REPUBLIC OF SOUTH AFRICA

# *IN THE SUPREME COURT OF APPEAL OF SOUTH AFRICA*

**Reportable**
**Case Number : 294 / 03**

**In the matter between**

**WESTERN PLATINUM LTD** **APPELLANT**

**and**

**THE COMMISSIONER FOR SOUTH AFRICAN REVENUE SERVICE** **RESPONDENT**

**Coram :** **SCOTT, MTHIYANE, CONRADIE, HEHER and VAN HEERDEN JJA**

**Date of hearing :** **17 AUGUST 2004**

**Date of delivery :** **27 SEPTEMBER 2004**

## SUMMARY

**Income Tax - attributes of income from mining operations capable of being set off by taxpayer against mining capital expenditure – when interest receipts qualify as mining income.**

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## J U D G M E N T

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**CONRADIE JA**

[1] The *fiscus* favours miners and farmers. Miners are permitted to deduct certain categories of capital expenditure from income derived from mining operations. Farmers are permitted to deduct certain defined items of capital expenditure from income derived from farming operations. These are class privileges. In determining their extent, one adopts a strict construction of the empowering legislation. That is the golden rule laid down in *Ernst v Commissioner for Inland Revenue* 1954 (1) SA 318 (A) at 323C-E and approved in *Commissioner for Inland Revenue v D & N Promotions (Pty) Ltd* 1995 (2) SA 296 (A) at 305A-B.

[2] The appeal and cross appeal before us are from a decision of Cloete J sitting in the Gauteng Income Tax Special Court.[1] They require us to decide in what circumstances interest may be characterized as 'income derived by the taxpayer from mining operations'. The fiscal importance of determining the derivation of this kind of income lies in s 15(*a*) read with s 36(7C) of the Income Tax Act 58 of 1962 ('the Act').

[3] Section 15(*a*) permits the deduction of capital expenditure by a miner in these terms:

> 'There shall be allowed to be deducted from the income derived by the taxpayer from mining operations –

[1] Reported as Income Tax Case 1753 65 SATC 310 and as Case no 10678 2003 JTLR 117 (WSpCrt).

(*a*) an amount to be ascertained under the provisions of section 36, in lieu of the allowances in section 11(*e*), (*f*), (*g*A) and (*o*).'

[4] Section 36(7C) supplements s 15(*a*) by providing that -

'Subject to the provisions of subsections (7E), (7F) and (7G), the amounts to be deducted under section 15(*a*) from income derived from the working of any producing mine shall be the amount of capital expenditure incurred.'

Section 36(7E) limits the deduction to amounts of capital expenditure that do not exceed the taxable income ' ... derived by the taxpayer from mining ...' but permits any excess to be carried forward and to be deemed to be an amount of capital expenditure incurred during the next succeeding year of assessment. Section 36 (11) then sets out in detail what items of capital expenditure qualify for deduction.

[5] Section 15(*a*) speaks of 'mining operations' and s 36(7E) simply of 'mining'. In terms of s 1 of the Act, they mean the same:

'Mining operations' and 'mining' (unless the context otherwise indicates)

' ... include every method or process by which any mineral (including natural oil) is won from the soil or from any substance or constituent thereof.'

The definition leaves scope for physical operations outside the winning of minerals from the soil to be regarded as mining; indeed, it was common cause that the refining of excavated minerals is included in the concept.

[6] Mining operations by themselves cannot produce income. However, the definition of 'mining' and 'mining operations', being context-dependent, is capable of accommodating commercial transactions. Since there can be no derivation of income without commercial activity we are entitled to read that into the definition.[2] In the case of minerals or metals from a mine such an income-producing transaction would commonly be a sale. One would therefore, at least, have to interpose a sale (and the associated delivery and payment) between the extraction of the minerals and the income, thus postulating a business. I am nevertheless unable to accept the argument for the appellant that the Act contemplates as the source of the income the mining trade carried on by the appellant. In order to derive income a taxpayer must generally carry on a trade, but that is not to say that the trade, although it is a *sine qua non* of the trading income, is its *source*. Cases such as *Sekretaris van Binnelandse Inkomste v Olifantsrivierse Koöperatiewe Wynkelders Bpk* 1976 (3) SA 261 (A) and *Income Tax Case* 1420 49 SATC 69 and *Commissioner for Inland Revenue v Zamoyski* 1985 (3) SA 145 (C) which held that mining or farming is a trade therefore do not advance the enquiry. Section 36(7C) of the Act speaks not of 'mining' or 'mining operations' but of '... income derived from the working of any producing mine.'[3] This expression (arguably more focused than the

[2] Two decisions of the Canadian Federal Court of Appeal espouse the approach that the operation of a mine is an economic, not a metallurgical, concept: *Falconbridge Nickel Mines Ltd v Minister of National Revenue* 72 DTC 6337; *Westar Mining Ltd v The Queen* 92 DTC 6358.

[3] The word 'producing' was inserted in section 36(7C) by s 29 of Act 113 of 1993 with effect from the years of assessment ending on or after 1 January 1994.

expressions ‘mining’ and ‘mining operations’) leaves no doubt that to be mining income its source must be minerals taken from the earth. This was the view correctly taken by the full court in *Commissioner for Inland Revenue v BP Southern Africa (Pty) Ltd* 1997 (1) SA 375 (C) when it said that –

> ‘Properly construed, in the context of the Act and the Schedule, the phrase “income derived from mining operations” means income derived from the business of extracting minerals from the soil ...’ (at 379C-D).

The court used this formulation to point the difference between the derivation of income from working a mine and the derivation of deemed income that accrued to the respondent from the sale of its interest in a mine.

[7] The appellant did not challenge the finding of the court *a quo* that in order to qualify as mining income, the income had to be directly connected to the mining source. ‘Directly connected’ is an expression from the judgment of the lower court[4] adopted by this Court in *D & N Promotions* (at 306C-D).

> ' " ... the income and the source from which the income arises, namely farming operations, which of course embraces numerous agricultural activities, must be directly connneted. An indirect connection or a remote one will not suffice." '

It was held that interest on the price of sugar cane delivered by a farmer to a miller was income directly derived from farming operations. The interest was designed to compensate the farmer for the miller’s retention during the year of

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[4] The decision is reported as *CIR v D&N Promotions (Pty) Ltd* 1993 (3) SA 33 (N).

the difference between the final price and the provisional price paid for the sugar cane: it was 'part and parcel' of the final price, no more than additional remuneration.

[8] On the other hand, interest on a payment received by the farmer from the SA Sugar Association to compensate it for a newly imposed obligation to bear the full costs of transport of cane to the mill, was held to fall 'outside the general ambit of the [farmer's] income-earning operations from sugar farming' (308H-I) in the same way as it would have done

> '[i]f the capital sum had been paid in one lump sum and such moneys invested with or loaned to another institution…' (at 308F-H).

The compensation paid by statutory authority under the Sugar Agreement promulgated in terms of the Sugar Act of 1978 was assessed in a lump sum but paid in instalments. In a passage from the judgment of the special court[5] quoted with approval by Corbett CJ (at 308E-H) the following approach was adopted:

> 'It is clear that the interest was derived from a capital sum due to the appellant retained by the SA Sugar Association. It was interest accruing on either a compulsory investment of a fixed amount by the appellant with the SA Sugar Association or on a compulsory loan of this amount to the SA Sugar Association. If the capital sum had been paid in one sump sum and such moneys invested with or loaned to another institution, it is clear that such interest would not have been regarded as being derived from farming

[5] Reported in ITC 53 1505 SATC 406.

> operations. In our view the position is not altered by the fact that such investment or loan was not effected voluntarily but compulsorily.'

The line of reasoning is straightforward and, adapted to this case, leads to the conclusion that income which is directly connected to a mining source qualifies as mining income; an intermediate investment of such income, putting it to work as capital, generally breaks the direct connection.[6]

[9] The appellant's counsel suggested that any income flowing from the *trade* of mining would be sufficiently closely connected to the mining operations to qualify as mining income. Counsel for the respondent on the other hand contended that only the proceeds of the *sale* of minerals would be sufficiently closely connected to the mining operations (the extraction and refinement of the minerals) to be properly characterised as mining income.

[10] The appellant's approach is too generous; the respondent's on the other hand is too narrow. Direct connection is a flexible concept. Its application does not inexorably lead to the categorisation of any income item other than the price itself as only indirectly or remotely connected with the mining source. A good example of this is an insurance payment, which, replacing mining income, has itself been held to be mining income. An insurance indemnity takes on the character of the amount that would have been received had it not been for the occurrence of the insured event (see *Income Tax Case* 597 14 SATC 264 and

[6] Where a portion of a farm was put to use as an investment the rental was held not to be income from farming operations: ITC 732 18 SATC 108.

the cases discussed therein). If the amount lost is of a revenue nature an insurance receipt is regarded as 'filling the hole of income' and is also revenue. The question in *Income Tax Case* 1572 56 SATC 175 was whether this income, when it replaced mining income (that would have been earned had it not been for a machinery breakdown) was also mining income. The court held that the connection of the insurance payment (an income receipt) with the lost mining income was sufficiently direct to qualify it as mining income.[7]

[11] The appellant maintains that certain interest items in its financial statements formed part of its income derived from mining operations. Cloete J analyzed the various sources of the interest income and concluded that some items derived from mining operations whereas others did not. In conducting this exercise he asked himself whether the interest could be said to have been derived directly from the mining operations or could more properly be said to have been derived from the capital employed to produce it.

[12] Current bank accounts, of which there were several, were managed in terms of a cash management system (CMS) operated by arrangement with the appellant's bankers and producing over the tax years in question interest of R1 776 187. The special court described the system thus:

[7] *ITC* 65 1753 SATC 310. Interestingly, this was also the conclusion of the Canadian Federal Court of Appeal on a similarly worded provision in *Westar Mining Ltd v The Queen* 92 DTC 6358.

> ‘If the total amounts overdrawn on all the accounts managed by the management company (those of the appellant and those of the other companies in the group) exceeded the amounts in credit, the banks charged the overdraft rate on the amounts in debit and paid interest at the overdraft rate on the amounts in credit. The nett effect was therefore that the bank charged interest at the overdraft rate on the nett amount in debit.
>
> If the total of the debits exceeded the total of the credits, the position was somewhat different. The bank paid overdraft interest on the total of the amounts in credit, but only on an amount equal to the total of the amounts in debit. On the nett excess credit the bank paid only the deposit interest rate, which was lower than the overdraft rate. The nett effect to the bank was therefore that it paid interest at the deposit rate to the companies on the total nett amount in credit. However, to alleviate administrative difficulty, the management company made up the shortfall between the overdraft and the deposit rate on this total nett credit.’

[13] The management company’s commitment to making up the interest shortfall could, of course, impose a considerable burden on it. It therefore tried to eliminate credit balances as far as possible by investing any surplus overnight in the money market. Interest received on overnight money lent to South African banks in this manner came to R13 868 980. The special court was of the view that the placing of money on overnight call was an investment decision that altered the character of the interest from mining to investment income. I agree. The interest was taken out of the mining income stream.

[14] The Commissioner challenges the special court finding that, since money in an banking account would invariably attract interest, and the keeping of a banking account was indispensable to the operation of the mine,

> ‘ ... the interest earned as a necessary concomitant of the operation of those accounts is mining income.’

[15] If the current accounts had simply been repositories of the proceeds of metal sales and interest were earned on credit balances so that such interest was the result of an (inevitable) disequilibrium from time to time between outgoings from that account and mining income paid into it, the connection between the interest and the mining source would be direct. Interest so earned could therefore be regarded as a necessary concomitant of the mining operations. The facts here do not, however, support such a conclusion. The accounts were manipulated in the manner described by the judge *a quo*. The management of the accounts of the whole group comprising twenty-six companies (and the intervention of the management company) meant that the appellant received from the banks, or from the banks subsidized by the management company, the overdraft rate of interest on its credit balances, a rate that it would not have received had it not been for the CMS. The scheme was obviously conceived to maximize the group’s interest income. It was, in essence, an investment scheme. The decision to manipulate the accounts broke any direct connection that the interest may have had with the mining source.

[16] Interest on money in foreign bank accounts for the tax years 1992 to 1997 came to R2 166 179. Proceeds of off-shore mineral sales were paid into foreign bank accounts conducted by the appellant for the convenience of its overseas customers. The evidence for the appellant was that this money was transferred to South Africa with a brief delay either because it was not possible to transfer it on the same day or because the appellant preferred to transfer rounded amounts rather than specific deposits. In this way interest accrued on (short term) credit balances in the accounts. That was the position up to the 1994 year of assessment and the special court found that the interest had until then been earned in the ordinary course of marketing the appellant's metals.

[17] The Commissioner contends that the appellant failed to discharge the *onus* of proving that the monies were not allowed to remain overseas for the purpose of earning income or deriving foreign exchange benefits and in any event argues that interest earned in this way was investment income, the fruit of capital derived from the appellant's metal sales. It is not readily apparent why in an era of electronic transfers money in the overseas accounts could not have been transmitted as soon as it had been received. It might have had something to do with different banking hours in this country and overseas or perhaps with time zone differences but that is speculation. The appellant laid no factual foundation for its assertion that deposits could not be transferred on the same day as they were received. The appellant's unexplained preference for receiving

rounded amounts is, on the evidence before us, too quirky to carry conviction; in any event, a decision to wait for rounded amounts to be made up (to leave money in an account until the happening of a specified event) is in itself a conscious investment decision. In my view the appellant has not discharged the burden of proving that this interest income was directly connected to the mining operations.

[18] From September 1994 the appellant arranged with the overseas banks to place sale proceeds on overnight call before transferring them to the appellant's head office account in South Africa. The delay in the transfer of the money was no greater than before but the interest earned increased by one percent. This interest was *a fortiori* not classifiable as income from mining operations.

[19] There were two overseas accounts exhibiting different features. They were the so-called escrow accounts held at the Hypobank and the Bayerische Vereinsbank in Germany. As part of the security arrangements for long-term loans to the appellant customers were obliged to pay the price of metals purchased from the appellant into these accounts so that the banks might lay claim to the funds if the appellant failed to comply with its obligations to them. Although the banks released funds on a daily basis monies inevitably remained in the accounts for short periods where they earned interest totalling R239 501 at rates equivalent to that earned on the off-shore current accounts.

[20] The court *a quo* concluded that since this interest arose from receipts held by the two foreign banks as part of the security for loans to enable the appellant to mine there was a direct connection between the interest earned and the operation of mining. I agree. The interest was the unavoidable result of the way in which the scheme for the remuneration of the appellant had been devised. It was not entitled to be paid the price for its metals except in accordance with its financing arrangement with the banks. The interest earned on the escrow accounts is part and parcel of the appellant's mining operations; it exhibits the direct connection with those operations that qualify it as mining income.

[21] On four occasions during the tax years in question the appellant lent money on fixed deposit. Two of the loans were to Lonrho Management Services: the interest totalled R2 686 478. Two further loans on which the interest came to R3 073 389 were made to other institutions. The appellant's counsel submitted that the placing of money on short term fixed deposit could not be regarded as an independent trade carried on by the appellant. I agree with the submission, but it does not answer the essential question of whether there was a direct link between the interest derived from the investment and the mining operations carried on by the appellant. The question of how to treat the investment of surplus income was settled in *D & N Promotions.* Whether funds are invested over the short or the long term the interest is properly characterized

as investment income not directly connected to a mining income source. The Commissioner succeeds on this issue.

[22] The court *a quo* held that interest (amounting to R4 614 125) accruing by virtue of an agreement under which a customer undertook to pay interest if it paid late was derived from the appellant's mining operations. Mitsubishi, one of the appellant's principal customers, was by agreement charged a favourable rate of interest for a short period if it failed to pay for metal sold to it on due date; thereafter it was charged ordinary interest. The Commissioner contends that the interest so received was not income derived from mining operations. The appellant should, he says, have adjusted the price to take account of the extended period for payment: had it done that, the income would have been mining income. In making this submission the Commissioner sees the income stream from mining operations too narrowly. The interest was part and parcel of the income stream; under the prescribed circumstances it augmented the income stream in exactly the same way as an increase in the purchase price would have done but it did so in a more flexible and commercially sensible way. I do not consider that the directness of the derivation of this income from the mining source can be doubted.

[23] In terms of the General Export Incentive Scheme in force at the time the appellant became entitled to incentives on the export of two base metals, nickel sulphate and copper cathodes. The export incentives were calculated according

to a formula Z = U x (M plus or minus E) x P in which Z was the value of the benefit payable under the scheme, U was the export sales value of the exported product, M the manufacturing level factor, E the exchange rate factor and P the local content factor. Larger incentives were paid by the Department of Trade and Industry by way of promissory notes on which interest became due. It is common cause that for the tax years in question (1992 and 1993) the incentives were tax exempt under the now repealed s 10(1)(zA) of the Act but that the interest was not. The only dispute is whether the interest, amounting to R421 163, is mining or non-mining income.

[24] It is not necessary to know precisely how the formula worked. The point is that it was devised to augment an exporter's income. The promissory notes were issued for varying periods depending on the department's budget and its ability to pay the notes. The interest was intended to compensate exporters for deferred payment, very like the interest paid by Mitshubishi for late payment, and incontestably part and parcel of the purchase price. I agree with the special court that there was a direct connection between the mining source and the export incentive interest.

[25] The final three items in dispute are all concerned with refunds by the Commissioner of tax or mining rental on which he was in terms of s 88(1) of the Act obliged to pay interest. The similarity between the second situation dealt with in the *D & N Promotions* case and these three items of interest is that

money due to the taxpayer was retained by government action and later repaid with interest. For the purpose of determining the derivation of the interest there is no difference in principle between the retention of money by the Sugar Association and the retention of money by the *fiscus*. In either case the retention of the money can be equated with a compulsory loan, the interest on which, as explained in para [8], is not derived from a farming or mining source.

[26] For the 1989 year of assessment the appellant claimed a deduction of R23 758 447 in respect of capital expenditure and paid its provisional tax on the footing that the deduction would be allowed. When the deduction was disallowed[8] the appellant had to pay more provisional tax and also, in terms of s 89*quat*(2) of the Act, had to pay interest on the difference between the provisional payment and the tax as assessed.

[27] An appeal against the disallowance of the appellant's objection to the assessment was later conceded by the Commissioner who during the 1994 year of assessment refunded to the appellant R10 697 186,64 plus the interest of R2 559 318,15 that it had been obliged to pay on that amount; moreover, in terms of s 88(1) of the Act the Commissioner paid the appellant interest of R7 044 140,62 on these overpayments – interest that the appellant claims is part of its mining income.

[8] A small portion of the expenditure was allowed in a later year of assessment.

[28] Apart from the considerations referred to in para [8], a tax is an impost on income; it has none of the attributes of revenue. By virtue of the statutory intervention that allows the imposition of the tax it is already one level removed from the mining income on which it is imposed. The refund of the tax occurred after procedures to secure that result had been adopted by the appellant so that the refund was two levels removed from the mining income. The interest that the Commissioner was statutorily obliged to pay on that refund is another level away. Its connection with the mining income is tenuous. It did not flow from the appellant's mining operations: it would have been payable whatever the source of the income on which tax had unjustifiably been imposed.

[29] The court *a quo* was correct in finding that ' ... the fact that the earning of the mining income was a *sine qua non* for the payment of the tax which was paid, does not provide a sufficiently direct causal link between the interest paid on the refund of the tax and the actual mining operation.'

[30] The downward revision of the appellant's tax liability following on the allowance of the capital expenditure meant not only that it owed the Commissioner of Inland Revenue less in tax but also that it owed the Commissioner of Mines less in rental.

[31] The appellant mined precious minerals under a mining lease in terms of the Mining Rights Act 20 of 1967 (now largely replaced by the Minerals Act 50

of 1991). The rental under the lease was calculated on the appellant's annual profit in the same manner as its taxable income from mining operations was determined under the Income Tax Act. When the Commissioner disallowed the deduction claimed by the appellant its taxable income increased and so in consequence did the rental on its mining lease, from R8 712 270 to R12 134 512. The appellant was required to pay the difference of R3 422 242 to the Commissioner pending the resolution of its dispute with the Revenue.[9] Since the rental was paid later than the appointed day the appellant paid interest of R1 107 623,52 for the period of the delay. As a result of the revised assessment, these amounts were repaid to the appellant together with R2 323 620 in interest.

[32] The direct cause of the payment of the interest was the reversal by the Commissioner of an earlier decision not to allow certain capital expenditure as a deduction. The interest was paid as compensation for the Commissioner's wrongful detention of these amounts. The repayment has much more to do with the complexities of the tax regime under which the appellant carries on its mining trade than with the extraction of minerals from the soil. For these reasons and for the reasons stated in para [8] the interest cannot be characterized as mining income.

[9] The Commissioner had in terms of the lease and s 26(7) of the Mining Rights Act, 1967 the same power to exact payment of rental and interest thereon as he had to exact payment of income tax and interest thereon in terms of the Act.

[33] In 1990 the appellant through a share issue to Impala Platinum Holdings acquired the Karee Mine owned by one of the latter's subsidiaries. This was a developing mine situated on land adjoining the Western Platinum mine. Capital expended by the appellant on the development of the Karee mine could not be set off against mining income earned from the Western Platinum mine since s 36(7F) of the Act prohibited such a set-off unless the Minister of Finance permitted it.

[34] Between the acquisition of the new mine in 1990 and the grant of permission by the Minister in 1992, the appellant had paid provisional tax on the basis of the then existing separate taxation regime. The appellant's 1992 assessment, based on the joint taxation of the two mines, entitled it for the 1990 tax year to a refund of R43 000 700 of provisional tax together with interest This interest, payable by the Commissioner in terms of s 88(1) of the Act, came to R4 827 353. The appellant contends that the interest should be classified as mining income.

[35] The tax refund flowed from a decision of the government to adjust the law relating to the ring fencing of the two mines in such a way that the appellant was able to deduct from its mining income greater capital expenditure than it was formerly permitted to do. This resulted in a reduction of its mining income and led to the tax refund together with interest. For the reasons stated above,

the interest on the tax refund was only remotely connected with the mining source of the income. I agree with the judge *a quo* in this regard.

[36] The special court did not issue an order in respect of each of the items of interest. It simply referred the matter back to the Commissioner to issue revised assessments in terms of its findings. The special court's order therefore stands but revised assessments will of course have to be issued in accordance with the findings as adjusted on appeal. It is necessary to identify the findings on which each of the parties has been successful in order to arrive at a just costs order.

1 The Commissioner has succeeded in having the following findings of the income tax special court overturned-

(a) that interest earned by the appellant by virtue of its participation in the cash management scheme is mining income;

(b) that interest earned on foreign current banking accounts is mining income;

(c) that interest on the refund of mining lease rentals is mining income.

2 The Commissioner has succeeded in having the following findings of the income tax special court upheld –

(a) that interest earned on money placed on overnight call is not mining income;

(b) that interest on fixed deposits is not mining income;

(c) that interest on tax refunds is not mining income;

3 The Commissioner has failed in his attempt to have the following findings of the income tax special court overturned –

(a) that interest on late payments by a customer of the appellant is mining income;

(b) that interest on escrow accounts is mining income;

(c) that interest on export incentives is mining income.

The overall result is that none of the appellant's attacks on the findings of the special court has succeeded. The Commissioner on the other hand has successfully attacked the findings of the special court mentioned in 1(a) – (c). It seems to me that this substantial success merits an award of costs in this Court which is to include the costs of two counsel.

1 The appeal is dismissed.

2 The cross-appeal succeeds to the extent set out in para [36] 1(a) – (c) above.

3 The appellant is to pay the respondent's costs of the appeal and the cross-appeal which include the costs of two counsel.

**J H CONRADIE**
**JUDGE OF APPEAL**

**CONCURRING:**
**SCOTT JA**
**MTHIYANE JA**
**HEHER JA**
**VAN HEERDEN AJA**