds that it provides certainty on what will constitute trading stock for the taxpayer conducting mining operations as well as clarity and guidance on the treatment of such classified trading stock.



1.5 RESEARCH OBJECTIVES

Three objectives were formulated to support and prove the hypothesis formulation:

- the first objective was a critical analysis of the position of the taxpayer conducting mining operations prior to the introduction of section 15A into the ITA by the Taxation Laws Amendment Act 17 of 2009;
- the second objective was a critical grammatical analysis of section 15A of the ITA, with specific focus on the amendments introduced in this section; and
- the third and final objective of this study was to evaluate clarity, effectiveness and guidance for the classification and consequent treatment of trading stock prescribed by section 15A of the ITA.

1.6 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

The research conducted contributes the following to the already-existing body of knowledge on the treatment of trading stock for purposes of taxation in the mining industry of South Africa.

There has never been a section in the ITA that provides specifically for the treatment of the asset trading stock for the taxpayer who conducts mining operations. Rather, the general application used for all other industries provided in section 22 of the ITA was to be applied on mining operations as well. Miners experienced increasing difficulties in proving to SARS that an item does not constitute trading stock.

The aim of section 15A of the ITA was to provide clarity and guidance on the problem. This study evaluates section 15A of the ITA and draws conclusions on the effectiveness, transparency and effective guidance provided by section 15A as applied in the critical and fragile South African mining industry as was evident from the introductory paragraphs of this chapter.

Ever-increasing improvements in mining extraction technology has resulted in increasing relevance of mine dumps once considered obsolete for the mining industry, thereby increasing the potential number of stockpiles for both taxation and



accounting purposes. It is therefore highly important to establish if the amendment of the ITA through section 15A provides sufficient guidance for the classification and treatment of such stockpiles to taxpayers engaged in mining activities.

1.7 DELIMITATIONS

The scope of the present study has been limited as this study:

- is not a comprehensive mining tax study but will focus only on the background, introduction and effect of section 15A into the ITA. The study was limited to the classification and treatment of trading stock for income tax purposes. A detailed review of income tax implications for the mining industry was excluded from the study;
- does not include any in-depth analysis of mineral royalty legislation in South Africa; and
- does not include an in-depth review of the tax legislation of the international tax regimes referred to in the study.

1.8 ASSUMPTIONS

The major assumption underlying the proposed study is that unless otherwise stated, the normal grammatical meaning can be attached to the words and phrases used in this study. It is also assumed that where reference is made to legislation, it was the legislation currently enacted as cited in referenced as part of the proposed study.

1.9 RESEARCH METHODS

The study was conducted in the form of non-empirical conceptual research by the conducting of a literature review. The literature review was specifically focused on the analysis of the relevant parts section 1 of the ITA (which includes the definition of trading stock, the definition of mining, and the definition of mining operations), section 15A and section 22 of the ITA.



Case law incorporated in the literature review includes the decided cases of *Commissioner for Inland Revenue v Richards Bay Iron & Titanium (Pty) Ltd and Another*, 1996,(1) SA 311(A)(58 SATC 55), and *CSARS v Foskor*.

The study further includes a critical analysis of the International Accounting Standards Board Framework (IAS1) requirement for disclosure of current assets such as inventories as well as an overview of the Australian Government Taxation Office Taxation ruling 93/33.

1.10 RESEARCH DESIGN

The study was structured according to the specific research objectives.

In chapter 2, the first research objective is addressed by means of a literature review, in order to determine what problems were experienced by the taxpayer conducting mining operations prior to section 15A of the ITA. This includes a critical analysis of the definition of trading stock in section 1 of the ITA, an overview of the workings and practical application of section 22 of the ITA, as well as the decided case of *CSARS v Foskor*.

In chapter 3, the second and third research objectives are addressed by means of a literature review that includes critical detailed analysis of section 15A of the ITA. The financial accounting of stockpiles as prescribed by IFRIS 1 is also included as part of the chapter.

Chapter 4 brings the study to a close by reaching a conclusion on the effectiveness and clarity of section 15A of the ITA for taxpayers conducting mining operations.

1.11 ABBREVIATIONS USED IN THE STUDY

AFS	Annual Financial Statements
CGT	Incremental normal tax payable attributed to taxable capital gain



CIR	Commissioner for Inland Revenue
CSARS	Commissioner for the South African Revenue Service
IAS	International Accounting Standard
ITA / “The Act”	Income Tax Act 58 of 1962
SA	South Africa
SAMREC	South African Mineral Resource Committee
SAMVAL	South African code for reporting of mineral asset valuation
SARS	South African Revenue Service
SATC	South African Tax Court
SIR	South African Inland Revenue
MRRA	Mineral Resource and Royalty Act
MRRP	Mineral Resource and Royalty Provisions

1.12 DEFINITIONS OF KEY TERMS OF THE STUDY

Trading stock	A detailed analysis of the definition of trading stock for purposes of this study is provided in chapter 2 and chapter 3 of the conducted study (section 1 definition and section 15A definition of the ITA).
Mineral right	Mineral right is defined as the “... right to search for and remove minerals from the land. Mineral rights may be sold or transferred to another party who becomes the mineral owner.”(BusinessDirectory online dictionary: Not dated).
Mining	Mining is defined as “...every method or process by which any mineral is won from the soil or from any substance or constituent thereof” (section 1, ITA).



Mining operations

Mining operations are defined as “...every method or process by which any mineral is won from the soil or from any substance or constituent thereof” (section 1, ITA).

Mining method or process

Mining method or process is defined as: “...the process extends to the time that the mineral is actually won, in the final form (at least in so far as the particular taxpayer is concerned). This will generally encompass far more than simply extracting the mineral bearing ore or substance from the earth. It will include all processes required to separate the mineral from the earth, including breaking down minerals into their component chemical parts.” (*Western Platinum Ltd v CSARS*, 2004 ZASCA 83 4 ALL SA 611(67 SATC 1)).

Stockpile

A stockpile is defined as “...[a] storage pile; gradually accumulated reserve of something” (Merriam Webster Online dictionary: Not dated.)



CHAPTER 2

TAXATION OF STOCKPILES PRIOR TO THE INTRODUCTION OF SECTION 15A OF THE ITA

2.1 INTRODUCTION

Trevor Manuel (2009: 22), the then Minister of Finance, made the following statement during the 2009/2010 budget proposal, namely that

“...recent court decisions may require legislative intervention to preserve the *status quo*. In the first decision, the Tax Court held that mining stockpiles could not be considered to be trading stock. While this decision will be appealed, it may be necessary to amend the Income Tax Act with immediate effect to prevent other taxpayers engaged in mining from taking this position while the appeal is under way.”

The above reference to “recent case law” specifically referred to the case appealed by SARS in *CSARS v Foskor*.

The “legislative intervention” referred to above materialised in the form of a new section 15A by the Taxation Laws Amendment Act 17 of 2009 (hereafter referred to as the Taxation Laws Amendment Act) introduced into the ITA, a section that provided for a definition of trading stock specifically applicable to the mining industry. The addition to the ITA was a proactive change from the side of the legislator (as the *CSARS v Foskor* decision had not yet been reached), in order to avoid similar problems repeating themselves as was experienced in latter case.

This chapter analyses the background and development of the problems experienced from the side of the Commissioner as well as by taxpayers involved in mining operations that resulted in the introduction of section 15A of the ITA.

The chapter begins with reference to a recent study performed on the classification of ore stockpiles for purposes of the ITA. The study emphasises the problem and uncertainty experienced by taxpayers involved in mining operations on what



constitutes trading stock for purposes of the ITA. This is followed by an analysis of the section 1 definition of trading stock as well as section 22 of the ITA, the only sections prior to the introduction of section 15A that were available in the ITA for application and guidance in the classification of the subject matter as trading stock. This is followed by detailed analysis of the problems experienced in *CSARS v Foskor* that was based on the principles available in the aforementioned sections at the specific time. The chapter concludes with an overview of the notion “intention of the taxpayer” (including reference to international guidance in this respect), that plays a crucial role in assisting with the interpretation and classification of what constitutes trading stock for taxpayers involved in mining operations.

2.2 STUDY PERFORMED ON THE CLASSIFICATION OF STOCKPILES FOR PURPOSES OF THE ITA

The results of the study performed by Faber (2008) were considered important, due to the clear illustration provided in the study of the uniqueness of the problems that arose before the courts in the content of the classification of trading stock for taxpayers involved in mining operations. In order to contextualise the timeframe and therefore relevance of the content for purpose of this study it was of significance that the study was concluded in September 2008, therefore, before the final appeal decision of *CSARS v Foskor* had been reached and before the introduction of section 15A into the ITA. As mentioned above, the only available sections at the relevant time in terms of the ITA were the general sections applicable to all industries, that of section 1 (definition of trading stock) and section 22 of the ITA. At this time the intention of the taxpayer was also considered of importance, as it assisted with the application of a more general provision provided in the ITA (section 1) on a specific industry such as mining.

Faber (2008:9) held as main objectives of his study to determine whether stockpiles constitute trading stock for purposes of the ITA and determined this objective by conducting a literature review which included an analysis of the legal nature of ore stockpiles, the tax nature of these stockpiles and an overview of the effect of



financial accounting on the classification of these stockpiles for tax purposes. The conclusions of this study are now briefly summarised.

Firstly, with regard to the legal nature of stockpiles, Faber (2008:1) held that stockpiles could by their nature in certain circumstances be considered immovable property even though they became movable by their separation from the soil. Intention was identified as one of the most important criteria in a test for determination of the legal nature of stockpiles. Faber (2008:14) held that intention remains an imperative part of the test as to whether a stockpile constitutes trading stock.

In addition, Faber (2008:14) concluded that as to the tax nature of stockpiles, a mine acquires immovable property to realise a scheme of profit making through its mining activities. Faber (2008:14) submitted that where the immovable property is to be subjected to mining activities, it cannot be considered floating capital or trading stock and thus the intention of the taxpayer would be to hold it as a fixed asset. He further held that in certain circumstances the same intention can be held for unmined stockpiles in such cases where the intention is to hold the stockpiles for a considerable period of time under circumstances where the expectation of its commercial viability is in doubt (2008: 15). *Western Platinum Limited v CSARS* (2004: 147) states that the realisation of a fixed asset through mining activities constitutes a scheme of profit making and the property becomes floating capital. Only once the intention exists to insert the immovable property or parts thereof into the mining process does the fixed property or the parts inserted (such as stockpiles) convert in nature to floating capital.

On the matter of the importance of the financial accounting of stockpiles for tax purpose Faber (2008:26) concluded that the accounting determination of the nature of stockpiles is relevant to the ultimate tax treatment thereof. Faber (2008:28) contented that the determination of a mineral asset for tax purposes has to be done according to the letter of the law and the weighting given to the accounting disclosure in such determination should be adjusted according to what is determined for tax purposes.



On the tax treatment and classification of stockpiles for purposes of the ITA, Faber (2008:44) stressed that the distinction between a mining and a manufacturing process is critical in the determination of an object as trading stock. Faber (2008:45) analysed a mining process separate to a manufacturing process and concluded that a manufacturing process required that raw material be subjected or inserted into the manufacturing process and that the resultant object would then have an essential difference compared to the initial raw product. Faber (2008:45) concluded that a subject matter that is still in the mining process cannot be trading stock and only when the mining process is complete, either by a change of intention (e.g. to sell in a scheme of profit making) or actual completion by the winning of the mineral, can the subject matter constitute trading stock for tax purposes.

Moreover, Faber (2008:48) concluded that stockpiles do not constitute trading stock and suggested that only if a wider definition of the accounting principles is accepted would they constitute inventory, albeit only to the extent that the measurement is defined and the stockpile mined within twelve months from the reporting date.

In short, the study of Faber was found to be of extreme value in the process of understanding the position that existed before the decision reached in the case of *CSARS v Foskor* and before the introduction of section 15A of the ITA. The importance of the grammatical definitions that did exist at the specific time, read together with the importance of case law and intention of the taxpayer, read together with the accounting principles that were considered of relevance for tax purposes, were all elements considered as part of his performed study. These elements were found to actually form the key pillars towards understanding the position before the introduction section 15A of the ITA.

2.3 DEFINITION OF TRADING STOCK PER SECTION 1 OF THE ITA

Before the introduction of section 15A, section 1 of the ITA was applied to all industries, including mining. This definition in section 1 of the ITA remained relevant for the purpose of this study, as this forms the point of reference for a comparative evaluation of section 15A of the ITA.



The detailed extracted section 1 of the ITA was included in Appendix A of this study. The definition contains subparagraphs (a) and (b), with paragraph (a) in turn containing paragraphs (i) and (ii), effectively resulting in a generally accepted and established three-part division of the definition (Faber 2008:28). These three parts of the definition were analysed below.

2.4 PART 1 OF THE DEFINITION

The first part of the definition of trading stock, as mentioned above, provides that:

“...anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by him or on his behalf” (section 1 of ITA).

The first part of the definition focuses on ways in which the subject matter has been acquired as well as the intention behind the acquisition of the subject matter (*CIR v Richards Bay Iron and Titanium(Pty)Ltd*,(1996:324 I-J)).The following summary was used to provide clarity on the construction of part 1 of the definition of trading stock:

Table 2: Grammatical and functional analyses of definition of trading stock section 1 of the ITA

Object subject to acquisition	Method of acquisition	Intention of acquisition
Anything	Produced, manufactured, constructed, assembled	Manufacture or sale or exchange
Anything	Purchased	Manufacture or sale or exchange
Anything	Or in any manner acquired	Manufacture or sale or exchange

The different identified methods of acquisition as well as the possible intentions of the taxpayer that existed during acquisition are briefly analysed below.



2.4.1 Methods of acquisition

For purpose of this study, a pure grammatical analysis of the words contained in the definition was performed.

“Produced” is defined as “to make things to be sold, especially in large quantities” (Oxford Advanced Learners Online Dictionary: Not dated).

“Manufactured” or “process of manufacturing” was approved in *SIR v Safranmark(Pty)Ltd*, 1982(1)SA 113(A) (43 SATC235)(1982: 238) to include and accepted for purpose of this study as:

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

“Constructed” is defined as “to form something by putting different things together” (Oxford Advanced Learners online dictionary: Not dated).

“Assembled” is defined as “to fit together all the separate parts of something (Oxford Advanced Learners online dictionary: Not dated).

“Purchased” is defined as “the act or process of buying something” (Oxford Advanced Learners online dictionary: Not dated).

The phrase “or in any other manner acquired”, read together with the aforementioned verbs, interpreted on a grammatical basis, creates a very wide ambit of the method of acquisition of the subject matter if a subject matter is tested against the definition of trading stock. The legislator prevails, grammatically spoken, with a wide ambit resulting in a rather difficult exclusion from the definition as a result of the method of acquisition of the subject matter.



2.4.2 Intention for acquisition

Part one of the definition of trading stock provides for the intention of the taxpayer acquiring the asset to be for the intention to either manufacture, sell or exchange the subject matter.

If something is acquired with the intention to sell or to exchange, it would imply the subject matter to have an independent existence and value as a saleable article, product or commodity (*CIR v Richards Bay Iron and Titanium(Pty)Ltd*, (1996: 325)). These two terms naturally differ from such cases where something acquired for purposes of manufacture that imply a change in form and in all likelihood include a conversion into, or form part of, something other than the state in which it was acquired. It would therefore, if acquired for purposes of manufacture, not (yet) be in a saleable form and the attribute of saleable or not saleable would, in any case, be deemed irrelevant. On the other hand, if the item was acquired for purposes of sale or exchange, it should be in a saleable or exchangeable form.

The first part of the definition, if a pure grammatical interpretation is applied, entails something of “inclusiveness”. Therefore, for the first part of the definition, both the intention of the taxpayer for the acquisition of the subject matter, as well as the method of acquisition, need to be considered in the determination of whether an item would constitute trading stock or not.

2.5 PART 2 OF THE DEFINITION

The second part of the definition of trading stock states that:

“...the proceeds from the disposal of which forms or will form part of his gross income, otherwise than in terms of paragraph (j) or (m) of the definition of ‘gross income’, or a recovery or recoupment contemplated in section 8(4) which is included in gross income in terms of paragraph(n) of that definition.”

This part of the definition, read together with the “or” of the first part of the definition, clearly provides for the situation where the first part of the definition is not met, the



item will still be considered trading stock on the premise where the subject matter is sold and the income derived from the sales transaction is included in the taxpayer's gross income (except for the sections paragraph (j) or (m) or (n) specifically provided for to be excluded). The latter sections were specifically excluded for purposes of this study. *CIR v Richards Bay* confirmed that the second part of the definition only has the objective requirement that the proceeds from the sale of the subject matter must be included in gross income (*CIR v Richards Bay*:72), for the subject matter to meet the requirement of the second part of the definition of trading stock.

Part two of the definition therefore postulates an objective question that is not dependant on the intention or the possibility to sell the subject matter in future. The only relevant factor for consideration as per this part of the definition is whether the subject matter has been disposed of or not. Once the item is disposed of, the only additional requirement is that the subject matter sold must be revenue in nature (a requirement of inclusion the definition of gross income per section 1 of the ITA). Should the subject matter constitute an asset of a capital nature, the proceeds will not constitute gross income and thus fall outside the ambit of the second part of the definition.

2.6 PART 3 OF THE DEFINITION

The third part of the definition provides for any consumable and spare parts acquired by the taxpayer to be used or consumed in the course of his trade. The part is excluded from the scope of the research and therefore does not form part of this analysis.



2.7 THE PROVISIONS OF SECTION 22 OF THE ITA

2.7.1 Introduction and background

If the subject matter acquired by the taxpayer meets the definition of trading stock as per section 1 of the ITA, the subsequent treatment of the asset for taxation purposes is in terms of section 22 of the ITA. Section 22 therefore is briefly described in the following paragraphs.

The general framework of the ITA, within which the sections of the ITA (including section 22) function, were described by the courts in *CSARS v Foskor* (own emphasis):

“...the South African system of taxation of income entails determining what the taxpayer’s gross income was, subtracting from it any income which is exempt from tax, subtracting from the resultant income any deductions allowed by the Act, and thereby arriving at the taxable income. It is on the latter income that tax is levied.”(*CSARS v Foskor*: 18).

The general effect on the deduction of expense where trading stock is acquired by the taxpayer and the consequent inclusion of the amount received as a result of the selling of this trading stock or the effect where trading stock acquired during the year and was still unsold on year end are described in *CSARS v Foskor* (2010: 18):

“...where a taxpayer is carrying on a trade, any expenditure incurred by him in the acquisition of trading stock is deductible in terms of section 11 (a) of the Act because it is expenditure incurred in the production of income and it is not of a capital nature. Income generated by the sale of such stock is of course part of the trader’s gross income. Where in his first year of trading a trader has bought, and thereafter sold, all the stock which he acquired during that year, no problem arises. There will be a perfect correlation between the trading income earned and the expenditure incurred in that particular year in purchasing and selling the stocks sold, and the difference between the two sums will give a true picture of the result of the year’s trading. There will be no stock on hand at the close of the year of which account need be taken” (own emphasis).



Section 22 of the ITA provides for the situation where trading stock has been acquired during the year of assessment, and a deduction has been allowed in terms of section 11(a) of the ITA, but where the trading stock was unsold at year end. Section 22 creates provisions for the inclusion of this closing stock on year end in order effectively only to allow the original deduction permitted in terms of section 11(a) to the extent that the stock has actually been sold and accounted for as part of gross income in the year of assessment. Section 22 of the ITA therefore provides for the treatment where expenses are incurred and allowed as a deduction in the current year of assessment but the gross income due to a selling transaction is only received and accounted for in gross income in subsequent years, or the situation where stock in trade is used as a manipulation to artificially increase the deduction of an expense incurred just before year end.

It is important therefore to determine firstly if a subject matter meets the definition of trading stock as per section 1 of the ITA, because only when the subject matter is considered trading stock will the section 22 of the ITA be applicable. In cases where the expense incurred are not trading stock, the deduction will simply be allowed as a deduction in the year it is incurred, without any adjustments needed (as prescribed in section 22 of the ITA) , needed at the end of the year or in the subsequent year of assessment.

The following paragraphs provide an analysis of the working of section 22(1) to section 22(4) of the ITA. (For the detailed extracted section 22 of the ITA, refer to Appendix A.)

2.7.2 Section 22(1) and section 22(2) of the ITA

Section 22(1) of the ITA prescribes the treatment of “closing stock” (stock acquired during the year of assessment where a deduction in terms of section 11(a) was allowed, but the stock was not yet sold on year-end). Section 22(2) in the case prescribes that this value of “closing stock” (allowed as a deduction), needs to be added back/included as part of gross income on year end. Section 22(1) therefore effectively results in the inclusion (adding back) of closing stock, without any receipt



or accrual actually arising (but as a direct result of the application of section 22) as “gross income” in the hands of the taxpayer. This “closing stock” will naturally form the “opening stock” in the consequent year of assessment, which will again be allowed as a deduction in terms of section 22(2) of the ITA. Opening stock is consequently allowed as a deduction without any expenditure having been incurred at that point as is normally required by section 11(a) of the ITA but as being a direct consequence of the application of section 22 of the ITA.

The mechanics of section 22(1) and section 22(2) effectively results in the deduction available under section 11(a) of the ITA to be postponed to the year the stock in trade was actually realised. This is achieved by fictitiously adding to gross income the value of any unsold stock on year end (without actual gross income that were received by the taxpayer) and fictitiously allowing as a deduction the value of “opening stock” in the consequent year of assessment even though no real expense has been incurred.

2.7.3 Provisions of section 22(3), section 22(4)

Subsections (1) and (2) of section 22 described above deals with the “timing” of the accounting for purposes of taxation of trading stock. Section 22(3) and 22(4) stipulates the “value” of this “opening and closing” stock on hand to be accounted at for purposes of section 22(1) and section 22(2) of the ITA. Section 22(3) specifically deals with the situation where trading stock was originally acquired for a consideration as opposed to section 22(4) that deals with the scenario where the stock was acquired for no consideration. A detailed analysis of these two subsections (the “value” provisions) was however excluded for purpose of this study.

2.8 THE PROBLEM IN *CSARS V FOSKOR*

2.8.1 Development of the problem

It is important to keep in mind that in *CSARS v Foskor* the decision was reached based on the section 1 definition of trading stock in the ITA, the only definition



available and applicable to all industries, including the mining industry, at the time the case was decided. As was mentioned in the introductory paragraphs of this study, Treasury deemed it necessary to introduce a new definition to be applied in the mining industry, specifically due to the difficulties experienced with the classification of these stockpiles held by Foskor in the latter case. Consequently section 15A was introduced into the ITA.

The case of *CSARS v Foskor* was in fact the decision reached by the Tax Court of Johannesburg in the case of *ITC 1836* (71 SATC 115) that was appealed by the Commissioner. In the latter case the taxpayer appealed against the inclusion of the amount of R203m in the appellant's taxable income (*ITC 1836: 1*). The appeal was upheld by the Tax Court, hence the appeal by the Commissioner which ended in the case of *CSARS v Foskor*.

The question on appeal in *CSARS v Foskor* was whether extracted mineral bearing ore belonging to the respondent in the case, *Foskor (Pty) Ltd* (hereafter referred to as "*Foskor*"), a mining company constituted trading stock for (in terms of section 1) for purposes of the ITA. The appellant, SARS, contended that it was, in which case Foskor's initially assessed taxable income would increase with an amount of R203m. Foskor was adamant that it was not. (*CSARS v Foskor: 1.*)

A summary of the facts of the cases (*ITC 1836* appealed in *CSARS v Foskor*) was that *Foskor* (the taxpayer) was involved in mining operations. During 1952 the taxpayer acquired rights to mine base minerals and phosphates from state-owned land. The taxpayer was therefore not the owner of the land, but had the right to extract the minerals required from the land. During 1963, *Phalaborwa Mining Company Limited* (hereinafter referred to as PMC) obtained the right to mine copper and other base minerals (except phosphorous minerals that were mined by Foskor) over some of the areas over which Foskor held its rights. (*CSARS v Foskor: 4-8.*) Otherwise formulated, PMC conducted the extraction activities of the ore from the earth and extracted the minerals required by them, leaving the phosphorous minerals for the extraction of Foskor.



This extraction of the earth done by PMC on behalf of Foskor was in terms of an agreement entered into by the parties in 1979 that allowed both companies to focus on their dedicated resources (*CSARS v Foskor*: 7). In terms of the agreement, PMC could extend its operations of an open pit copper mine into Foskor's area, effectively allowing PMC to concentrate on copper mining and Foskor on phosphate bearing ore, called foskorite (*CSARS v Foskor*: 8).

Foskor therefore did not extract the phosphate-bearing ore from the earth themselves but instead in terms of the agreement entered allowed PMC to extract the foskorite as a by-product of its copper mining operations and to deliver the ore to Foskor, which in turn paid for the mining and transport. Upon delivery of the unmined ore at the premises of Foskor by PMC, Foskor became the owner of the ore. (*CSARS v Foskor*: 7.) Foskor allowed these delivered tons of foskorite to be dumped "for further processing" on their premises, effectively creating stockpiled material for future use (*CSARS v Foskor*: 8).

From these ore dumps (stockpiles) dumped by PMC on Foskor's premise, Foskor extracted phosphates and other minerals by way of different processes, which included firstly the crushing of the ore via a primary and secondary crusher. This was followed by the subjection of the ore to a milling process in order to liberate the mineral particles from the ore. These liberated particles were then subjected to a floatation plant where the minerals that bear economic importance were separated by means of different metallurgical processes. Finally, the extracted phosphate concentrate was dried and stockpiled. (*CSARS v Foskor*: 9.)

These phosphate minerals were sold to customers worldwide, mainly for the use in the production of fertilizer (*CSARS v Foskor*: 10).

The foskorite dumps were not considered to be trading stock in the respective years of assessment of 1991 and 1992 and were consequently assessed by the Commissioner on the basis that the dumps then did not constitute trading stock (*CSARS v Foskor*: 14). In 2006 a revised assessment was issued where the Commissioner constituted these stockpiles to be trading stock (*CSARS v Foskor*:



13). Accumulated costs to the value of R203m incurred as a result of the mining and transportation costs paid to PMC, as described above (costs that were allowed as a deduction in terms of section 11(a) of the ITA), were included in the revised tax assessment in 2006, for the 1999 year of assessment (*CSARS v Foskor*: 13). This was done due to the Commissioner assessing the stockpiles as “closing stock” on hand as at 30 June 1999 in terms of the definition of section 1 of the ITA that calls for the consequent application of section 22 of the ITA (*CSARS v Foskor*: 13). This revised assessment was appealed by Foskor to the Johannesburg Income Tax Special Court in *ITC 1836*. The appeal was upheld by the court resulting in the *CSARS v Foskor*.

The statutory provisions of particular interest are the applications of section 22 of the ITA, as well as the definition trading stock as was dealt with in the preceding paragraphs of this study (section 15A not yet being invoked into the ITA). At the time of the decision, the ITA clearly differentiated between the process “mining” and the process of “manufacture”. “Mining operations” and “mining” were to include “every method or process by which any mineral is won from the soil or from any substance or constitution thereof” (section 1, ITA). “Manufacturing”, on the other hand, was not defined and the court accepted manufacturing as described in *SIR v Safranmark (Pty) Ltd* (1982: 238) where it was held:

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

In *ITC1836* (2007: 28-29) it was held that it is apparent that the processes of extracting or winning the phosphates from the stockpiled ore without a different finished product emerging were the result of a mining process, and not a manufacturing process. Essentially, what is sold to customers is the phosphate already found in the phosphate-bearing ore (similar to the gold or diamonds which have already surfaced in the earth and have merely to be extracted by one or



another chemical process), resulting in a substance that is no different or has different qualities (*ITC 1836: 25*). All that has really occurred is the removal of the mineral particles from the ore by means of a chemical process. It follows that the essence of the process undertaken by the taxpayer was the extraction or winning of the phosphates without creating a different finished product. (*ITC 1836: 26*.) This was “mining” and not “manufacturing”. Also, the product sold to the customers was still the phosphate-bearing ore. No different substance with different qualities was created or produced (*ITC 183 : 26*). All that had actually occurred was the separation of the mineral particles from the ore by means of a certain metallurgic engineering process. Therefore, the phosphate sold by the taxpayer had been present naturally in the earth, similar to gold and diamonds (*ITC 1836: 27*). It could not be manufactured but had to be mined. The phosphate-bearing ore was not acquired for the purpose of manufacture, as suggested in both the first part of the definition of trading stock and the contention held before the court. Rather, this constituted a process of “mining”. (*ITC 1836: 27*.)

As neither of the requirements of the definition of trading stock as per section 1 of the ITA was met, it was concluded that the piles of phosphate-bearing ore did not constitute trading stock as they did not fall within the ambit of the first part of the definition and were therefore not subject to the application of section 22 of the ITA (*ITC 1836: 32-33*).

This decision was appealed by SARS, with a decision on the appeal case only reached on 31 March 2010, hence the discussion of the outcome of *CSARS v Foskor* below.

2.8.2 Outcome of *CSARS v Foskor*

The Foskor case was a result of an appeal of the Commissioner on the decision reached in *ITC 1836*. The Commissioner held that the stockpiles constitute trading stock based on the contention that the stockpiles were in fact part of the process of manufacturing, and not held as part of a process of mining. The formulation of the final decision reached by the court in the case was as follows:



- foskorite ore was acquired (from PMC) by Foskor for the purpose of manufacture towards the final project, namely, fertiliser (*CSARS v Foskor: 44*);
- the phosphate minerals occurred naturally in the earth and are contained in what is sold to fertiliser producers worldwide. Classification of these minerals as constituting part of mining and not manufacturing was incorrect and too simplistic (*CSARS v Foskor: 45*);
- the court held that the view of *ITC 1836* ignored not only the complexity of the processes to which the ore was subjected but the fact that several minerals were separated and sold separately (*CSARS v Foskor: 46*); and
- further, *ITC 1836* ignored the fact that there was no market for the product before the incurred processes as opposed to the international market that was created after the processes were complete (*CSARS v Foskor: 46*).

The court ruled that the processes involved in manufacturing the foskorite, the final product, did indeed meet the requirements of a “manufacturing process”, and consequently also met the requirement of section 1 of the ITA (acquired for purpose of manufacture), resulting in the application of the relevant parts of section 22 of the ITA. The stockpiles were deemed trading stock and the assessment raised by the Commissioner was found to be correct. The appeal of the Commissioner against the decision of *ITC 1836* was therefore upheld by the court (*CSARS v Foskor: 47-48*).

2.8.3 Remarks on the decisions of *CSARS v Foskor*

Evident from the above is that the Commissioner, only after many a winding turn, finally succeeded with the application of the definition as contained in section 1 of the ITA by proving the process to be part of a “manufacturing process” as opposed to being a “process of mining”.

The Commissioner succeeded in classifying the stockpiles as trading stock, followed by the application of section 22 of the ITA, resulting in the inclusion of the R203m as gross income of the taxpayer.



What is considered of more importance for purposes of this study, however, was the consequent introduction of section 15A of the ITA. As was previously mentioned, the problems experienced by the Commissioner referred to in the budget proposal of 2009 (extracted below, own emphasis), was a direct reference to the “problems experienced” in *CSARS v Foskor* namely that:

“... recent court decisions may require legislative intervention to preserve the status quo. In the first decision, the Tax Court held that mining stockpiles could not be considered to be trading stock. While this decision will be appealed, it may be necessary to amend the Income Tax Act with immediate effect to prevent other taxpayers engaged in mining from taking this position while the appeal is under way.”
(Manuel, T, 2009)

2.9 REVIEW OF THE INTENTION OF THE TAXPAYER

The notion of “intention” is running as a golden thread throughout this chapter pertaining to the background and position experienced of the taxpayer prior to the introduction of section 15A. Intention plays a crucial part in the definition of trading stock in section 1 of the ITA (as illustrated that the subject matter can be acquired due to an intention of the taxpayer “for the purposes of manufacture, sale or exchange by him or on his behalf”(section 1 of ITA)). Intention of the taxpayer further played a crucial part/factor for consideration in the decided case law as to whether the taxpayer was involved in as process of mining or in a process of manufacturing.

Generally speaking, intention of the taxpayer when it comes to the application and interpretation of any Act should not be underestimated. It is not possible to read any Act (including the ITA), in isolation – intention always needs to be considered. This is due to the fact that (in the case of the ITA), the ITA is imposed on the taxpayer (an individual, or, in the case where the taxpayer is not an individual, the management of the non- natural persons is at core individuals). And an individual is always steered by the underlying, subjective factor that pertains to intention.

Intention, however, has provided the courts with relative difficulty in the past due to the inherent subjective nature thereof. Intention of the taxpayer needs to be



evaluated, established and verified with reference to subjective (such as ipse dixit of the taxpayer) but more importantly, to objective (external) factors. The final part of this chapter deals with the illustration of the importance of “intention of the taxpayer”, especially with the classification of an asset for the purpose of taxation.

2.9.1 Intention: No halfway house between revenue and capital

In the case of *Matla Coal Ltd v CIR* 1987 (1) SA 108(A)(48 SATC 223) the court held that all property, including mining and mineral rights, can be held as capital assets or trading stock. The court further held that a mineral such as coal can only be deemed trading stock once it has been separated from the earth. It was emphasised that there is no halfway house between revenue and capital. (*Matla Coal v CIR: 227.*)

In order to understand this classification and established difference between revenue and capital it is necessary to determine what the “intention of the taxpayer” is when a transaction is entered into. The different options (or, intentions) available in terms of the ITA are the intention of entering into a transaction of a ‘revenue’ nature (trading stock or current asset) or “capital” in nature (non-current asset).

Intention is inherently subjective in nature. Every transaction entered into by a taxpayer may result in a different taxation implication for the unique taxpayer involved. If one standard set of criteria or rules is to be developed and applied in every situation regardless of the circumstances, it may result in incorrect application and unfair tax consequences due to the ignorance of the subjectivity factor when classifying an asset. This problem of subjectivity has been addressed over time with the courts having laid down useful tests to help determine whether an asset or transaction should be viewed as being of a capital or a revenue nature. The Supreme Court case of *New States Areas Ltd v CIR*, 1946 AD 610 (14 SATC 155) provided leading guidelines to help with this classification problem. The case illustrates the vast amount of variables that can be evaluated and taken into account in the process of objectively evaluating and verifying the intention of the taxpayer with the classification of the relevant asset. In this case it was held by the court (own emphasis) that:



“...the distinction must be remembered between floating or circulating and fixed capital. When the capital employed in a business is frequently changing its form from money to goods and vice versa (for example, the purchase and sale of stock by a merchant or the purchase of raw material by a manufacturer for the purpose of conversion to a manufactured article) and this is done for the purpose of making a profit, then the capital so employed is floating capital. The problem which arises when deductions are claimed is therefore usually whether the expenditure in question should properly be regarded as part of the cost of performing the income-earning operations or as part of the cost of establishing or improving or adding to the income-earning plant or machinery.” (*New States Areas Ltd v CIR*: 627.)

It was further held in *New States Areas v CIR (AD)* that the true nature of each transaction must be inquired into, in order to determine whether the expenditure attached to it is capital or revenue expenditure and that the purpose (intention) of the expenditure is an important factor.

It stands to reason, however, that due to the subjective nature of intention, the need to take into account the surrounding circumstances (for example the nature of the taxpayer and the nature of the industry involved) is crucial in the classification of the true nature of each type of transaction entered into by the taxpayer. This guidance from external circumstances was often relied on in South African case law. The following section provides a short overview of this established case law.

2.9.2 Case law and intention

Case law included as part of this study, is only dealt with to the extent that it is relevant to the clarification of the “intention of the taxpayer”. The two identified cases selected to analyse to this extent were *CIR v Richards Bay* as well as *Ernst Bester Trust v CSARS*, 2008 ZASCA 55 (5) SA 279 (SCA) (70 SATC 151) discussed below.

It is also important to remember that the intention identified in each case described below formed the framework for classification of the true nature of the transaction entered into, with resulting consequences for taxation purposes. Resultant taxation



consequences are thus only evinced once the true nature of the transaction has been established, and can, therefore, clearly not be viewed in isolation.

2.9.2.1 CIR v Richards Bay Iron and Titanium (Pty) Ltd

The short summary of the facts of *CIR v Richards Bay* decided by the tax courts in 1996 (therefore before the introduction of section 15A) were that the appellant, the taxpayer and Richards Bay Iron and Titanium (Pty) Ltd were involved in the process of beneficiation of minerals from sand dunes off the Richards Bay area. The process involved creating self-contained water ponds in the dunes, after which the sand and water were turned into a slump by the taxpayer in the case. First, the slump was removed by suction, after which the heavy mineral concentrate was removed from the sand by means of a gravity-separation procedure. In the course of these operations, various stockpiles were created, some of which contained heavy metal, while others contained the separated individual minerals within the concentrate. The purpose of the stockpiles was to ensure that there was enough concentrate available to guarantee the continuous operation of the plant. (*CIR v Richards Bay*: 56.)

For the financial records of the taxpayer, some of the stockpiles were excluded for purposes of section 22 of the ITA, even though the costs incurred in creating the stockpiles were claimed as a deductible expense. An additional assessment was issued by the Commissioner of SARS who assessed the taxpayer's alleged neglect in not including the stockpiles as trading stock in terms of section 22 of the ITA. (*CIR v Richards Bay*: 57.)

The taxpayer argued that the stockpiles of sand had no separate identity, did not have a value as a saleable item and that some of the some of the stockpiles were not saleable in their current form and therefore had no market value. The taxpayer also argued that the legislator could not have intended the assignment of an artificial value to stockpiles still to be subjected to further processing at the end of the year of assessment. The taxpayer however, never disputed the fact that the process actually was a process of manufacturing, and never argued that the intention of the process



was an intention of mining from the side of the taxpayer. (*CIR v Richards Bay*: 57-58.)

The court dismissed the arguments of the taxpayer and found that it is not a requirement for the subject matter to be in a “saleable condition”, neither to have a “market value” in order to be described as “trading stock” in terms of section 1 of the ITA. The stockpiles were therefore to be classified as trading stock. (*CIR v Richards Bay*: 59.)

What is relevant for purposes of this part of the study was the fact that the taxpayer never argued that the intention of the taxpayer with the stockpiles was not an intention within the scope of manufacturing at all, but rather held with the intention for mining. In the *obiter dicta* raised by the court, it was held that had the taxpayer argued the intention of holding the stockpiles for purposes of mining, the result would probably have been different.

From the abovementioned case, it is clear that the “intention of the taxpayer” forms a base for steering the argument in a certain direction. In the *CIR v Richards Bay* the fact that the intention of the taxpayer was not argued to be the conducting of mining operations, the work in process was found to meet the criteria of trading stock, being part of a manufacturing process. Had the intention been argued and proven to be the conducting of mining operations, the section one definition of trading stock in the ITA would not be applicable. This was however never pressed in an oral argument by counsel for the appellants and was therefore not considered any further by the court. (*Richards Bay*: 75.)

2.9.2.2. Ernst Bester Trust v CSARS

The facts of *Ernst Bester Trust v CSARS* were that in 1965, a certain Mr Bester purchased a farm. He farmed grapes and grain on it until his death in 1989. From time to time, he sold sand to an independent client. The Ernst Bester Trust (the taxpayer in the case) had inherited the farm as a bequest from Mr Bester (therefore, no costs were incurred in acquiring the farm). The farm held deposits of sand suitable for use in the building industry and some years later the legal right to



remove the sand from the farm was granted to a contractor. The farm was otherwise let to a farmer who used it for farming. The trust derived some income from a lease but a great deal more from the sale of sand, albeit irregular, for some years. (*Ernst Bester Trust v CSARS*: 2-4.)

It is important to note that the taxpayer (the Ernst Bester Trust) played no role whatsoever in the sand-mining activities and merely received amounts per cubic metre for the sand removed from its land by the contractor. Also relevant was the fact that at the time of acquisition / inheritance of the farm by the trust, its potential to provide income from the disposal of sand was known to the trustees. (*Ernst Bester Trust v CSARS*: 4.)

In this case, which related to selling sand, the questions held before the court were:

- whether the amount received as a result of the sale of the sand to a third party had to be classified as being of an 'income' in the hands of the taxpayer or classified as 'capital' in nature (*Ernst Bester Trust v CSARS*: 10); and
- if the receipts were found not to be of a capital nature, the taxpayer was entitled to an opening stock deduction in respect of the trading stock of which it disposed, therefore reliance was to be placed on section 22 of the ITA (*Ernst Bester Trust v CSARS*: 20).

On the first contention held before the court on whether the proceeds derived from the sales of the sand were capital (non current) in nature, the court held that when a taxpayer permits another to enter his property and remove sand against a monthly consideration calculated with reference to the volume removed, he displays the intention of productively employing his capital asset (the farm) (*Ernst Bester Trust v CSARS* (15)). The court decided that there was no doubt that the amounts received by the taxpayer for the sand extracted and sold to the third party represented an intention to realise profits in the operation of an ongoing scheme of profit-making over many years from sales of sand at a market-related price. The court held that the case, without doubt, provided evidence that the intention of the taxpayer was to employ a capital asset productively in order to receive income. (*Ernst Bester Trust v*



CSARS: 11-12.) This income was therefore to be included as part of gross income for the purpose of calculating the taxpayer's taxable income.

On the second contention, the court held that no evidence prevailed that the whole or any part of the sand deposit had ever transcended a notional stock in trade because of the *ad hoc* nature of the purchase and the absence of proof of the size of the market. The extracted sand was further not allowed to accumulate on the premises of the taxpayer. (*Ernst Bester Trust v CSARS*: 23-24.) The definition of trading stock (in the content of application of the intention of the taxpayer) was therefore not even relevant. Intention of the taxpayer provided evidence of the productive employment of an asset, not of acquiring trading stock for purposes of the ITA.

The appeal of the taxpayer against the commissioner failed effectively resulting in the taxpayer being taxed on the proceeds derived from the selling of the sand, with no corresponding relief obtained in terms of the ITA, as the farm was actually acquired for no consideration as the farm was inherited by the taxpayer (*Ernst Bester Trust v CSARS*: 3).

Again, based on the intention of the taxpayer to productively employ a capital asset, as is evident from the facts of the case, the scope and sections that pertain to trading stock in the ITA were found to be irrelevant. The true intention of the taxpayer was the productive employment of an asset, resulting in gross income as a result of profit making. Intention was therefore the crucial framework to determine the direction of the applications of the relevant sections of the ITA.

We can summarise this matter by stating that the notion of trading stock was irrelevant due to the intention of the taxpayer to employ a capital asset productively.



2.10 INTERNATIONAL GUIDELINES ON INTENTION

2.10.1 Background and introduction

As is illustrated above, the lack of specific legislative guidelines necessitates the interpretation of the intention of the taxpayer in order to establish the tax implications of any transaction entered into by the taxpayer.

Some very useful international guidelines, specifically relating to the intention of the taxpayer with the classification of assets in the mining industry (classification between “capital in nature” (non-current asset) as opposed to being “revenue in nature” (trading stock, current asset) were found in Australian Tax Ruling TR93/33., The detail of the ruling is not important for the purposes of this study. What is important, however, is the underlying key driver to all of the guidelines in the ruling to assist in determination of the “intention of the taxpayer”.

The Australian Taxation Ruling TR93/33, is a “public ruling” in terms of Part IVA of the Australian Taxation Administration Act 1953 and specifically refers to the Income Tax Act of Australia. The ruling explains the different possibilities for the classification of assets in the gold mining industry. Although the ruling specifically focuses on the subject of tailing dumps as trading stock in the gold mine industry, it was found to be of relevance due to the ‘intention of the taxpayer’ that is identified as the key driver of the ruling.

As mentioned earlier in this chapter, intention is subjective in nature and requires the analysis of surrounding facts and circumstances (objective measures) to classify intention correctly. Ruling TR93/33 refers to typical surrounding facts and circumstances (objective measures) relevant to the mining industry to be used in the classification of an asset.

Section 1(a) (i) and (ii) of the ruling differentiates between circumstances where a mine stockpile will be considered (classified) revenue in nature (trading stock) as opposed to being capital nature. It also specifically addresses the process and factors to assist in identification as to when there has been possibly a change of



intention from the side of the taxpayer. These circumstances may include for example, in the scenario where an asset has always been held as a capital asset, but is now, due to particular circumstances and events, held as trading stock (Ruling 93/33, section 1(b)).

The ruling specifically provides for that in the process of determining where a mining asset has in fact been 'abandoned' (defined as "to leave (a place or vehicle) empty or uninhabited, without intending to return" (Oxford Dictionary of English, Revised Edition, Oxford University Press 2005). This is, for instance, the case where a stockpile that has been classified as trading stock is now, due to a change in circumstances, no longer regarded as trading stock. In terms of the ruling the facts of each case have been considered.

Factors for consideration mentioned in Ruling 92/33 include:

- how long the asset has been left undisturbed;
- accounting for the asset in the financial accounts of the miner;
- the value placed on the asset by the owner/ miner himself; and
- whether there are any existing, definite proposals to process or to otherwise deal with for the asset, or continuing to mine the site.

These factors are not dissimilar to the well-established objective factors used to determine the intention of the taxpayer in *New Sates Areas Ltd v CIR*, with the purpose of establishing whether an asset is considered to be of a 'capital' or of a 'revenue' nature.

2.10.2 Summary of guidelines supplied by the ruling

In terms of the ruling, assets are divided into two parts, namely, where the granting / acquisition of the gold mine asset would, in fact, constitute a capital asset (Ruling 33/93:section 4-5) as opposed to being classified as a revenue item.

Sections 5 and 6 of the Ruling provides guidance for the disposal of gold mine stockpiles under different circumstances, resulting in different outcomes (either being



capital or revenue). Section 8 of the ruling further describes what the situation would be when abandoned assets become trading stock again. Sections 13 to 20 of the Ruling provide practical examples that serve as explanations for the principles mentioned in the ruling. The examples provide clarity in the difference of treatment between assets treated as a capital asset (profit) as opposed to being of a revenue nature (trading stock). Additional examples are also provided in sections 22 to 24 of the Ruling. (Sections 22, 23 and 24 of the Ruling 33/93.)

To summarise, the ruling provides guidance by listing and discussing various practical scenarios that may occur as a result of a change in the intention of a taxpayer conducting gold mine operations, resulting in different treatment of the taxpayer's activities for taxation purposes. The ruling therefore provides additional guidelines to objectively assess the intention of the taxpayer, in order to determine the classification of the stockpiles either as being either revenue in nature (constituting trading stock) or being of a capital nature.

2.11 CONCLUSION

This chapter focused on the position that prevailed on the classification of trading stock prior to the introduction of section 15A into the ITA. The study included the analyses of the results obtained by Faber in 2008. This study proved to be of relevance as it describes the position that prevailed prior to the introduction of section 15A (as it was applied in 2008) in an exceptional accurate way. The reliance that was placed on the notion of the "intention of the taxpayer" in order to distinguish between a "process of manufacture" as oppose to a "process of mining" was considered very important. Further, Faber's reference to the importance of the accounting treatment as well as financial disclosure of mining stockpiles was considered of relevance.

The chapter secondly dealt with the grammatical interpretation of the definition of trading stock provided in section 1 of the ITA. Both the "method of acquisition" of the subject matter as well as the "intention of acquisition" of the subject matter by the taxpayer was analysed. Based on this grammatical and functional analysis, the



definition of trading stock was found to be a very wide and all-inclusive definition and is applicable to stockpiles.

The chapter thirdly dealt with an overview of the working of section 22 of the ITA, the section that provides for the tax treatment once an asset is classified as trading stock in terms of section 1 of the definition of trading stock in the ITA. This was considered important due to the rather unique application of section 22 of the ITA. Section 22 effectively postpones the deduction available in terms of the ITA for the expense incurred for the acquisition of trading stock to the taxation period under which the trading stock was actually sold (realised) and included in gross income. Due to this unique application and effect of section 22, the importance of correct classification of the subject matter in terms of the definition of trading stock in section 1 of the ITA was again highlighted.

The chapter subsequently proceeded to analyse the facts and decisions reached by the court in the case of *ITC 1836* appealed in *CSARS v Foskor*. Difficulties experienced by the Commissioner in these cases resulted in the legislative intervention by way of introduction of section 15A into the ITA (analysed in chapter 3 of this study). These difficulties experienced by the mining industry (as well as the Commissioner) were primarily due to a lack of guidance in respect of the classification of an asset as trading stock in the absence of a definition of trading stock specifically to be applied in the mining industry. (The cases were decided within the context of only the general section 1 definition trading stock available at the time.) As confirmed in the 2009 budget proposal by Trevor Manuel, these difficulties experienced by the Commissioner greatly contributed to the introduction of a definition of trading stock specifically applicable in the mining industry in the form of section 15 A.

This chapter was concluded by an overview discussion of the importance of establishing the ‘intention of the taxpayer’ as a framework for the application of any section or definition of any part of the ITA. This overview included the importance of intention with the reading and interpretation of especially the section 1 definition of “trading stock” as well as the relevance and guidance on intention that has been



provided by South African case law. Intention was emphasised as crucial for the accurate application of any act, before the details of the provisions of the ITA itself are applied.

In the next chapter, section 15A is analysed in detail. This is done in order to determine if the section actually does provide for a more clear-cut and simplistic approach and guidance for the taxation treatment of mining assets in South Africa as was intended by the legislator as a result of the problems experienced in the decision of the Foskor case.



CHAPTER 3

TAXATION OF STOCKPILES AFTER THE INTRODUCTION OF SECTION 15A of THE ITA

3.1 ITA SECTION 15A DEFINITION OF TRADING STOCK

The previous chapter of the study dealt with the definitions of trading stock in section 1 of the ITA as well as its consequent treatment for purposes of section 22 of the ITA. The chapter further dealt with the problems experienced by the SARS Commissioner in the decided case of *CSARS v Foskor*, which served as the subsequent catalyst for the introduction of a definition of trading stock, specifically for the purposes of the mining industry of South Africa, in section 15A of the ITA.

As previously noted, there was no definition of trading stock for the mining industry before 2009. The general definition in section 1 of the ITA (applicable to all other industries) had to be applied to determine whether an asset constitutes trading stock for the mining industry. The reason for the introduction of the definition was clear from clause 30 of the Explanatory Memorandum of the Taxation Laws Amendment Bill of 2009 that stated the:

“...insertion of section 15A: A recent Tax Court judgment regarding the recognition of mining stockpiles as trading stock has given rise to the concern that taxpayers may attempt to exclude mining stockpiles from trading stock for tax purposes while an appeal against the judgment is underway. The proposed amendment is aimed at ensuring that such mining stockpiles continue to be reflected as trading stock in terms of section 22 of the ITA at a value that is not less than that used for accounting purposes. This accounting treatment of mining stockpiles is intended to maintain the *status quo* based on information supplied by the mining industry” (Clause 30, Explanatory memorandum Taxation Laws Amendment).

Section 15A was introduced into the ITA with the Taxation Laws Amendment Act and is formulated as follows: (own emphasis)



“[a]mounts to be taken into account in respect of trading stock derived from mining operations

15A. For the purposes of section 22, trading stock related to mining operations—

(a) includes anything that is—

(i) won or in any other manner acquired during the course of mining operations by a taxpayer for the purposes of extraction, processing, separation, refining, beneficiation, manufacture, sale or exchange by the taxpayer or on the taxpayer’s behalf; and

(ii) taken into account as inventory in terms of South African Generally Accepted Accounting Practice; and

(b) must not be valued at an amount less than the amount so taken into account.”.

The definition, for purposes of this study, was divided into two parts, (a) and (b). Part (a) was further subdivided into (i) and (ii). The definition resulted in a materially more detailed definition to be applied in the case of dealing with mining assets (inventory) as opposed to assets in other industries provided for in section of ITA, as was discussed in chapter 3 of the study.

The words and phrases added to the original definition in section 1 of the ITA, which resulted in the section 15A definition specifically to be applied in mining industries, are the following:

- “won“ was included as an additional “method of acquisition”, in addition to the methods of acquisitions identified in chapter two of the study;
- “course of mining” specifically requires the actions/methods of acquisition of the subject matter by the taxpayer to be acquired as part of specific mining operations;
- “extraction, processing, separation, refining, beneficiation” were all included intentions of acquisition of the subject matter by the taxpayer, in addition to the intentions identified for the section 1 definition in chapter two of this study; and
- The provision for the accounting treatment of the subject matter that needs to be determined and read together with the first part of the definition (relating to the methods and intentions of acquisition).



The following part of the study follows with a grammatical interpretation of the additional words and phrases (those not included in the section 1 ITA definition of trading stock as described and discussed in chapter 2 of the study) included in the section 15A ITA definition.

3.2 GRAMMATICAL ANALYSES OF SECTION 15A OF THE ITA: PART 1

As mentioned in the previous paragraph, the following part of this chapter analyses the grammatical meaning of the differences between the definition of trading stock in section 15A and the definition in section 1 of trading stock.

3.2.1 “Won” (ITA, section 15A (i))

Section 15(a) (i) provides for the methods of acquisition for purposes of the section to be “won or in any other way acquired”. A pure grammatical analysis of the abovementioned phrases illustrates the wide ambit intended in this first part of the definition with the phrase “in any other way acquired”.

The Merriam Webster online dictionary (Not dated) defines “won” as “...to obtain (as ore, coal, or clay) by mining; to prepare (as a vein or bed) for regular mining; to recover (as metal) from ore”.

The phrase “in other manner acquired” read together with the word “won” concerning the methods of acquisition for purposes of this definition expresses the notion of “all-inclusiveness” by the legislator, not excluding anything as a result of “method of acquisition”. These verbs were accepted, without further analysis conducted, purely from a grammatical point of view, to create an effect of all-inclusiveness, therefore, acquisition of the subject matter by any possible method would be accepted for purpose of defining the subject matter for this part of the definition.



3.2.2 “In the course of mining” (ITA, section 15A (i))

Section 15(a)(i) of the ITA makes specific provision for the phrase “in the course of mining”. This implies that where the subject matter is acquired by any means other than “in the course of mining”, the definition of section 15A will not be applicable to the subject matter. This phrase therefore limits the initial expectation of a wide scope that was introduced in the first part of the definition, as described in the previous paragraph.

The phrase “in the course of mining” is considered crucial for the understanding and application of the definition and consequently analysed further. To summarise up to this point, we have established that the subject matter must be “won or in any other way acquired” provided that it is in the “course of mining”, in other words, where a mining process is conducted. Therefore, where the subject matter is not acquired as a result of a process of mining that is conducted immediately (but, for example acquired by means of buying the asset in order to use it in production / manufacturing) the definition in terms of section 15A is not applicable to the classification of the subject matter.

Case law in the past (as illustrated in the previous chapter) has differentiated between what would constitute a course of mining as opposed to what would constitute, for example, a course of manufacturing as well as, the classic question raised in *ITC 1455*(51 SATC 111) regarding when the process of mining ceases and the process of manufacturing commences.

Mining and manufacturing processes are not always easily distinguishable, due to the similar nature of the industries and processes that are involved (illustrated in *CSARS v Foskor*). The following paragraphs analyse the differences between the two processes.



3.2.2.1 Process (course) of manufacture

Section 15A of the ITA provides that the definition is only applicable if the “method of acquisition” is part of a process that constitutes a “process of mining”. This implies that where a process constitutes manufacturing, section 15A is no longer applicable.

A “process of manufacture” or “manufacturing” is not defined in the ITA. Guidance in the courts on what a process of manufacturing would constitute was found in the decided case of *SIR v Safranmark (Pty) Ltd* (1982: 122 G-H) namely a:

“...[p]rocess of manufacture is an action or series of actions directed to the production of an object or thing which is different from the materials or components which went into its making [which] appears to have been gradually accepted. The emphasis has been laid on the difference between the original material and the finished product.”(own emphasis).

From this description of what manufacturing would entail, there is clearly a process (action or series of actions) where the original material used in the process differs from the finished product. The moment this can be verified as true, we are dealing with a manufacturing process and section 15A will no longer be applicable.

For example, in a case where gold particles are mined from the earth, the extraction of the particles from the earth itself does not constitute the creation of a new subject matter – the item originally won in the process was gold, and remained gold as it was only isolated from the earth. Generally speaking, section 15A will be applicable to the classification of the gold in this stage of the process. The moment, however, the extracted gold is processed further (say, for example to manufacture gold earrings), the earrings (finished product) is substantially different from the original gold extracted from the earth. A process of manufacturing has occurred, the section 15A definition is no longer applicable and one must revert to the section 1 definition provided in the ITA.



3.2.2.2 Process (course) of mining

The moment a subject matter needs to be classified and the subject matter is subjected to a process of mining, section 15A (and not the general section 1 definition) of the ITA becomes relevant.

Mining and mining operations are defined in section 1 of the ITA as “...every method or process by which any mineral is won from the soil or from any substance or constituent thereof”.

In addition to these formal definitions provided in the ITA, South African case law has also provided guidance as to what will constitute a process of mining. In *Western Platinum Ltd v CSARS* (2004: 6) it was held that:

“...mining operations’ and ‘mining’ (unless the context otherwise indicates) include every method or process by which any mineral (including natural oil) is won from the soil or from any substance or constituent thereof.’

The definition leaves scope for physical operations outside the winning of minerals from the soil to be regarded as mining; indeed, it was common cause that the refining of excavated minerals is included in the concept.”

It was further held in *Western Platinum Ltd v CSARS* (2004: 6) that:

“...mining operations by themselves cannot produce income.”

Another excellent formulation of the essence of the process of mining is contained in *ITC 145* (1989: 19-20). In the latter case the court described the process of mining in the following way:

“...it is tempting to compare appellant’s operation to the production of gold bullion in a gold mine. The gold ore exists in discreet particles in the rock. The mined rock is crushed and the gold is leached out. The gold ore is then heated and bullion is poured. In ordinary parlance the latter operation will not be referred to as the manufacturing of gold but to the mining of gold.



Another comparison is with diamond mining. It must in that context be accepted that all the acts done, whether underground or on the surface, to win diamonds will be regarded as mining operations.”

Both these examples, the gold and the diamonds already existed in the earth, and were merely isolated from the earth, which is considered a mining process, thereby falling under the ambit of section 15A.

3.2.3 The purposes (intention) of extraction, processing, separation, refining, beneficiation

For the purpose of this study, the grammatical meaning of the words was considered sufficiently clear and no further analysis on the words was included. What is evident, however, is that the intention of the legislator in this part of the definition was to be very wide and very inclusive, similar to the methods of acquisition described above. The definition in section 1 of trading stock in the ITA (verbs “manufacture, sale, exchange” analysed as part of chapter 2) is refined in the definition in section 15A.

The following table provides a summary of the respective grammatical meanings of the inserted intentions of holding the asset by the taxpayer. The definitions were obtained from the Merriam Webster Online Dictionary.

Table 3 Definitions of intentions included in the section 15A of the ITA

Verb/Intention	Definition
Processing	“...to subject to a special process or treatment”(Merriam Webster online: Not Dated).
Separation	“...to isolate from a mixture”(Merriam Webster online: Not Dated).
Refining	“...free (as metal, sugar, or oil) from impurities or unwanted material”(Merriam Webster online: Not Dated).
Beneficiation:	“...treatment of raw material (as iron ore) to improve physical or chemical properties especially in preparation for smelting” (Merriam Webster online: Not Dated).



Based on the abovementioned grammatical definitions, the legislator clearly had a wide scope, including a very wide ambit of intentions appertaining to the categories of taxpayer that will qualify under this part of the definition.

This next paragraph of the study deals with section 15A(ii). It is important, to note the conjunction “and” which implies that the first part of the definition (section 15A(i)) needs to be read together with section 15A(ii). All the requirements and specifications stipulated discussed in the previous paragraphs of this chapter therefore need to be met, in addition to the criteria stipulated in section 15A(ii), that is described below.

3.3SECTION 15A PART 2: RELEVANCE OF ACCOUNTING PRACTISE

The second part of the definition as per section 15A of the ITA as well as part (b) of the definition provide for the accounting treatment of the subject matter to be taken into account in the classification of the subject matter for taxation purposes.

For purposes of this study, part (b) of the definition, that deals with the “value” that such stock have to be accounted for, was excluded.

The requirement in part (a)(ii) of the definition provides that the full definition in terms of section 15A will only be fulfilled in such cases where the subject matter meeting the requirement of part (a)(i) of the definition is accounted for as trading stock (inventory) for accounting purposes in terms of South African accounting practice by the taxpayer and therefore be classified as trading stock.

The accounting treatment was therefore analysed in the next part of the chapter as per the inserted definition, the accounting treatment of a specific subject matter (that meets the first part of the definition) determines the consequent taxation treatment thereof.



3.3.1 Financial accounting of trading stock in the mining industry.

As was mentioned in the previous paragraphs, section 15A(ii) specifically provides for the inclusion of an item as trading stock for taxation purposes provided that the specific item was accounted for inventory in terms of South African Generally Accepted Accounting Practice.

South Africa subscribes to the accounting prescriptions of the published statements of generally accepted accounting practise (“hereafter referred to as “GAAP”) as issued by the International Accounting Standards Committee (“IASC”) in the form of International Accounting Statements (“hereafter IAS”). This body has since been replaced by the International Accounting Standards Board (“IASB”) which issues the accounting statements in the form of International Financial reporting statements (hereafter referred as “IFRIS”) (Voster, Koornhof, Oberholster & Koppeschaar, 2004:5-7).

During January 2009, an updated Framework for the Preparation and Presentation of Financial Statements (hereinafter referred to the “framework’) was issued by the International Accounting Standards Board (“IASB”). This framework provides for criteria which underlie the recognition of an item for financial accounting purposes as well as fair presentation and disclosure in the financial statements of the entity.

3.3.1.1. Distinction between current assets and non-current assets

The IAS1 statement issued by IFRS, which is the statement that deals with the Presentation of Financial Statements, provides guidelines to be considered when an asset is to be classified as a current asset. In terms of IAS1, the asset will be classified as a current asset if it:

- is expected to be realised, or intended to be sold or to be consumed, in its normal operating cycle;
- is held primarily for the purpose of trading;
- is expected to be realised within twelve months after the reporting period; or



- is cash or a cash equivalent (as defined in IAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

Any assets not meeting these criteria should be classified as non-current assets.

3.3.1.2 Stockpiles as inventory (current assets)

IAS 2 classifies inventory as assets either:

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

Based on this guidance any asset in the mining industry should be recognised as inventory as soon as it is extracted from the earth and a reliable assessment of the realisable state of the extracted mineral is objectively assessed. Intention of management is therefore a key element for consideration in the classification of an asset as current (trading stock) or as non-current.

Where management decides to defer the processing of stockpiles (realise the asset) for some time (more than a year), in terms of IAS1 the subject matter will not be classified as inventory (trading stock).

Stockpiles should therefore only be accounted for in the financial accounting to the extent that they will be utilised in the mining process within twelve months after reporting date. Stockpiles that have no reasonable expectation of future economic benefits should be impaired. Where mineral reserves such as stockpiles do not qualify as inventory they should be accounted for as non-current assets within the framework of general accepted accounting standards until such time as more guidance is available.



3.3.1.3 Valuation of assets for accounting purposes

Another key factor for consideration in the classification of an asset as current in nature (trading stock) is that the subject matter needs to be valued correctly for purposes of financial disclosure. From the previous paragraph it was evident that an asset can only be accounted for and disclosed as such in the financial records of an entity as a current asset in terms of IAS 2, if a value can be attached to the asset.

Without describing in detail the valuation requirements that pertain to mining assets, the following provides a brief overview of the latter.

Mineral and mineral products inventory should use the net realised value for valuation (IAS 2009: 28). The South African Code for Reporting of Mineral Resources and Mineral Reserves (hereinafter referred to as the “SAMREC code”) sets out minimum standards, recommendations and guidelines for public reporting for the mining industry that should be used as a guideline to value stockpiles for a consistent valuation measure.

In addition to the SAMREC requirement, the value of stockpiles is determined in accordance with the guidelines of the South African Code for the Reporting of Mineral Asset Valuation (hereinafter referred to as the ‘SAMVAL code’). The SAMVAL code sets out minimum standards and guidelines for Public Reporting of Mineral Asset Valuation in South Africa with the main objective that valuations should be carried out by appropriately qualified persons and all relevant information fully disclosed. The 2009 SAMVAL code: 20 provide three generally accepted approaches to Mineral Asset Valuation namely:

“[c]ash flow approach

The Cash Flow Approach relies on the ‘value-in-use’ principle and requires determination of the present value of future cash flows over the useful life of the mineral asset;



[m]arket approach

The Market Approach relies on the principle of ‘willing buyer, willing seller’ and requires that the amount obtainable from the sale of the Mineral Asset be determined as if in an arm’s-length transaction; and

[c]ost approach

The Cost Approach relies on historical and/or future amounts spent on the Mineral Asset.”

The SAMVAL code (2009: 24) further suggests that at least two of the abovementioned approaches must be applied hence the “cost approach” should not influence the net realisable value.

Faber (2008: 25) confirms this and note that mineral reserves should be disclosed at cost and must at least disclose the significant assumptions and sources of estimation uncertainty, such as:

- the methodology used and major assumptions for mineral reserve estimates;
- the sensitivity of carrying amounts of assets and liabilities to mineral reserves estimates used;
- the range of possible outcomes in the following financial year of the affected assets and liabilities; and
- an explanation of the changes made to past mineral reserves estimates and key assumptions.

It should be noted that the results from the SAMVAL valuation approaches and methods employed only provide the value and do not determine the classification of the asset as inventory. Thus whether the subject matter constitutes inventory will be determined from the general accepted accounting standards with the focus on the expectations to realise the asset, period of realisation and the probability of cash. These GAAP principles on the actual classification of the stockpiles, read together with the guidance provided in both the SAMREC as well as SAMVAL codes provides for guidance to assure just classification and valuation for financial accounting purposes and disclosure.



Only once the subject matter is accounted for and disclosed as a non-current asset for accounting purposes, will the subject matter fall within the ambit of section 15A for the ITA.

3.3.1.3 Practical example: Annual financial statements of *Foskor*

The Annual Financial Statements (Foskor Annual Report 2009: 22), are included as Appendix C of this study. Further included, in Appendix B, are extracted accounting policies of the mining company, AngloGoldAshanti (2009: 235) for the financial year ended 13 December 2009.

Without describing in detail on this extracted information, the information was deemed relevant for this part of the study due to the clear distinction made in the Financial Statements between stockpiles that are deemed for accounting purposes to be of a current nature, as opposed to those deemed to be of a non-current nature.

As mentioned, section 15A prescribes that the accounting treatment of the subject matter provides the guidance for the classification and treatment for taxation purposes. Therefore, based on the assumption that these stockpiles do in fact meet the criteria of section 15A(i), section 15A(ii) merely prescribes that whatever the treatment and classification for accounting purposes is, will be followed for purposes of the tax treatment. Section 15A(ii) therefore creates a simple and uncomplicated measure to determine the classification for these stockpiles, by providing for a similar treatment as has been utilised for accounting.

Effectively this results in a situation where the guidelines and measures that were already available and developed for the classification and measurement of assets for accounting purposes, effectively became applicable and relevant for taxation purposes as well, creating an interdisciplinary (accounting as well as taxation) means for the classification of the subject matter. Without creating a detailed new set of rules that should be applied for taxation purposes, the established rules and guidelines (provided by for example the IASB, the IASC, SAMVAL as well as



SAMREC guidelines) are effectively applied to the classification of these stockpiles for tax purposes as well.

The effective formulation, as well as the specific inclusion of section 15A(ii), provides for valuable guidance on the classification of what would constitute trading stock for the mining industry. The reference to the accounting treatment widens the application of the specific section without creating difficulty where the tax treatment of assets differs from the accounting treatment. Furthermore, as described above, the abovementioned entities that regulate the accounting treatment and classification as well as disclosure already have much guidance at their disposal, specifically in the mining industry (SAMVAL, SANREC) that provides guidance on classification and valuation. The formulation of section 15A(ii) effectively opens this door from a taxation point of view, to access all the established guidelines already existing from an accounting point of view.

3.4 CONCLUSION

The problems experienced by the Commissioner with the classification of what constitutes trading stock in the mining in *CSARS v Foskor* were one of the main catalysts that resulted in the introduction of section 15A into the ITA.

Section 15A is to be applied exclusively for taxpayers that are conducting mining operations. If the process involved does not constitute a process of mining (for example a process of manufacturing) the definition of trading stock in section 1 (described in chapter 2 of this study) is to be applied.

Grammatically analysed, the provisions of section 15A(a)(i) (for both the method of acquisition as well as the intention of acquisition) is formulated very broadly and inclusively from the perspective of the taxpayer. Once it is therefore established that a taxpayer is in the process of mining / conduction mining operations, almost any means of acquiring the subject matter, as well as any intention with regard to the acquisition from the side of the taxpayer will meet the requirements of this part of the section 15A definition.



Section 15(A)(ii) stipulates that whatever treatment used by the taxpayer for the classification of the subject matter for accounting purposes should be followed for purposes of the classification of taxation. The formulation of this part of the definition effectively provides for the provisions, frameworks and guidelines applicable to financial accounting and valuation as well as disclosure for financial purposes, effectively being applicable (as well as available) for taxation purposes as well.

It is concluded that the formulation of the definition of trading stock in section 15A of the ITA, provides for a wide, inclusive definition of what would constitute trading stock for the taxpayer conducting mining operations. The provision of the accounting treatment of the subject matter to guide the treatment for taxation, provides much clarity and guidance (as well as simplicity) for the taxpayer as well as the Commissioner, as pertains to the classification of what constitutes trading stock for taxation purposes. Instead of “re-inventing the wheel” for purposes of taxation, by means of creating additional guides and measures of what would constitute trading stock for mining operations, the already existing treasure of knowledge and guidelines are “accessed” with the formulation of section 15A(a)(ii).

It is therefore concluded that legislator has met his aim to clarify what would constitute trading stock for mining operations, in order to prevent similar problems repeating themselves as was the case of *CSARS v Foskor*.



CHAPTER 4 CONCLUSION

4.1 INTRODUCTION

The purpose of the study was to perform a critical evaluation of section 15A of the ITA. The hypothesis statement that guided the study was that section 15A of the ITA provides certainty concerning what will constitute trading stock for the taxpayer conducting mining operations as well as clarity and guidance on the treatment of such classified trading stock.

Three research objectives were formulated in order to support and prove the hypothesis formulation. The first objective was a critical analysis of the position of the taxpayer conducting mining operations prior to the introduction of section 15A into the ITA by the Taxation Laws Amendment Act 17 of 2009. The second objective was to perform a critical grammatical analysis of section 15A of the ITA, with specific focus on the amendments introduced in this section. The third and final objective of this study was the evaluation of the clarity, effectiveness and guidance provided by section 15A of the ITA on the classification and consequent treatment of trading stock for taxpayers conducting mining operations.

4.2 SUMMARY OF FINDINGS

Prior to 2010, there has never been a section in the ITA that provided specifically for the classification and treatment of trading stock for taxpayer conducting mining operations. Rather, the general definition provided in section 1 of the ITA, as well as the general section prescribed for the treatment of such defined trading stock applicable on all other industries (provided in section 1 and section 22 of the ITA) were to be applied on mining operations as well. This lack of a specific provision resulted in increasing difficulties experienced by taxpayers conducting mining operations in proving to SARS that an item does or does not constitute trading stock for taxation purposes. The latter difficulties experienced were highlighted in the *CSARS v Foskor*.



In March 2010, section 15A was introduced into the ITA, a section that provided for the classification of what would constitute trading stock as well as the treatment of such classified trading stock, specifically applicable to the mining industry. It was found that the introduction of section 15A was a direct result of the difficulties experienced in *CSARS v Foskor*. Grammatically analysed, the provisions of section 15A was found to be formulated very broad and inclusively viewed from the perspective of the taxpayer conducting mining operations. Furthermore, it was found that the grammatical formulation of section 15A provides for clear guidance on the treatment of such classified trading stock.

It was found that with the introduction of section 15A of the ITA the aim of the legislator, namely, to provide clarity and guidance on both the classification as well as subsequent treatment for purposes of taxation of trading stock in the mining industry has been met.

4.3 ACCOMPLISHMENT OF RESEARCH OBJECTIVES

The abovementioned summary of findings was guided by the proposed objectives formulated in chapter 1 of the study.

The first objective of the study (addressed in chapter 2) evaluated the position of the taxpayer prior to the introduction of section 15A into the ITA. This objective was achieved by an evaluation that was primarily based on problem that arose and manifested in *CSARS v Foskor*. The conclusion was reached that prior to the introduction of section 15A of the ITA, taxpayers who conducted mining operations were faced with increasing difficulties with the classification and treatment of trading stock. This was due to a lack of a definition and provision for specific treatment for trading stock that provides for a specialised industry such as mining.

The second objective (addressed in chapter 3) was to grammatically analyse the provisions of section 15A of the ITA. This objective was achieved by the performance of critical grammatical analyses of the section. The conclusion was



reached that the inserted section 15A of the ITA was formulated in a very broad and inclusive manner. The section was also grammatically formulated to provide clear guidance on the treatment of such classified trading stock.

The third objective (addressed in chapter 3) was to evaluate the clarity, effectiveness and guidance provided by section 15A on the classification and subsequent treatment of trading stock for the taxpayer conduction mining operations. This objective was achieved by the overall evaluation and conclusion on the formulation and guidance provided by section 15A of the ITA. Specific emphasise was placed on reference made in section 15A to the accounting treatment of such classified trading stock, to be used as guidance for the tax treatment of latter. It was concluded that the section 15A of the ITA formulation does provide clear guidance on both the classification and subsequent treatment of trading stock for the taxpayer conduction mining operations.

The research objectives, that in turn support the hypothesis formulation, were therefore met by the performed literature review.

4.4 FINAL CONCLUSION

The study finally concludes that the formulation and provisions of section 15A of the ITA provides clarity and guidance on the classification and consequent treatment of trading stock for taxpayers involved in mining operations in South Africa. It is concluded that the aim of the legislator to clarify what would constitute trading stock for mining operations, in order to prevent similar problems repeating themselves as was the case of *CSARS v Foskor* has been met.

4.5 ISSUES FOR FURTHER RESEARCH IDENTIFIED

This study merely focussed on the grammatical and functional evaluation of section 15A shortly after the introduction of this section as part of the ITA. A future study



may include an analysis of the practical effectiveness of this section based on the practical application of the section by taxpayers involved in the mining industry.

The study did not provide an in depth evaluation of the different guidelines available and followed by other countries regarding the classification and treatment of trading stock (stockpiles) in the mining industry. A future study may include detail reference to guidance available internationally on the subject matter.

The study did not provide a detailed differentiation between the nature of stockpiles as opposed to the nature of mine dumps, both being assets unique to the mining industry. Further research may include an evaluation between the differences between the two types of assets with specific focus on the differences (or similarities) in the classification and treatment for taxation purposes of these assets. Future research may prove to be of value if it focuses specifically on the evaluation of the effectiveness and guidance provided by section 15A of the ITA on the classification and treatment of the abovementioned assets unique to the mining industry in South Africa.



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APPENDIXES

APPENDIX A : Section 1 and section 22 of the Income Tax Act

Section 1

Definition of trading stock

- (a) (i) anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by him or on his behalf or
- (ii) the proceeds from the disposal of which forms or will form part of his gross income, otherwise than in terms of paragraph (j) or (m) of the definition of “gross income”, or as a recovery or recoupment contemplated in section 8 (4) which is included in gross income in terms of paragraph (n) of that definition; or
- (b) any consumable stores and spare parts acquired by him to be used or consumed in the course of his trade, but does not include a foreign currency option contract and a forward exchange contract as defined in section 24I (1).

Section 22

Amounts to be taken into account in respect of values of trading stocks -

“22(1) The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be—

(b)... the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock, not being shares held by any company in any other company, has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason satisfactory to the Commissioner...” (own emphasis supplied)



“(2) The amount which shall in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the beginning of any year of assessment, shall—

(a) if such trading stock formed part of the trading stock of such person at the end of the immediately preceding year of assessment be the amount which was, in the determination of the taxable income of such person for such preceding year of assessment, taken into account in respect of the value of such trading stock at the end of such preceding year of assessment; or

(b) If such trading stock did not form part of the trading stock of such person at the end of the immediately preceding year of assessment, be the cost price to such person of such trading stock”(own emphasis supplied).



APPENDIX B

Extracts from the Annual financial statements accounting policies of Anglogold Ashanti : 2009 Annual Financial Statements

“The IAS financial statements are prepared on the historical cost basis. The group's accounting policies set out below are consistent in all material respects with those applied in the previous financial year. The policies adopted comply with the standards issued by the International Accounting Standards (IAS) Committee.

3. Mining assets

Mining assets are recorded at cost of acquisition less amortisation and amounts written off. Cost includes preproduction expenditure incurred during the development of the mine. Cost also includes interest capitalised during the construction period where such costs are financed by borrowings.

Mine development costs

Capitalised mine development cost includes expenditure incurred to develop new ore bodies, to define further mineralisation in existing ore bodies and to expand the capacity of the mine. Development costs to maintain production are deferred, where applicable, and expensed against the related production. Amortisation is first charged on new mining ventures from the date on which production reaches commercial quantities. Mine development costs are amortised using the units-of-production method based on estimated proved and probable mineral reserves.

Proved and probable reserves reflect estimated quantities of economically recoverable reserves, which can be recovered in future from known mineral deposits.

Mine infrastructure

■ Plant and equipment



■ Plant and equipment are amortised using the lesser of their useful life or units-of-production method based on estimated proved and probable mineral reserves.

■ Other

Land

Land is not depreciated.

Mineral rights, dumps and other

Mineral rights are amortised using the units-of-production method based on estimated proved and probable mineral reserves. When there is little likelihood of a mineral right being exploited, or the value of an exploitable mineral right has diminished below cost, a write down is effected. The cost of exploration programmes not anticipated to result in additions to the group's reserves are expensed when incurred.

Leased assets

Assets subject to finance leases are capitalised at cost with the related lease obligation recognised at the same value. Capitalised leases are depreciated over their estimated useful lives. Finance lease payments are allocated, using the effective interest rate method, between the lease finance cost, which is included in interest paid, and the capital repayment, which reduces the liability to the lessor.

Operating lease rentals are charged against operating profits in a systematic manner related to the period of use of the assets concerned.

4. Inventories

Inventories are valued at the lower of cost and net realisable value after appropriate provisions for redundant and slow moving items. Cost is determined on the following bases.

Gold on hand, uranium oxide and sulphuric acid are valued on an average



production cost method.

Gold in process is valued at the average production cost of the relevant stage of production.

Consumable stores are valued at the lower of average cost or net realisable value.

5. Environmental expenditure

Rehabilitation expenditure and related accrued liabilities, which are based on the group's environmental management plans, in compliance with the current environmental and regulatory requirements, are accrued and expended over the operating life of the mines using the units-of-production method based on estimated proved and probable mineral reserves. The carrying amount of liabilities is regularly reviewed and adjusted as appropriate for new circumstances or changes in law or technology. Expenditure on ongoing rehabilitation costs is brought to account when incurred.

Annual contributions are made to the group's Environmental Trust Fund, created in accordance with the statutory requirements, to provide for the estimated cost of pollution control and rehabilitation during and at the end of the life of the mine. Interest earned on monies paid to the trust fund is accrued on an annual basis and is set off against future liability of the group”



APPENDIX C:

Extracts from the Annual Financial report of Foskor: 2009

Notes to the financial statements

Ore stockpile

The ore stockpile comprises ore containing phosphate and copper minerals still to be extracted and was acquired, in terms of an agreement, from the neighbouring Palabora Mining Company (PMC).

The ore stockpile is valued at the lower of cost and net realisable value. The cost includes the expenditure incurred in the mining and stockpiling of the ore for use in future production.

Extract from the 2009 Annual Financial Statements (Balance Sheet)

	Notes	GROUP		COMPANY	
		2009	2008	2009	2008
		R'000	Restated R'000	R'000	Restated R'000
ASSETS					
Property, plant and equipment	3	1,956,217	2,248,417	1,955,547	2,247,621
Ore stockpile	9.2	-	30,401	-	30,401
Intangible assets	4	1,801	672	1,801	672
Investments in subsidiaries	5	-	-	104,007	187,007
Loans to subsidiaries	5	-	-	12,270	3,475
Investment in joint venture	6	25	25	25	25
Investment in associate	7	30,052	-	26,006	-
Financial investments	8	121,560	117,025	111,560	117,025
Non-current assets		2,109,655	2,396,540	2,211,216	2,586,226
Inventory	9.1	674,802	919,746	674,802	919,746
Ore stockpile short-term	9.2	11,412	12,428	11,412	12,428
Prepaid taxation		-	2,399	-	2,399
Trade and other receivables	10	1,496,695	944,160	1,492,338	940,593
Derivative financial instruments	11	12,201	13,019	12,201	13,019
Cash and cash equivalents		365,829	1,280,863	364,495	1,277,815
		2,560,939	3,172,615	2,555,248	3,166,000
Non-current assets held for sale	13	-	91,176	-	91,176
Total current assets		2,560,939	3,263,791	2,555,248	3,257,176
Total assets		4,670,594	5,660,331	4,766,464	5,843,402



	GROUP		COMPANY	
	2009 R'000	2008 R'000	2009 R'000	2008 R'000
9 INVENTORY AND ORE STOCKPILE				
9.1 Inventory				
Spares and consumables stores	232,010	219,298	232,010	219,298
Phosphate rock	90,439	14,721	90,439	14,721
Raw materials	190,030	514,314	190,030	514,314
Finished goods	162,230	171,355	162,230	171,355
Work in progress	-	-	-	-
Other minerals	93	58	93	58
Total	674,802	919,746	674,802	919,746

There was a write-down of R56.538 million on inventory in 2009 (R2.910 million for stock obsolescence and R53.628 million for phosphate sludge); and R398.527 million of inventory was written down as a net realisable value adjustment at 31 March 2009.

The following inventories are carried at net realisable value: phosphoric acid - finished goods (R142.055 million), ammonia - raw materials (R37.109 million), MAP - finished goods (R33.849 million) and MAP Zinc - finished goods (R130.974 million).

9.2 Ore stockpile

The ore stockpile of R11.412 million (2008: R42.829 million) comprises ore containing phosphate and copper minerals still to be extracted and was acquired in terms of an agreement with the Palabora Mining Company.