SNG Grant Thornton

Capability Statement 2024

Mining Sector

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About Us

SNG Grant Thornton is the South African member firm of Grant Thornton International Ltd. We have progressed expeditiously in every aspect ever since our establishment in 1985. We invest in listening, building relationships and understanding your concerns to deliver an experience that's more personal, agile and proactive. Our team has more than 25 years industry experience in mining sector.

Mining Tax Laws and Incentives

Complexity of the mining tax laws and incentives

Navigating through complex and often uncertain mining tax laws requires expert knowledge and technical know-how. As if that is not enough, constant change in tax legislation, tax returns and court decisions generally increase the tax risks that companies in the mining sector are facing. For example, Chile introduced a new Mining Royalty Law in August 2023 that subjects mining operators to an ad valorem component and a mining margin according to their level of sales and the type of minerals exploited. The Act came to effect on January 1, 2024.

Key Industry Stakeholders

Junior and Emerging Miners

While in South Africa the junior sector comprises mainly smaller producers, there is a smaller exploration sector. The emerging miners are mainly black economic empowerment companies. The Minerals Council is actively involved in lobbying efforts with the DMRE, the Council for Geoscience, National Treasury and the Johannesburg Stock Exchange (JSE) to improve the support of the financial services industry for exploration in South Africa. Part of this involves a tax incentive to promote exploration in the country.

Mining Tax

What is mining tax?

The fiscal regime for minerals is often different to those prevailing in other sectors due to the presence of resource rental and unusual risks. The mining industry is unique, and the government recognizes that investors often faced significant capital outlays and delayed income. The unique nature of the mining sector requires a special tax dispensation that includes a wide range of taxes such as corporate income taxes, royalties, etc. In recognition of the challenges within this sector government provide accelerated capital expenditure, general tax incentives, Research and Development, extended loss-carry forwards limits. Accordingly, the Mining tax dispensation is both vital and challenging.

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Navigating Through the Mining Tax Maze

Throughout the world, specifically in developing countries such as South Africa, it has been acknowledged that the system of taxation plays pivotal role in attracting economic growth, job creation and reducing poverty. For many decades the income tax dispensation for miners has been different from those governing other businesses.

Miners are generally given privileged treatment to encourage the growth in this sector of economy. The special tax dispensation afforded by government attracts additional complexity due to tax reliefs and incentives which in turn places government in a dilemma to strike a balance between economic growth and simplified tax system to encourage compliance with tax laws.

Tax complexity arises from sophisticated mining tax always. Usually, tax complexity is harmful to the economy of the country and to everyone else who adhere to the tax laws.
We highlight below some of the unique tax laws and their associated tax risks within the mining industry. In the main, covers the following in respect to corporate income tax for mining companies (including limitation and Ordering Rules):

- Capital expenditure regime for mining operation and unredeemed mining capital expenditure.
- Assessed loss restriction rules.
- One mine limitation

Capital Expenditure Regime

Section 36 read with section 15 of the Act makes provision for a taxpayer that derives income from mining operations, to accelerate the deduction of any capital expenditure actually incurred during any year of assessment, subject to certain limitations, ordering rules and ring-fencing provisions. Accordingly, Miners are entitled to deduct capital expenditure incurred from income derived from mining operations, whereas other taxpayers deduct capital expenditure incurred over a period of time depending on the nature of the asset acquired and its expected utilization thereof.

The reasons for affording miners the right to claim the amount of capital expenditure actually incurred, instead of the asset being depreciated over time (as would be the case with other industries) are, in simple terms, to lessen the impact of deriving little or no income when a mine is being established. Section 1 of the Act defines 'mining operations' and 'mining' as including 'every method or process by which any mineral is won from the soil or from any substance or constituent thereof.

Can the capital expenditure be claimed as deduction by contract miners?

The question that often arises is whether contract miners are carrying on mining operations and are entitled to deduct from their income the capital expenditure incurred in the year in which it is incurred. The Supreme Court of Appeal in *Benhaus Mining (Pty) Ltd v Commissioner for the South African Revenue Service* (165/2018) [2019] ZASCA 17 (Benhaus case) dealt with this question and provided clarity on whether the contract miners can be regarded as carrying on mining operations.

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One Mine Limitation

Subject to certain exceptions, section 36(7F) of the tax Act contains rules that provides for the ring-fencing of expenditure of a particular mine. This means that the expenditure of a particular mine is restricted to the taxable income of that mine and cannot be deducted from taxable income of other distinct mines owned by the same company. The Supreme Court of Appeal in *Armgold/Harmony Freegold Joint Venture (Pty) Ltd v Commissioner, South African Revenue Service* [2012] ZASCA 152; 2013 provided the correct approach to the ordering rules and held that the effect of section 36(7E) was to set a maximum cap for the total amounts' deductible as capital expenditure.

Food for thought: How do you currently account for mining accelerated capex if you operate different mines or use subcontractors to run you mining operations? Have you completed an assessment to see if you are in compliance with the law? Do all your capex qualify for a deduction under 36, what can you do when it does not?

Interest Limitation Rules and Capital Expenditure

Interaction between the application of the interest limitation rules and capital expenditure regime for mining operation

In terms of section 36(11)(b) of the Income Tax Act, mining companies that are not producing, are allowed to include any interest incurred during such period of non-production as part of their capital expenditure.

Interest Limitation Rules and Capital Expenditure

At issue is the application of the provisions of section 23M of the Act to the interest of non-producing mining operations that forms part of capital expenditure of such mining operations. In brief, section 23M of the Act is an anti-avoidance provision that limits the deductibility of interest on debt arising between parties where such interest is paid by a South African tax resident to a non-resident person not subject to tax.

The proposed amendments in the 2022 Budget Speech provided that clarification be made in section 23M of the Act that the interest limitation rules will not be applied to the interest incurred on a loan utilised for mining purposes during any period prior to the commencement of production or during any period of nonproduction, as contemplated in paragraph (b) of the definition of capital expenditure in section 36(11) of the Act.

Potential risk:

There is a risk that the new provision in this section may not be correctly applied by mining companies when determining mining taxable income against which any available unredeemed mining capital expenditure may be utilised or assessed loss.

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Assessed Loss Restriction Rules

There are recent changes in the provisions of section 20 of the Income Tax Act, in relation to the limitation of assessed loss. The new limitation rules provides that, for entities with year of assessment ending on or after 31 March 2023 the assessed loss deduction should be limited to 80% of the taxable income or R1m whichever is the higher. In terms of the ordering rules, the calculation of the assessed loss restriction should be determined before considering the capital expenditure deduction in terms of section 36 of the Act.

Royalty Taxes

Another tax that the miners are exposed to is Mineral Royalty Tax. Royalty tax is payable by any persons who are involved in the mining industry who are regarded as a persons affected by the Mineral and Petroleum Resources Royalty Act (the Act). The royalty tax is calculated as a percentage of gross sales of mineral resources. The percentage is calculated in terms of different formulae depending on whether the mineral resources are unrefined or refined. The two important determinants for the calculation and determination of the value of the royalty tax are gross sales and EBIT.

Potential risk:

The rules and formulae to calculate the royalty tax are often complex and not applied correctly when determining the royalty tax payable. This may result in understatement of royalty tax paid which may lead to SARS levying understatement payment interest and penalties.

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Tax Technology & Data Analytics

Tax Technology and Data Analytics are central to our tax strategy. Given the significant volume of tax data transactions, any approach that overlooks the integration of technology and data analytics/science techniques is bound to fall short. Following this principle, we have developed a strategy that heavily leverages a variety of tools and solutions:

Tax Technology Tools | Applications

- Transfer Pricing Risk Assessment | Tax Computation | Validation Tools (e.g., Credit Cards | Identification | Tax Numbers)

Solutions | Tax Data Analytics

- Customs & Excise | Fixed Assets | VAT | PAYE

Other Data Analytics Solutions

- Asset Condition Monitoring | Anomaly Detection | Trend Analysis | Exception Reports | Visualize Data using Interactive Dashboards |

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