RE: ANNEXURE C PROPOSAL FOR 2019 BUDGET: MINING TAX

We have attached the comments from the SAIT Mining Tax Work Group on the Annexure C tax proposals for the 2019 Budget 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

Andre de Klerk
Chair of the Mining Tax Work Group

Enclosures: Annexure C Proposals

SAIT representatives to be invited to National Treasury workshops
ANNEXURE C PROPOSAL FOR 2019 BUDGET: MINING TAX

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1. FOREIGN REMUNERATION EXEMPTION AMENDMENT - IMPACT OF RESIDENTIAL ACCOMMODATION FRINGE BENEFIT

1.1 Legal nature of the problem

The amendment of section 10(1)(o)(ii) of the Income Tax Act with effect from 1 March 2020 will mean that remuneration from a foreign source earned by South African tax resident employees while they are working outside South Africa will no longer be fully exempt from tax. Only the first R1 million per annum of foreign sourced remuneration will be exempt from tax. The foreign sourced remuneration includes not only cash salary but also fringe benefits such as the value of employer-provided residential accommodation. The cash equivalent of the value of the taxable benefit is determined according to the Seventh Schedule which makes provision for different proxy’s to be used for different fringe benefits. Depending on the circumstances, the proxy may not be reflective of the real benefit to the employee. In the case of employer-provided residential accommodation a key variable in the determination of the fringe benefit is the remuneration factor of the employee.

1.2 Detailed factual description of the affected transaction

South African headquartered mining groups often have mines in various parts of Africa. Because of the remote location of the mines, the mining companies provide accommodation to their employees. The accommodation is mostly very basic. Refer to the Annexure for detail and pictures. However, because the seconded employees are often highly qualified engineers, etc, their remuneration proxy is high and hence the value of the residential accommodation fringe benefit is disproportionally high. The real benefit experienced by the employee is normally much less, taking into consideration the nature and location of the accommodation and the fact that the employee is often stuck at the mine with very few options, if any. The consequence namely that this fringe benefit pushes up their total remuneration, with the result that a large part of their remuneration is likely to be above the R1 million exemption threshold, serves as a disincentive to work at these mines.
1.3 Nature of the business(es) impacted

South African headquartered mining groups who second South African tax resident employees to mines in various parts of Africa are impacted. These employers often have to gross-up the remuneration of the employees for any additional tax in order to retain the services of the employees. This becomes very expensive. South African tax resident individuals who try to find employment in Africa and other parts of the world are similarly adversely impacted. This makes South Africa less competitive in relation to other mining jurisdictions such as Canada and even the USA which has a much higher exemption.

1.4 Proposed solution

Now that the foreign remuneration exemption will be capped and will no longer cover the full amount of remuneration including fringe benefits, consideration should be given to placing a nil value on the residential accommodation fringe benefit in the circumstances described above. A precedent exists in paragraph 9(7) of the Seventh Schedule where no rental value is placed on any accommodation away from an employee’s place of residence in the Republic provided by his employer while he is away from his usual place of residence in the Republic for the purposes of performance of his duties. In the case of employees who work on the mines, they may no longer have a usual place of residence in the Republic for practical reasons, but the only reason why they stay on the mine is because they are required to do so for the purposes of proper performance of their duties. It could be argued that any personal benefit is incidental to the requirement of the mining company. This can be distinguished from expatriate employees who is provided with accommodation of their choice by their employer.
2. FOREIGN REMUNERATION EXEMPTION AMENDMENT – FOREIGN TAX CREDITS

2.1 Legal nature of the problem

When the amendment of section 10(1)(o)(ii) becomes effective on 1 March 2020, those individuals who were previously exempt from tax in South Africa on their foreign sourced remuneration, will become entitled to claim foreign tax credits to the extent that their foreign sourced remuneration becomes subject to tax in South Africa. The Income Tax Act has, however, not been amended to assist with the practical aspects of the claiming of the foreign tax credits on a monthly or annual basis.

2.2 Detailed factual description of the affected transaction

In the case of South African resident individuals with expatriate / secondment type arrangements there will be a monthly employees’ tax (PAYE) withholding obligation in SA and in the foreign country. This would mean that the employee would suffer double tax from a cash flow perspective.

While a rebate exists, the rebate is normally given at the end of the year of assessment unless SARS chooses to provide special relief. The net result is severe cash flow constraints when PAYE is deducted both at source and in the country of residence. Total taxes of both countries typically can range from 60%-to-80% of total salary. While the proposal contains a R1 million exemption, this often relief does not sufficiently assist individuals with expatriate / secondment type arrangements, especially given the fringe benefit charge. Once this change comes into effect, it would appear that there is a PAYE obligation is SA, and in the foreign country.
2.3 Nature of the business(es) impacted

Businesses who second employees from South Africa to a foreign jurisdiction and whose employees’ foreign remuneration exceed the R1 million exemption.

2.4 Proposed solution

Various options should be considered to mitigate these practical issues. The approach proposed by National Treasury in 2017 to use the existing hardship ruling route would only be viable if it was capacitated, streamlined and clear guidance was provided on the specific process to be followed. More importantly, heavy double taxation from two countries should be viewed as an automatic hardship. The starting point should be to allow for rebates without the need to resort to SARS discretion.

Another option could be that a “high tax exemption” similar to section 9D of the Income Tax Act be introduced. In this regime, an estimate of the foreign tax payable should be made at the beginning of the year and if it is 75% or more of the tax liability that will be levied in SA, then the individual can apply for an exemption from withholding of PAYE by the SA holding company. This makes sense, as had the individual paid the SA tax, he would have been entitled to claim the credit anyway when he submitted his tax return. This is also distinguishable from a situation where the individual is working in a jurisdiction with a low tax rate, and ends up paying little or no tax.

Alternatively, as is the case in other jurisdictions, where SA employees of a SA multinational company are deployed in foreign countries, an estimate of the tax payable in the foreign country could be determined upfront. These employees will be on both the SA and foreign payroll. The SA resident can then apply for this estimate to be used as a rebate against the SA tax liability when calculating the PAYE to be withheld in SA, by the SA company. This is in line with current law, of giving the employee a credit for foreign taxes, but also caters for the cashflow constraint issue. We propose that employees be allowed to make these applications
for upfront rebates on an annual basis, so as to ensure that the most relevant and accurate amount of foreign taxes is determined.

Another option would be to legislate for the relevant portion of the actual foreign employees’ tax to be offset as a credit against the South African employees’ tax on a monthly basis. A practical level of proof of the foreign taxes will be necessary, e.g. the monthly payslips / payroll and basic proof of payment of the payroll tax by the employer to the revenue authorities.

The requirement of section 6quat of “taxes proved to be payable” should also be reconsidered in the context of the various other jurisdictions, particularly those in Africa, and the practical difficulties of obtaining such proof.

3. RECOGNITION OF PROSPECTING COSTS UPON DISPOSAL OF MINING RIGHTS

3.1 Legal nature of the problem

Section 15 of the Income Tax Act allows for the deduction from the income derived by the taxpayer from mining operations any expenditure incurred by the taxpayer on prospecting operations (including surveys, boreholes, trenches, pits and other prospecting work preliminary to the establishment of a mine) in respect of any area in the Republic. Sadly, there are instances where these costs are incurred during the prospecting phase but the taxpayer is not in a position to proceed with mining operations. Inherently, there would be no income from mining operations under these circumstances. Therefore, these costs cannot be deducted by the taxpayer.

Very often, where the taxpayer abandons mining operations, such taxpayer would sell its rights to a third party. The selling price of these rights would take into account the costs incurred by the taxpayer including surveys, boreholes and other prospecting work undertaken by the taxpayer. These costs would be of a capital nature, but are only deductible in terms of section 15 of the Act.
Firstly, the proceeds to be received on disposal of the mining rights does not qualify as income derived from mining operations. Therefore, section 15 would not apply under these circumstances. Furthermore, the provisions of paragraph (j) of the gross income definition are also not applicable.

Secondly, according to paragraph 20(3) of the Eighth Schedule, the base cost of a person must be reduced by any amount which is or was allowable or is deemed to have been allowed as a deduction in determining the taxable income of a person. Arguably, the costs envisaged in section 15 are allowable in determining the taxable income of a person. Therefore, these costs cannot be included into the base cost of that person when the mining operations are disposed of following the abandonment of mining by the taxpayer. Our view is that it may have not been the intention of the legislature to exclude from base cost expenses incurred that have not been deducted. The alignment between mining tax and the legislation governing the taxation of capital gains does not appear to be complete.

3.2 A detailed factual description of the affected transaction

Any transaction involving the sale of mining rights and prospecting rights, by someone who incurred costs on prospecting operations such as surveys, boreholes, trenches, pits and other prospecting work preliminary to the establishment of a mine, is likely to be affected by this anomaly. The seller will not get an income tax deduction nor capital gains tax base cost for its prospecting costs, even though the proceeds that it receives on disposal of the right will be augmented by the value added by the prospecting activities.

3.3 The nature of the business(es) impacted

Every entity that has applied for mining and prospecting rights may be negatively affected, especially companies mainly dedicated to exploration for greenfield projects. These entities typically focus on isolated exploration projects that lack income until the exploration proves successful. Many junior miners prefer to sell once minerals are found. For these junior miners, immediate losses merely lie unused; whereas, cost can be used to offset gain on sale.
3.4 Proposed solution

We recommend that these prospecting costs which have not been allowed as an income tax deduction should be allowed as part of the base cost of the right upon disposal or that companies be allowed to elect not to claim immediate deductions so cost is retained in the underlying assets.

4. SHORT TERM INSURANCE POLICIES (UNINTENDED CONSEQUENCE)

4.1 Legal nature of the problem

Section 23L (read with section 23(c)) seems to go further than the mischief which it sought to address when introduced, which was effectively to treat various forms of so-called captive insurance as investments rather than as standard short-term insurance. This has the unintended consequence that taxpayers who have standard insurance policies will not be tax neutral as should be the case.

Section 23L(3) determines that short-term insurance policy benefits received or accrued to a person must be included in the gross income of that person. Policy is defined as “a policy of insurance or reinsurance other than a long-term policy as defined in section 1 of the Long-term Insurance Act”. This definition is wide enough to include all short-term insurance policies. This definition contradicts the heading of section 23L that states “Limitation of deductions in respect of certain short-term insurance policies” (our underlying). In the absence of limiting the definition of “policy” to the “certain” insurance policies that the legislator intends to deal with in this section, all short-term insurance policies are affected.

The interplay between section 23L, which includes all short term insurance policies, and section 23(c) that determines that no deduction shall be made in respect of “any loss or expense, the deduction of which would otherwise be allowable, to the extent to which it is
recoverable under any contract of insurance, guarantee, security or indemnity”, have the
effect that when a taxpayer receives a payment in terms of an short-term insurance
policy/agreement, the amounts so received will be taxed (by virtue of being included in gross
income) and the cost of the repair to an asset covered by the insurance policy/contract will
not be deductible for tax. It is considered that the effect of the interplay between sections
23L(3) and 23(c) was unintended as the outcome is not business-like and instead of addressing
avoidance issues with regards to certain short term insurance policies, all policies are effected.

4.2 Detailed factual description of the affected transaction

In the case of a taxpayer suffering a loss due to an insurable event that is covered by an
insurance policy/contract and it lodges a claim against the insurer for the repair of the
damaged asset and for losses resulting from business interruption, the insurer will
determine the cost of the repair and the loss of profits resulting from the incident and
reimburse the taxpayer. The amount of the reimbursement received from the insurer will be
included in the gross income of the taxpayer (in terms of section 23L(3)) but in computing its
taxable income, the cost actually incurred to effect the repair of the damaged asset will be
denied as a deduction in terms of section 23(c). The effect is that the proceeds of the
insurance pay-out after tax will be less than the loss suffered for which there is no tax relief
so that the taxpayer will not be in a neutral position. For example, say a building burns
down and the damage is R10m. The insurance proceeds is R10m and is taxed at 28% which
means that after tax the taxpayer will have R7,2m which is insufficient to repair the damage,
taking into account that it will not get any tax relief for the loss.

4.3 The nature of the business(es) impacted

All businesses who have standard insurances policies and who have insurance claims could
be impacted.
4.4 Proposed solution

The definition of “policy” in section 23L could be amended to limit the definition to the intended insurance arrangements where the insurer does not take on significant risk of the insured in terms of that policy. Alternatively, by amending section 23(c) by allowing a deduction of the any loss or expense of repair to an asset in respect of which the indemnity payment has been included in gross income by virtue of section 23L(3).
FOREIGN REMUNERATION EXEMPTION AMENDMENT - IMPACT OF RESIDENTIAL ACCOMMODATION FRINGE BENEFIT

Expatriates are often required to stay in remote locations e.g. at the mine site in the case of mining companies. In most cases the accommodation provided is basic, but the fringe benefit could be substantial. This type of accommodation has the following characteristics:

- The accommodation is solely for the use of the mine employees and based on the mine concession.
- Due to the remoteness of location, it is also not possible to lease or sell the accommodation. A market related rental for the mine accommodation cannot therefore be determined.
- The accommodation is generally very basic with minimal and often shared amenities (motel type accommodation).

The photos below are examples of typical accommodation on the various sites, although there are houses as well, which accommodate families.

*Accommodation in Guinea, Siguiri:*

Single rooms with a bed, shower and toilet.
Accommodation in Mali, Sadiola:

Single rooms with a bed, shower and toilet. There are three rooms next to each other.
Accommodation in Geita, Tanzania
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