South African Institute of Tax Professionals

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The National Treasury

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The South African Revenue Service

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RE: DRAFT TAXATION LAWS AMENDMENT BILL (TLAB), 2017: COMMENTS PERTAINING TO KEY MINING TAX ISSUES

We have attached the comments from the SAIT Mining Tax Work Group on the draft Taxation Laws Amendment Bill pertaining to key mining tax issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

Please do not hesitate to contact us should you need further information.

Yours sincerely

Henry Nysschens

Chair of the Mining Tax Work Group

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THE ETHICS INSTITUTE

MINING TAX ISSUES

1. Debt Cancellations in the Case of Mining Companies (Section 36(7E))

a. Treasury proposal

Current law does not adequately cater for debt cancellations of funding that was used for mining capital expenditure. It is now proposed that the cancellation of debt initially used for mining capital expenditure be applied to reduce mining capital expenditure not yet taken into account as a deduction. Excess debt beyond this expenditure gives rise to ordinary revenue.

b. Comment

We question the basis for the inclusion of the excess amount, once the mining capital expenditure has been eliminated, in gross income. This is inconsistent with the general rules where the borrower suffers debt relief tax consequences, in terms of section 19 and paragraph 12A. Under the general rules the borrower may suffer recoupments, suffer a reduction in the cost of assets and forfeit capital losses. The borrower would not, however, have an inclusion in gross income of any remaining amount.

Paragraph 56 of the 8th Schedule sets out the circumstances under which capital losses arising from the cancellation of a debt by a connected person must be disregarded. It then carves-out circumstances where the borrower has suffered the debt relief tax consequences to prevent a double hit. To be consistent, the paragraph 56 carve-outs should be extended to cover the situation where section 36(7EA) read with paragraph (j) of the gross income definition applies. Group relief as envisaged for paragraph 12A (prior to the proposed amendment to 12A which we do not support) should also apply in this case. This could potentially be achieved by inserting the reference to section 36(7EA) in paragraph 56(2)(a)(ii).

The proposed amendment does not adequately address the treatment of debt foregone which was used to finance multiple mining assets located in separately ring-fenced mines. The amendments

should address the treatment of debt used to fund mining capital expenditure across separately ring-fenced mines.

Once Gold Mines have effectively recouped against its capital balances, the impact of paragraph (j) results in the excess amount being taxed at the average rate of tax since inception. Historically this is something that the taxpayer has to obtain from the SARS e-filing system. Currently the e-filing system is unable to obtain such a rate and would again coincide with our recommendation to limit the recoupment to unredeemed capital expenditure and capital losses.

2. Strengthening Anti-Avoidance Measures Related to Mining Rehabilitation Funds (Section 37A)

a. Treasury proposal

It is proposed that the current provisions aimed at curbing abuse of the benefit of tax-deductible contributions (by using such funds for purposes other than rehabilitation) be strengthened. It is proposed that the premise for the penalty regime be changed to one where there is a deemed normal tax calculated based on 40% of the market value of certain investments/withdrawals.

The following penalty provisions are proposed to replace the existing penalty regime:

Measure	Basis	Link back to	Nature	Taxed in
Impermissible investments by the fund	40% of highest MV of impermissible investment	Cash originally paid by company into fund	Deemed normal tax	Mineral right holder or mining company
Impermissible distributions from the fund	40% of highest MV of distribution	Property distributed	Deemed normal tax	Rehabilitation fund
Contravention of any s37A provision	2 x 40% of highest MV of fund property	Property derived from cash paid by company into fund	Deemed normal tax	Mineral right holder or mining company

b. <u>Comment</u>

We question whether the proposed penalty regime will address the abuse that it is designed to attack. Historically the section was introduced to encourage mining companies to contribute throughout the Life of Mine to the fund as opposed to closure dates. With all the amendments relating to the National Environmental Management Act as well as SARS VAT audits, this has become an incentive that is no longer effectively utilised by the mining companies.

Clearly the main concern should be material misappropriation of the funds by unscrupulous operators. We are of the view that effective measures, outside of the tax legislation, are required to prevent this from happening. Retrospective reporting and the imposition of tax penalties are unlikely to be effective. For example, if a fund has distributed all its funds in an impermissible manner, how will SARS collect the tax penalty from it? Will this really be an effective deterrent? Furthermore, if a fund incurs a significant tax penalty, will it be able to pay the tax penalty from its funds bearing in mind that the limited objects of the fund would not include paying tax penalties?

Ironically, the even more onerous proposed penalty regime is more likely to serve as a deterrent for rehabilitation funds to be applied to perform legitimate rehabilitation. Fund trustees are already very concerned that any minor unintended mistake in the application or management of the funds could trigger the penalties for contravention of any provision of section 37A. Whereas SARS has a discretion whether or not to impose the penalty under the current regime, under the proposed new regime, they will *have no discretion*. We do not know if this was drafted intentionally, with the result that even minor contraventions could lead to massive penalties.

Please note that mining companies and their fund trustees carry significant risk in relation to the use of the funds in the rehabilitation trusts for rehabilitation. There are no proper mechanisms in place to enable the mining group to mitigate these risks by receiving confirmation that their modus operandi is compliant, be that from the Department of Mineral Resources (DMR) or Department of

Environmental Affairs (DEA). This results in the funds being passive and not utilised. We suggest that a way should be found for an efficient and effective certification process.

According to Annexure C of the 2017 Budget Review:
"In November 2015, the Department of Environmental Affairs published regulations in terms of the National Environmental Management Act (1998) for financial provisioning for the rehabilitation, management and effects of mine closures for mining companies. To take into account some of the financial provisioning requirements, amendments will be made to the Income Tax Act."

There are no proposed amendments to section 37A to take into account the process of amendment of the regulations. We suggest that section 37A should be amended in such a way that the any amendments to the regulations are concurrently aligned for tax purposes. In order to achieve this, we recommend that the DMR, DEA and National Treasury meet in order to align its expectations and concerns.

The deeming of a penalty amount to be normal tax does not fit into the scheme of the Income Tax Act which defines "normal tax" with reference to section 5(1). In terms of section 5(1) normal tax is an income tax based on taxable income. This is per definition calculated after the set-off of assessed losses. We are also of the view that it is not good tax policy to give a tax penalty a different label and to then not give the taxpayer access to the remedies that it would have had in respect of penalties. Be that in the form of objection, appeal so applicable under the Tax Administration Act. For example, the taxpayer cannot mitigate its risks by obtaining a filing position opinion under section 223 of the Tax Administration Act. We suggest, given the very severe nature of the penalties, that taxpayers should be given access to full administrative justice provisions and that the current regime more than serves as a deterred when it comes to the Rehabilitation Funds.

We generally think that this penalty regime should be subject to further consultation.