THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

Case number : 134/98

In the matter between :

THE COMMISSIONER FOR SOUTH AFRICAN REVENUE SERVICES — Appellant

and

FOODCORP LIMITED — Respondent

CORAM : F H Grosskopf, Zulman, Streicher JJA, Melunsky and Mthiyane AJJA

HEARD : 16 May 2000

DELIVERED : 31 May 2000

JUDGMENT

INCOME TAX - WHAT CONSTITUTES "A MINING PROPERTY" IN TERMS OF SECTION 37 OF INCOME TAX ACT - REFERRAL BACK TO COMMISSIONER FOR RE-ASSESSMENT

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MELUNSKY AJA/

MELUNSKY AJA :

[1] The essential question in this appeal is whether the provisions of s 37 of the Income Tax Act 58 of 1962 ("the Act"), read with par (j) of the definition of "gross income" in s 1, apply to an amount of R20 million received by the respondent during the 1989 year of assessment. The amount was paid to the respondent by Douglas Colliery Limited ("Douglas") pursuant to two contracts entered into on the same day, 12 July 1989 - R15 million in terms of one of the contracts ("the coal rights sale agreement") and R5 million in terms of the other ("the sale and assignment agreement"). The appellant ("the Commissioner") contended that pursuant to the contracts ownership of the respondent's mining property had passed to Douglas, that s 37 of the Act applied to the transactions, that development assets the cost of which had previously been allowed as a deduction

to the respondent were included in the assets transferred, and that the effective value of the development assets, as determined by the government mining engineer in terms of the section, amounted to R12 498 078.

[2] The Commissioner included the sum of R12 498 078 in the respondent's gross income for the 1989 year of assessment and assessed the respondent accordingly. The respondent objected to the assessment and appealed to the Special Income Tax Court, Pretoria. The appeal was partially successful. In the view of the Special Court the R5 million received in terms of the sale and assignment agreement was subject to the provisions of s 37 read with the aforesaid par (j), but the R15 million received under the coal rights sale agreement was not. The court remitted the assessment to the Commissioner for re-assessment on the basis that only R5 million was subject to the provisions of the said par (j) read with s 37(1) and (2) of the Act. The President of the Special Court (Southwood J) granted the Commissioner leave to appeal directly to this Court in terms of s 86

A(5) of the Act against the decision that the R15 million was not subject to the aforesaid provisions and the respondent noted a cross-appeal against that part of the judgment relating to the referral back to the Commissioner for re-assessment.

[3] The respondent is the owner of portions 1 and 2 of the farm Klipfontein in the district of Middelburg. On 21 September 1977 it ceded a half share of the coal rights on the properties to BP Southern Africa (Pty) Limited ("BP"). On 21 October 1982 BP, Douglas and the respondent (then known as Kanhym Estates (Pty) Limited) entered into a written agreement in which they recorded that they "shall be deemed to have ... associated themselves as a joint venture" with effect from 16 June 1980. The joint venture was formed for the purpose of carrying on coal mining, prospecting and ancillary operations on land known as the Middelburg Mine. Each party to the agreement (referred to as "the members" therein) undertook in terms of clause 4.2.1 to

> "contribute to the joint venture their respective coal rights as fully

described in Annexure "A" hereto ...."

Annexure "A" contains a description of various immovable properties, including portions 1 and 2 of Klipfontein, and a reference to the mineral rights held by each party in respect of the properties. The coal rights which the respondent contributed to the joint venture consisted of its half share of the coal rights on portions 1 and 2 of Klipfontein. The respondent's share in the joint venture was fixed at 6.497% and its "operating expenses obligations" was determined at 5.867%.

[4] In terms of the sale and assignment agreement the respondent (then known as Kanhym Limited) sold Douglas its interests in the joint venture for R5 million and in terms of the coal rights sales agreement it sold to Douglas its rights to coal on portions 1 and 2 of Klipfontein for R15 million. It will become necessary to refer to some of the terms of the agreements in due course but for the present it is sufficient to record that the agreements were implemented by both parties.

[5] This is a convenient stage to refer to the statutory provisions that apply to the

appeal and cross-appeal. Section 15(a) of the Act allows a deduction from the income derived by a taxpayer from mining operations in respect of capital expenditure as ascertained according to the provisions of s 36. "Capital expenditure" is defined in s 36(11) and it includes expenditure on shaft sinking and mine equipment and on development, general administration and management prior to the commencement of production. The expressions "capital expenditure incurred" is defined in s 36(11) to mean the amount (if any) by which the capital expenditure during the period of assessment in respect of a mine exceeds the sum of the amounts received or accrued during that period from disposals of assets the cost of which has wholly or partially been taken into account for the purposes of a deduction in respect of that mine.

[6] Paragraph (j) to the definition of "gross income" in s 1 deals with recoupments of capital expenditure by the taxpayer. For the purposes of this appeal it is sufficient to say that the paragraph provides that amounts received by

a taxpayer during a year of assessment in respect of the disposal of assets, the cost of which had previously been taken into account as a deduction under s 15(a) in respect of a mine, is included in the taxpayer's gross income to the extent that the amount so received exceeds the capital expenditure incurred during the year of assessment in respect of that mine. The capital expenditure incurred during the year in question is determined before applying the definition of "capital expenditure incurred" in s 36(11), thus resulting in the avoidance of double taxation on the recoupments (see De Koker: *Silke on South African Income Tax*, Memorial Ed Vol II, par 16.4).

[7] The Commissioner, as I have indicated, was of the view that a change of ownership of a mining property had occurred pursuant to the two agreements between the respondent and Douglas and he applied the provisions of s 37 to the amount of R20 million received by the respondent. It is therefore desirable to set out the terms of that section in full. At the relevant time s 37 read:

"*Calculation of capital expenditure on change of ownership of mining property.*

37. (1) For the purposes of this Act, whenever a change of ownership of a mining property occurs the new owner shall be deemed to have acquired such preliminary surveys, boreholes, shafts, development and equipment (in this section referred to as the development assets) as are included in the assets passing by such change of ownership, at a cost equal to the effective value to the new owner of the development assets at the time the change of ownership takes place, and the said cost shall be deemed to be expenditure that is incurred by the new owner during the period of assessment during which the change of ownership occurs and to be capital expenditure which is in respect of such period required to be taken into account for the purposes of the definition of 'capital expenditure incurred' in section 36(11): Provided that if in a case in which consideration is given, the effective value of all the assets so passing exceeds the consideration, the amount of such cost and expenditure shall be deemed to be an amount which bears to the amount of such consideration the same ratio as such effective value of the development assets bears to the effective value to the new owner at the said time of all the assets passing.

(2) For the purposes of par (j) of the definition of 'gross income' in section 1 and section 36, the person from whom ownership of any mining property is acquired in consequence of a change of ownership of that property shall be deemed to have disposed of the development assets included in the assets passing by the change of ownership for a consideration equal in value to the cost of the development assets to

the new owner, as determined under subsection (1), and such consideration shall be deemed to have been received by or to have accrued to the said person at the time the change of ownership takes place.

(3) If the value of the consideration given or of the property passing where no consideration is given is in dispute, it may with the consent of the new owner be fixed by the Commissioner and shall failing such consent be determined in the same manner as if transfer duty were payable.

(4) The effective value at the time the change of ownership takes place, of all the assets passing and of the development assets included therein shall be determined by the Government Mining Engineer who shall notwithstanding the repeal of the Second Schedule to the Transvaal Mining Leases and Mineral Law Amendment Act, 1918 (Act No. 30 of 1918), for the purposes of such determination have all the powers which were conferred upon him by the provisions of that Schedule."

[8] In terms of s 37 the government mining engineer determined the value of the development assets sold at almost R18,2 million and the effective value of all the assets passing at slightly more than R29 million. By applying the formula contained in the proviso to s 37(1), the value of the development assets passing was fixed at R12 498 078, the amount which the Commissioner included in the respondent's

gross income. It is to be observed that in terms of s 37(1) the effective value of the development assets ranks as "capital expenditure incurred" in the hands of the transferee and the same amount, for the purposes of par (j), is deemed to be a recoupment in the hands of the transferor in terms of s 37(2). Interestingly enough, clause 7.6 of the sale and assignment agreement contains an undertaking by Douglas that it would not, without the respondent's written consent,

> "... claim as a deduction any portion of the purchase price (R5 million) in terms of any provision of the Income Tax Act, 1962, as amended."

The only witness to testify before the Special Court, the respondent's group financial adviser, Mr Payne, gave an explanation for the inclusion of clause 7.6. He said that the respondent considered that the sale and assignment agreement would not result in a recoupment of capital expenditure in the respondent's hands in terms of s 37 and for this reason Douglas was apparently prevailed upon not to claim the deduction. It is not clear, however, whether Douglas, too, believed that s 37 did

not apply and abandoned its right to claim the deduction on this ground but there is no need for anything further to be said on that matter.

[9] The court *a quo* decided that the provisions of par (j) read with s 37 did not apply to the coal rights sale agreement on the grounds that coal rights, which were the subject matter of the sale, were not defined as capital expenditure in terms of s 36. On the other hand, the Special Court held that the respondent's interest in the joint venture, which was sold in terms of the sale and assignment agreement, included the respondent's rights to development assets. The parties agreed before the court *a quo* that such a finding would have the result that the provisions of par (j) and ss 37(1) and (2) of the Act should be applied to the sum of R5 million. It was on this basis that the matter was remitted to the Commissioner for re-assessment.

[10] In this Court it was argued on the Commissioner's behalf that the two contracts - the coal rights sale agreement and the sale and assignment agreement -

were in substance one transaction in terms whereof the respondent sold its assets and rights connected with the joint venture to Douglas for R20 million. Consequently, according to the argument, it was artificial to separate the two agreements and to apply the provisions of s 37 to one and not to the other. Moreover, it was submitted that the subject matter of the transaction was "a mining property" for the purposes of s 37 and the Commissioner was therefore entitled to assess the respondent in terms of the section as he had done.

[11] There is considerable substance in the first part of the argument. Indeed, it has not been properly explained why the parties found it necessary to enter into two contracts. In both instances the seller was the respondent and the purchaser Douglas. The subject matter of the sales were similar, if not identical. On the respondent's behalf it was argued that different parties were involved in the contracts as another company, Witbank Colliery Limited ("Witbank") was a party to both agreements while BP and Kanhym Investments Limited (the respondent's

holding company) were additional parties to the sale and assignment agreement. The joining of the extra parties hardly necessitated separate agreements. BP and Kanhym Investments Limited apparently became parties to the sale and assignment agreement as they were parties to the joint venture agreement. Witbank undertook to perform all of Douglas' obligations under the sale and assignment agreement in the event of the latter's default and this was the reason why it became a party thereto. The reason for Witbank's participation in the coal rights sale agreement is unclear as it acquired no rights and incurred no obligations thereunder.

[12] The subject matter of the coal rights sale agreement was the respondent's rights to coal in, on and under portions 1 and 2 of Klipfontein. The purchase price of R15 million was allocated as to R5 million for the rights to coal on portion 1 and R10 million for the coal rights on portion 2. Douglas was also granted certain surface rights and rights ancillary to mining on the properties including the rights which a holder of mineral rights may be entitled to exercise in law. For its part

Douglas agreed that it would not be entitled to exercise the rights "in respect of coal ... in any manner other than as contemplated in the [joint venture] agreement", and also undertook in terms of clause 3.5.2.1 that

> "The rights to coal acquired by it in terms of this agreement shall be made available by it to the joint venture ..."

[13] The sale and assignment agreement recorded that the respondent had agreed to sell to Douglas all of its rights, save for certain rights that were excluded, in the following agreements:

> "The MJV documents, the sales agreement and in respect of the SATS loan."

"The MJV documents" denotes the joint venture agreement and an operating agreement relating to the development and operation of the Middelburg Mine. "The sales agreement" refers to an agreement between the members of the joint venture whereunder BP undertook to market the coal from the Mine. For the purposes of this agreement BP undertook to make use of its provisional export licence and its

port allocation at the Richards Bay Coal Terminal (”The RBCT”). “The SATS loan” relates to money lent to the South African Transport Services (SATS) in connection with the construction of a railway link. At the time of the sale and assignment agreement, the respondent was owed R825 000 in respect of the SATS loan. In terms of clause 6.1.3 of the sale and assignment agreement, all of the respondent’s rights under the MJV documents were ceded to Douglas. These rights included, specifically, the right

> “to take delivery ... of an to sell for its own account, [the respondent’s] entitlement to coal in terms of the MJV agreement.”

[14] Douglas and the respondent agreed, in terms of the sale and assignment agreement, that the purchase price of R5 million consisted of the respondent’s unredeemed contribution to the SATS loan of R825 000 and the purchase price of the respondent’s rights in the sales agreement, including its right in respect of the RBCT entitlement, “subject to a maximum of R4 175 000". The balance of the

purchase price, if any, was to be paid "as the purchase price of the rights referred to in [clause] 6.1.3". In effect, therefore, no value was given for the redeemable assets, i.e. the capital expenditure as defined in s 36(11). Mr Payne conceded that no value was given for those assets. Moreover, and while the respondent's rights to coal were transferred to Douglas in terms of the coal rights sale agreement, the same rights, which were part of the respondent's contribution to the joint venture, were apparently sold to Douglas in terms of clause 6.1.3 of the sale and assignment agreement. What seems to be clear, however, is that, save for the immovable properties on which the mining was carried on, all of the respondent's mining assets and interests in the said properties passed to Douglas in terms of the two agreements. Mr Payne agreed that this was the case. The Special Court, in my view, erred in treating each of the two contracts as unrelated or separate transactions. Perhaps the Special Court adopted this approach because the Commissioner's representative accepted "that he could not argue that the

transactions were simulated transactions". However that may be, I am satisfied that counsel for the Commissioner in this court was correct in submitting that on the face of it the respondent sold its rights and assets in the joint venture, save for the immovable property, to Douglas for R20 million.

[15] The second part of the Commissioner's argument - that the subject matter of the two transactions was "a mining property" for the purposes of s 37 is, however, not correct. The words "mining" and "mining operations" are defined in the Act but the expression "mining property" is not. It is true, as counsel for the Commissioner emphasised, that the word "property" is capable of a variety of meanings (cf *Commissioner for Inland Revenue v Estate Crewe and Another* 1943 AD 656 at 667), but it is not merely the word "property" which requires to be considered in this appeal. In its ordinary sense the phrase "a mining property" relates to a property (i.e. land) on which mining is carried on. This was the meaning given to the same expression in the High Court of Australia by Kitto J in

Commissioner of Taxation of the Commonwealth of Australia v Broken Hill Proprietary Company Limited (1969) 120 CLR 240 at 245. The learned judge said:

> "The word 'property' seems here to be used in its popular sense of land considered as a subject of private rights, and accordingly 'a mining property' may be defined as land which a person is mining in exercise of a private right, either his own right or (by licence) a right vested in someone else."

Although an appeal against the judgment was partially successful, Kitto J's definition was endorsed by the Full Court which also considered mining property to be land on which mining, or at least some steps for mining, was undertaken (at 271). The *Broken Hill* case was concerned with the meaning of "a mining property" in a section of an Australian Income Tax statute which differed completely from s 37 of the Act. It is obvious that the same meaning cannot be mechanically attributed to identical words used in different statutes but the decision in the Australian case is illustrative of a sense in which the words may be used if the context so permits and it shows that both Courts had no hesitation in

concluding that the words referred to land.

[16] Counsel for the Commissioner contended that the mineral rights and the other mining assets which the respondent transferred to Douglas constituted a mining property within the meaning of that expression in s 37. It was therefore submitted that the transfer of a right to carry on mining operations amounted to a transfer of a mining property. It may be accepted, as counsel argued, that one of the objects of the section is to enable the Commissioner to apply a value to development assets where the parties to an agreement do not do so. This, however, is no justification for extending the sense of the words in the section beyond their proper meaning. There are clear indications in the section that the legislature intended the phrase to apply only to land on which mining was carried on. For the purposes of this judgment I leave aside the question of whether the word "ownership" in the section might be applied to all rights, both personal and real, and also to physical property. It will also be assumed that, in an appropriate context, the word "property" may

include property of every description, including rights. It is not readily conceivable, however, that the phrase "a property" can apply to anything other than an immovable property. If it is assumed, therefore, that the transfer of mineral rights and the right to conduct mining operations might, in an appropriate case, be described as a transfer of mining property, such transfer cannot be characterised as a change of ownership of "a mining property". On a proper interpretation the latter expression in s 37 means land on which mining is carried on.

[17] It is not disputed that the properties known as portions 1 and 2 of Klipfontein remained registered in the respondent's name at all relevant times and that no part of the land was transferred to Douglas. It follows that the Commissioner's assessment was incorrect to the extent that he relied upon s 37 to establish the amount received by the respondent for the development assets. He should have determined the amount received by the respondent in respect of the disposal of assets according to the provisions of par (j) without regard to s 37. To fix this

amount will probably require further investigation into the circumstances surrounding the two agreements whereunder the respondent's mining interests were sold. The amount, if any, which is ultimately determined by the Commissioner in respect of the disposal of the assets might differ considerably from the amount which the respondent was deemed to have received in terms of s 37(2). It would therefore be appropriate to remit the matter to the Commissioner for further investigation and assessment.

[18] On the respondent's behalf it was argued that the respondent did not dispose of assets, the costs of which had previously been included in capital expenditure under s 15(a). What the respondent disposed of, it was submitted, was its participating interest in the joint venture agreement and that this interest amounted to "a bundle of rights" and not to the underlying assets. This submission was based on remarks made in *Desai and Others v Desai and Another* 1993 (3) SA 874 (N) at 881B-C to the effect that a partner's interest in a partnership, "that is the

bundle of rights of action where the existence of such interest persists", does not include immovable property for the purposes of the Contracts of Sale of Land Act 71 of 1969. That is not the issue that arises in this appeal. This Court has to decide which assets of the members became joint venture assets in terms of the joint venture agreement and the answer depends upon the terms of the agreement. Clause 5.3.3 of the agreement reads:

> "The assets shall be owned by the members in the proportions of their perspective percentage shares in the joint venture and in the event of any asset being disposed of during the operation the net proceeds of such disposal will be distributed to the members in proportion to their participation interests."

The agreement defines "assets" as the mining facilities and all other property, movable, immovable and incorporeal, developed, constructed, held or acquired by the members or any of them in connection with the joint venture (excluding saleable coal which is referred to in clause 5.4). The agreement defines "participation interest" as follows:

"(i) each Member's respective interest (as determined in accordance with sub-clause 5.3 hereof) in the Assets; and

(ii) each Member's Coal and surface rights referred to in Clause 4 hereof and other rights and obligations under this Agreement (save and except each Member's respective Operating Expenses Obligation) and where the context so requires, each Member's percentage share for the time being in the Joint Venture."

[19] It is clear from the aforesaid provisions that the members were to become joint owners of all of the assets as defined. For the movables to become the joint property of all of the members it was sufficient for each member to hold the assets in co-ownership without physical delivery; but ownership in the immovable properties did not pass as registration of transfer was not effected (cf *Berman v Brest and Another* 1934 WLD 135 at 138-9). It is also clear that a sale of a member's participation interest (which is dealt with in clause 14 of the agreement) includes a sale of the assets. This follows from the definitions and from clause 5.3.3. That the parties intended co-ownership of the movable assets to occur is

underscored by clause 5.4 which provides that the saleable coal was regarded as each member's "own and absolute property".

[20] In my view, therefore, the provisions of par (j) apply to the disposal of at least some of the assets which were transferred to Douglas in terms of one or both of the agreements.

[21] As a result of the aforegoing, the appeal should be dismissed. The cross-appeal succeeds to the extent that the Commissioner, in reconsidering the matter, should do so without regard to the deeming provisions of s 37.

[22] On behalf of the Commissioner it was submitted that costs should be reserved in the event of this Court deciding to refer the matter back to the Commissioner. This submission cannot be acceded to. Quite apart from all other considerations, the matter is no longer pending in any court. The costs of the appeal should, therefore, be paid by the Commissioner. As far as the costs of the cross-appeal are concerned, the respondent was wrong in contending that there was

no sale and that the matter should not be referred back. This contention was argued fully both in the heads of argument and in the oral submissions. As the respondent fails on this issue it seems to me that it would be reasonable to make no order as to costs in respect of the cross-appeal. The order which is made is the following:

1. The appeal is dismissed with costs;

2. The orders of the court *a quo* are set aside;

3. There is no order as to the costs of the cross-appeal;

4. The Commissioner's assessment is referred back for investigation and re-assessment in respect of the receipt of R20 million by the respondent, such re-assessment to be made without the application of the provisions of s 37 of the Act.

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L S MELUNSKY
ACTING JUDGE OF APPEAL

Concur:

F H Grosskopf JA
Zulman JA
Streicher JA
Mthiyane AJA