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The Standing Committee on Finance

The Committees Secretary

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Attention:

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MINERALS COUNCIL COMMENTS ON THE 2020 DRAFT TAXATION LAWS

AMENDMENT BILL

1. Introduction

- 1.1. This submission contains the comments by the Minerals Council South Africa (“**Minerals Council**”) on the 2020 Draft Taxation Laws Amendment Bill (“**Draft TLAB**”) which was published for comment by National Treasury on 31 July 2020.
- 1.2. The key provisions in the Draft TLAB which affect the Minerals Council and its members are those in respect of the proposed amendments to sections 15 and 36 of the Income Tax Act, 58 of 1962 (the Act).
- 1.3. The Minerals Council welcomes the opportunity to provide comments to the Standing Committee on Finance on the proposed amendments as well as the effect and impact thereof on the mining industry.

2. **About the Minerals Council**

- 2.1. The Minerals Council is a voluntary membership, private sector employer organisation founded in 1889. The Minerals Council is a mining industry employers' organisation that supports and promotes the South African mining industry.
- 2.2. The Minerals Council exists as the principal advocate of major policy positions endorsed by the mining industry employers and represents these policy positions to various organs of South African national and provincial governments and to other relevant policy making and opinion-forming entities, both within South Africa and abroad.
- 2.3. The Minerals Council also works closely with the various employee organisations in formulating these positions where appropriate. It represents mining companies producing about 90% of South Africa's mineral production and employing about 90% of the employees employed in the mining industry.

3. **Minerals Council position on the proposed amendments to sections 15 and 36 of the Income Tax Act, 58 of 1962**

- 3.1. National Treasury has proposed amendments to limit the accelerated capital expenditure allowance applicable to taxpayers conducting mining operations to only those taxpayers that hold a mining right as defined in the Mineral and Petroleum Resources development Act No. 28 of 2002 (the "MPRDA").
- 3.2. **The amendments in their current form present various adverse unintended consequences, including the following:**

Impact on taxpayers who do not hold a mining right

- 3.2.1. The definition of "mining" in section 1 remains unchanged. Accordingly, contract miners who conduct "mining operations" per the definition in section 1 of the Act who will be precluded from claiming the capital expenditure allowance, will also be precluded from claiming capital allowances in terms of section 12C of the Act (which specifically prohibits the deduction of expenditure incurred where the taxpayer's trade is mining), and in some instances section 11(e) of the Act. The now excluded "contract miners" will therefore be left in the untenable position where they are unable to claim capital expenditure incurred in terms of any other provisions of the Act.

- 3.2.2. The mechanics of section 36 of the Act deem any disallowed or unredeemed capital expenditure in a year of assessment to be capital expenditure incurred in subsequent years of assessment. The Proposed Amendments to the relevant provisions are proposed to apply in respect of expenditure incurred on or after 1 January 2021. Accordingly, the Proposed Amendments may have the undesirable and unintended effect of deeming a taxpayers' balance of unredeemed capital expenditure as at 31 December 2020 to be incurred on or after 1 January 2021, thus jeopardising taxpayers' balance of unredeemed capital expenditure which was rightfully incurred and deductible at the time of incurral.
- 3.2.3. The Proposed Amendments would result in an adverse unintended impact on mining taxpayers that conduct mining operations for their own benefit (i.e. not a contract miner) which are not required to have mining rights in terms of the MPRDA and the legal interpretation thereof (e.g. taxpayers who reclaim ore from pre-2004 tailings dumps). Moreover, unincorporated joint ventures wherein mining rights and assets are pooled and shared, and taxpayers who hold mining leases and not mining rights, will similarly be adversely impacted.

Impact on B-BBEE parties who are party to unincorporated joint ventures

- 3.2.4. Broad-Based Black Economic Empowerment (“**B-BBEE**”) structures commonly take on the form of unincorporated joint ventures, and the B-BBEE partners are commonly not the holders of the mining rights. The arrangement between the parties is typically structured as an unincorporated joint venture based on the fact that the transfer of rights in terms of section 11 of the MPRDA is usually a lengthy and drawn-out process. This structure is therefore not typically the preferred structure for B-BBEE transactions but is utilised for purposes of expediency.
- 3.2.5. The exclusion of non-mining right holding taxpayers from claiming the capital expenditure allowance will therefore have an impact on the B-BBEE parties to unincorporated joint ventures, who will be obliged to incur costs relating to capital expenditure, without a corresponding allowance in respect of such costs.

3.3. Appropriateness of amendments which reduce tax relief – Is there really a mischief in contract miners qualifying for the accelerated capital expenditure allowance?

- 3.3.1. National Treasury states that at issue is “*whether both a contract miner that excavates minerals for a fee and a mineral rights holder, should qualify for accelerated capital expenditure incurred by them in terms of sections 15 and 36 of the Act*”.
- 3.3.2. We submit that a mining taxpayer that does not hold a mining right should qualify for the accelerated capital expenditure allowance in terms of sections 15 and 36 of the Act on mining capital expenditure actually incurred by that non-mining right holding taxpayer, as much as a taxpayer that holds a mining right should qualify for the accelerated capital expenditure allowance in terms of sections 15 and 36 of the Act on mining capital expenditure actually incurred by that mining-right holding taxpayer. In this regard, contract miners incur substantial upfront investment costs at inception of their operations, and only generate income following the incurral of such expenditure, similar to mining right holders, and should be entitled to claim the upfront deduction in this regard.
- 3.3.3. As each taxpayer qualifies for the accelerated allowance only on expenditure actually incurred by it, there is no risk of prejudice to the *fiscus* as a result of double-deductions in respect of the same capital expenditure. Given that the holder of the mining right who incurred the capital expenditure would be able to qualify and claim the allowance, it needs to be considered why then a contract miner that incur the capital expenditure should not qualify for the accelerated capital expenditure allowance.
- 3.3.4. We submit that National Treasury should also take into consideration the impact of the Proposed Amendments on investment in the mining industry. In this regard, the exclusion of taxpayers who carry on the trade of mining from the capital expenditure allowance regime may discourage further investment into the country by way of the expansion of mining activities, which investment would result in the creation of jobs and the improvement of infrastructure in the communities where the mines are located.
- 3.3.5. We therefore submit that the rationale for the amendments is flawed.
- 3.3.6. We therefore recommend that the proposed amendments to sections 15 and 36 should not be implemented.

3.4. Specific comments on the proposed amendments to sections 15 and 36 of the Act

Proposed amendment to the preamble to section 15 of the Act

3.4.1. Proposed amendment(s):

The accelerated deduction of the following expenditure is limited to instances where the “taxpayer holds a mining right as defined in section 1 of the Mineral and Petroleum Resources Development Act in respect of the mine where those operations are carried on”.

3.4.2. Issue(s):

3.4.2.1. The word “mine” is not defined in the Act.

3.4.2.2. The wording of the Proposed Amendment is contradictory to the definitions per the MPRDA as it effectively limits the definition of a “mine” to that of a “mining area”, which could give rise to the unintended effect of disqualifying legitimate mining capital expenditure where the relevant assets are located outside of the area demarcated under the mining right.

3.4.2.3. The wording of the Proposed Amendments effectively creates a “per mining right ring-fence”, which, based on the reason for the amendments per the Draft EM, cannot be the intention of the legislature.

3.4.2.4. The requirement to hold a mining right as defined in the MPRDA per the Proposed Amendment applies to both paragraphs (a) and (b) of section 15 of the Act. Paragraph (b) deals with the deductibility of prospecting expenditure, which will now be effectively disqualified as a taxpayer cannot hold both a mining right as defined as well as a prospecting right over the same area. This cannot be the intention of the legislature.

3.4.3. Recommendation(s):

3.4.3.1. We recommend that the Proposed Amendment should not be implemented.

3.4.3.2. Alternatively, we recommend that the wording be clarified such that the amendments limit the accelerated allowance strictly for independent professional contract miners. However, as stated above it is our submission that contract miners should qualify

for the allowance. There is absolutely no risk of double-deduction in regards to the same capital expenditure.

Proposed amendment to the heading of section 36 of the Act

3.4.4. Proposed amendment(s):

3.4.4.1. The heading is amended to clarify that the provisions for the calculation of the redemption allowance and balance of unredeemed capital expenditure will now be limited to certain mining operations.

3.4.5. Issue(s):

3.4.5.1. Please refer to the issues raised in paragraphs 3.2 and 3.3 above in connection with the Proposed Amendments in general.

3.4.6. Recommendation(s):

3.4.6.1. Please refer to the recommendations raised in paragraphs 3.2 and 3.3 above in connection with the Proposed Amendments in general.

Proposed amendments to sections 36(7EA), 36(7G) and 36(10) of the Act

3.4.7. Proposed amendment(s):

3.4.7.1. The wording "if that taxpayer holds a mining right as defined in section 1 of the Mineral and Petroleum Resources Development Act in respect of the mine where those operations are carried on" is inserted into each of the abovementioned subsections, presumably to align with the stated intention to exclude "contract mining" from the ambit of the accelerated allowance regime.

3.4.8. Issue(s):

3.4.8.1. The indiscriminate insertion of the abovementioned wording into subsections (7EA), (7G) and (10) of section 36 of the Act –

3.4.8.1.1. is unnecessary as the wording would have already been inserted in the taxing provision, namely section 15 of the Act, which by necessary implication extends the restriction to the calculation in terms of section 36 of the Act;

3.4.8.1.2. creates confusion and unintended overreaching results as well as unnecessary confusion and absurdity in the interpretation and application of section 36 of the Act.

3.4.8.2. We highlight the issues attendant on this Proposed Amendment below. In respect of –

3.4.8.2.1. **Section 36(7EA):** In light of the comment made in paragraph 3.2.2 above, this Proposed Amendment would have the undesirable and unintended effect that the now excluded taxpayers may not recoup a debt benefit against their rightfully incurred balance of unredeemed capital expenditure.

3.4.8.2.2. **Section 36(7G):** In light of the issue raised in paragraph 3.4.2.3 (the unintended “per mining right ring-fence”), a taxpayer may not be able to determine a balance of unredeemed capital expenditure in respect of all producing new mines, as intended.

3.4.8.2.3. **Section 36(10):** In light of the issue raised in paragraph 3.4.2.3 (the unintended “per mining right ring-fence”), section 36(10) of the Act is rendered ineffective and superfluous, as a ring-fence would in any event be created even where mining operations are not “separate and distinct” or carried on in mines that are “contiguous”.

3.4.9. Recommendation(s):

3.4.9.1. We recommend that the Proposed Amendment to the abovementioned subsections should not be implemented i.e. the proposed wording should not be inserted in the abovementioned subsections.

Proposed amendments to section 36(7F) of the Act

3.4.10. Proposed amendment(s):

3.4.10.1. The Minister of Finance’s discretion to direct that the “per mine” ring-fence is not applicable to certain taxpayers, having considered, in consultation with the Minister of Mineral Resources, any relevant fiscal, financial or technical implications, is proposed to be removed.

3.4.10.2. The Commissioner for the South African Revenue Service (“SARS”) (the “Commissioner” or “SARS”) will be empowered with the discretion to deem mines to be one mine for purposes of the “per mine ring-fence” upon application by taxpayer, after taking into account certain criteria.

3.4.11. Issue(s):

3.4.11.1. The proposed criteria per section 32(1)(c)(a) of the TLAB, 2020 refers to the contiguity of mining operations. It is unclear how this will be determined as “mining operations” is a wide term referring to activities on and off the mining area. In terms of the current section 36(10) of the Act which deals with the concept, contiguity qualifies “mines” and not “mining operations” as currently proposed.

3.4.11.2. The criteria set out considers factors which would, in any event, be considered upon the application of section 36(10) of the Act. As a result, the proposed criteria is rendered tautologous and superfluous.

3.4.11.3. It is unclear how the criteria will be applied, that is, how each criterion will contribute to a negative or positive outcome for a taxpayer.

3.4.11.4. The Ministerial discretion and consultation requirement was originally introduced to enable the Minister of Finance, together with the Minister of Mineral Resources, having been informed by economic, fiscal and technical considerations, and not solely tax-related factors, to override the tax ring-fence in the interests of the country’s broader economic and investment needs and goals.

3.4.11.5. Therefore, the rationale behind the insertion of the ‘per mine ring-fence’ provision was to protect the tax base. This is not the rationale behind the insertion of the Ministerial discretion. The Davis Tax Committee recognises (correctly in our view) that mining is a long-term activity requiring significant upfront capital investment and expertise to develop large ore-deposits to the mining production stage. The steps of moving from greenfield exploration involves decade(s) and many billions of Rands to bring a project to fruition. Over this period the project will be exposed to fluctuating commodity cycles, changing technology and risks on the geology and technical side of a project, as well as other extraneous (potential) risks. This is why the legislature thought it wise to ameliorate the risks posed to mines by providing for Ministerial intervention.

3.4.11.6. In further augmenting support for the above, the ‘one mine’ restriction substantially decreases the rate of return on any new project undertaken by an existing company when a new project is deemed itself to be a new mine (as opposed to an extension of an existing mine). More importantly, the restriction considerably increases the risk factor relating to the launching of such a new venture as, in the event of failure of the venture, the expenditure as yet unredeemed would never be deductible. When the restriction was debated in Parliament, Mr. HH Schwarz raised this very point and in reply, the then Minister of Finance, Mr. BJ du Plessis stated that:¹

“I will go into the matter. It is a capital loss and the Minister of Finance has a discretion as far as that is concerned. If there is a deserving case, the Minister can use his discretion.” [Emphasis added]

3.4.11.7. In this regard, the Ministerial discretion and consultation requirement was originally introduced to enable the Minister of Finance, in consultation with the Minister of Mineral Resources and Energy, having been informed by fiscal, financial and technical considerations (which are colloquially, economic considerations) and not solely tax-related factors, to override the tax ring-fence in the interest of the country’s broader economic and investment needs and goals. Thus, the aforementioned discretion is provided for those taxpayers:

3.4.11.7.1. whose operations/activities do not constitute ‘one mine’ (per section 36(7F)); or

3.4.11.7.2. whose mining operations are separate and distinct and whose mines (on which those mining operations are carried on) are not contiguous (per the so-called ‘catch-all’ provision of section 36(10)).

3.4.11.8. Further to the above, SARS is a tax-collecting agency of the South African government. It was established by legislation to collect revenue and ensure compliance with tax laws. The service SARS offers is an administrative autonomous organ of the state according to the South African Revenue Services Act No. 34 of 1997 (“**SARS Act**”), meaning it is outside the public service, but within public administration. As is evident from the aforementioned, SARS’ mandate is to collect and administer national taxes due to the government to deliver on its constitutional

¹ Hansard, 14 June 1985 at page 7635.

obligations, policy and delivery priorities in pursuance of better life for all in South Africa.

3.4.11.9. Furthermore, we submit that the proposed amendment to section 36(7F) of the ITA will result in a conflict of interest for SARS since SARS has an obligation in terms of the SARS Act to collect and administer national taxes whilst the proposed amendment imposes a statutory discretion on SARS to potentially provide tax relief by treating mines as one mine (albeit the tax relief is merely a matter of delaying the payment of tax).

3.4.11.10. It is therefore our respectful view and submission that -

3.4.11.10.1. shifting this discretion to the Commissioner represents a significant shift in the country's investment policy, and is not a mere shift in "administrative burden", as intended;

3.4.11.10.2. as an administrative organ designed for the collection and administration of taxes, SARS does not have the necessary fiscal, financial, technical insight to perform the necessary balance of the country's broader interests as was intended by the introduction of this discretion; and

3.4.11.10.3. moreover, SARS does not have the necessary mining technical insight or expertise to give the appropriate consideration to the specific needs and circumstances of miners.

3.4.12. Recommendation(s):

We recommend that the discretion currently bestowed on the Minister of Finance, in consultation with the Minister of Mineral Resources and Energy (advised by their respective financially and technically skilled departments) should remain with these members of Cabinet, and should not be allocated to SARS.

Therefore, section 36(7F), as it currently reads, must remain unchanged.

4. **Potential Economic Impact of Proposed Amendments and the role of contract miners in the mining industry**

4.1.1. The contribution of contractors' in the mining sector is difficult to measure; and yet they play a very important role. Contractors services' offering spans the project life

cycle, including feasibility studies, specialist engineering, site establishment, vertical and decline shaft construction, mine development, specialist mining services such as raise boring and grouting, construction, equipping, ledging, stoping up to vamping. At some operations contractors take the full role of the employer/owner as they appoint general managers down to the lowest ranking employee. They would also supply the full set of equipment and all consumables for the operations.

4.1.2. Many of the activities contractors undertake involves high capital expenditure, such as:

- **Surface mining:**
 - ❖ **Drilling.** This process may require a specialist contractor, especially if it is not a straightforward process.
 - ❖ **Blasting.** This process is usually not a core activity for the mining company and is associated with low equipment utilization and specialized skills which better suits contractors.
 - ❖ **Loading.** This activity is rarely at the centre of the skills at the disposal of the mining company, and better suited for contractors. Loading can influence productivity, operating costs, flexibility, and grade control.
 - ❖ **Hauling.** This is a major cost area and is better suited for contractors.

- **Underground mining:**
 - ❖ Shaft sinking
 - ❖ Station and level development
 - ❖ Construction (services pipe, pumps, rails)
 - ❖ Equipping (boxfronts, grizzlies, etc); primary and secondary mining support (roofbolts, grouting, long anchors, sets etc)
 - ❖ Diamond and borehole drilling
 - ❖ Drop Raising
 - ❖ Management of dams
 - ❖ Rehabilitation

- **Treatment/Processing post extraction from the earth – metallurgical extraction plants**

The financing of mining operations (particularly for junior miners very often hinges on Build-Own-Operate and Build-Own-Operate- Transfer business models for the largest capital item which is the metallurgical plant. Under these arrangements the Contractor is an engineering company that accepts the high risk in start-up operations financing the plant construction and providing the operating expertise during a critical early stage of mine life.

4.1.3. Contractors are also active in the junior mining space such as in construction works. The establishment of a mine requires high upfront capital infrastructure expenditure. In addition, the nature of mining operations is such that there is a considerable time lag between the upfront capex investment and the subsequent generation of income. In such cases junior miners employ the services of contractors who have the expertise and experience in carrying out such an exercise.

4.1.4. In addition, and unlike big mining companies, contractors also have the advantage of being agile and versatile in their operations. In this regards they play an important role in:

- i) **Higher production rates associated with contractors.** The production rates in ore mining and waste stripping operations are higher for contract miners than those achieved under owner mining. In 2015 the Southern African Institute of Mining and Metallurgy (SAIMM) reported, for example, that jumbo drill advance rates in owner-operated mines were in the order of 60–100 metres/month while contracting crews were operating a jumbo drill rigs underground at advance rates of 200–300 metres/month. This experience has also been observed in other countries. For example, table 2 shows the production rates between contractors and owner mines in Ghana.

Table 1: Contractor versus Mine Owner Output in Ghana

Period	Contractor Production rates (bcm/hr)	Owner production rates (bcm/hr)
1	618	302
2	603	326
3	261	150
4	246	219

Source: Conference on Technologies (Ghana)

- ii) **A shortage of capital can justify contract mining, as the contractors' operating costs / rate is inclusive of the capital cost of the contract.** Thus, owners are paying for the use of the contractor's capital equipment in a 'pay as you go' manner. This is especially relevant for junior miners who usually do not have sufficient capital to operate all parts of the mining process. An added advantage is that as contracting companies purchase equipment on a regular basis, they are usually able to secure better commercial terms for equipment.

- iii) **Contractors help the mining right holders to specialise.** By contracting out one or more mining activities, the mining companies can specialise on their core business. Therefore, the benefits associated with contractor involvement in mining are immense, and in virtually all cases it involves the mining right holder not having the necessary expertise to develop a mine and/or to carry out all or parts of the mining process.

4.1.5. Overall economic impact on mining

The activities carried out by contractors in mining involve significant capital outlays. At times, the mining companies (right holders) – and especially junior miners - do not have sufficient capital or expertise to conduct such activities. This is where contractors fill the gap, not as transient participants of the mining process but as producers who have the wherewithal to produce efficiently. There is no doubt, therefore, that not extending the capital expenditure allowance to contractors will negatively affect the industry. The industry will be affected in the following ways:

- **Reduced investment and overall output.** Declining ore grades which are not cost effective for the big mining players to exploit are exploited by junior miners because they have very little overheads compared to the majors. Junior miners, who have surfaced post-1994 because of the South African government's programme of making mining accessible to previously disadvantaged persons, employ contractors to do most of the work because the juniors do not possess the necessary expertise to exploit the resource. Thus, if contractors are excluded from benefitting from the capital allowance it will directly affect, not just mining investment and output, but also government's BBBEE model. Without investment, employment will be adversely affected. Between 2010 and 2018 the

mining sector lost 50 000 jobs, mostly on account of policy uncertainty and escalating electricity tariffs.

- **Lower employment.** Reduction in the development or employment of productive technologies which are at the disposal of contractors will inevitably negatively affect jobs. For example, most South African platinum producers make use of contract mining for open pit operations, as surface mining skills are generally not available in-house.
- For many years contractor involvement in mining, measured in terms of employment, averaged around 30% of the total workforce in the sector. Since 2016 as the global economy stuttered and following the 2008 financial crisis, mining companies have experienced squeezed margins. The result has been a steady increase in the use of contractors, registering 36%, or 163 999 employees, of total mining jobs in 2019. In terms of total remuneration, contractors were paid 20% (or R29 billion) of total sector salaries and wages.

Table 2: Contractors - Total remuneration and employees (2019)

	Remuneration (R mn)		No. of employees	
	Contractors	As % of industry	Contractors	As % of industry
Gold	2 915 821 687	11%	13 450	14%
PGMs	10 551 105 426	19%	48 566	29%
Diamonds	1 653 082 131	33%	5 900	39%
Chrome	1 073 130 734	17%	10 566	35%
Iron ore	1 456 017 401	21%	6 489	53%
Manganese	1 316 124 412	34%	6 489	58%
Coal	7 655 913 583	26%	55 208	59%
TOTAL	29 019 656 681	20%	163 999	36%

Source: Minerals Council and DMRE

- **Reduced beneficiation.** In South Africa, common surface operations such as mineral beneficiation, waste disposal, security, and product transport are also outsourced to contractors. Beneficiation is a major government programme aimed at adding value to the country's raw minerals. This part of the value chain also requires high capital outlays and expertise.

4.1.6. Overall mining competitiveness will be affected

The issues discussed above have a direct bearing on the competitiveness of the South African mining industry. For example, the fact that contractors' labour costs are lower compared to owner miners, filters through into the total costs of the industry, and supports its competitiveness. Withdrawing the capital allowance benefit from contractors will therefore have a devastating effect on a sector that has been losing competitiveness at a faster rate mainly on account of policy uncertainty.

CONCLUSION

The contract mining business model is an essential part of the mining industry as a whole in South Africa. As a result, we submit that National Treasury reconsider the appropriateness, as a whole, of amendments such as the proposed amendments to sections 15 and 36 of Act, which have the impact of reducing relief for businesses, particularly as there is no mischief on the part of the taxpayers. Alternatively, we request that National Treasury embark on further detailed consultation with the mining industry to obtain greater clarity on the role and contribution of contract miners in the mining sector before any decisions can be taken to implement the proposed amendments to sections 15 and 36 of Act.

The Minerals Council therefore respectfully requests that the proposed amendments to the Taxation Laws Amendment Bill be reviewed in accordance with the Minerals Council's representations above.

Kindly acknowledge receipt.

Yours sincerely



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