REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT MEGAWATT PARK)

CASE NO.: **25334**

(1)	REPORTABLE: ~~YES~~ / **NO**
(2)	OF INTEREST TO OTHER JUDGES: ~~YES~~ / **NO**
(3)	REVISED.
31 March 2023	**……**
DATE	SIGNATURE

In the matter between:

SSN TAXPAYER **APPELLANT**

and

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

J U D G M E N T

This judgment was prepared and authored by the Judge whose name is reflected and is handed down electronically by circulation to the Parties / their legal representatives by e-mail and by uploading it to the electronic file of this matter on CaseLines. The date of the judgment is deemed to be 31 March 2023.

MALINDI J:

Parties

[1] The appellant, SSN Taxpayer in the pleadings, is a corporate entity. It undertakes mining operations and its trade constitutes mining. Its operations are opencast mining for iron ore in the Northern Cape Province.

[2] The respondent is the Commissioner for the South African Revenue Service ("SARS"). It is a state entity, duly empowered to administer the Income Tax Act number 58 of 1962 and other related legislation.

[3] The parties are mainly referred to as SSN Taxpayer and SARS, respectively.

Introduction

[4] References to sections 36(1)(*e*), 36(11)(*a*), 11(*a*), 15, 11(*c*) and 11(*e*) are to the Income Tax Act, 58 of 1962. Safety Act is the Mine Health and Safety Act, 29 of 1996. MPRD Act or "the Act" is to the Mineral and Petroleum Resources Development Act, 28 of 2002. TAA to the Tax Administration Act, 28 of 2011.

[5] On 29 June 2018, the respondent issued its finalisation of audit for the tax years 2012, 2013 and 2014. It imposed certain amounts for 2012 as an understatement penalty, disallowed an amount under section 11(*a*) and section 36 and another amount for legal costs under section 11(*a*) and section 36. Further amounts were disallowed for the tax years 2013 and 2014 as not deductible under section 11(*a*) and section 36. The letter of findings of 26 August 2016 preceded the letter of assessment.

[6] On 16 October 2018, the appellant issued an objection to the additional assessments for 2012, 2013 and 2014.

[7] On 11 December 2018, the respondent issued its notice of disallowance of objection, that is, its rejection of the appellant's objection. The basis of disallowance was set out and the appellant was advised that it may appeal against the assessment.

[8] The appellant filed its notice of appeal within the prescribed period on 21 February 2019. These proceedings follow upon the notice of appeal.

Background facts

[9] SSN Taxpayer relies on the grounds and facts set out in its response to SARS's statement of grounds of assessment.

[10] The material facts are largely common cause between the parties. SARS does not dispute that SSN Taxpayer conducts opencast mining processes, which entail waste stripping. That is the removal of everything that would hamper safely accessing iron ore; such as surface vegetation, surface impediments, topsoil and waste materials (known as overburden) under which the iron ore body lies. These operations were conducted in compliance with SSN Taxpayer's obligations in terms of its approved Mining Work Programme ("MWP") which forms part of its mining right granted by the Minister of Minerals and Energy.

[11] SARS has set out the issues in dispute in its rule 31 statement as follows:

> "3. The tax appeal relates to the 2012, 2013 and 2014 tax years. In the said tax years, SARS raised additional assessments (the assessments) against SSN Taxpayer pursuant s92 read with s96 of the TAA. In terms of the assessments, the following adjustments were made: (i) SSNW Expenditure (costs related to the demolition, removal and the subsequent reconstruction of Third-Party Infrastructure) was disallowed as a deduction (ii) the "Town B Relocation Expenditure" (costs related to the resettlement of the Town B community, including the reconstruction of Third-Party Infrastructure) was also disallowed as a deduction. Legal expenditure related to the resettlement of the Town B community was also disallowed. All the items of expenditure were disallowed, firstly in terms of the special provisions of the ITA (s15(*a*) read with 36(11)(*e*) of the ITA. Secondly, the said expenditure items were also disallowed pursuant the general deduction formula (s11(*a*) of the ITA).
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> 4. In the context of the above summary, the following issues are in dispute:
>
> 4.1. Whether it was permissible for SSN Taxpayer, both in respect of the SSNW Project/Town B Project, to claim reconstruction costs related to Third-Party Infrastructure in terms of s15(*a*) read with s36(11)(*e*)(*a*) of the ITA.
>
> 4.2. Alternatively, in the event of SSN Taxpayer not succeeding to claim such expenditure under s36(11)(*e*), whether it was permissible for SSN Taxpayer to claim such expenditure in terms of the general deduction formula (s11(*a*) read with s23(*g*) of the ITA)?
>
> 4.3 Whether it was permissible for SSN Taxpayer to claim relocation costs of the 66KV electricity line in terms of s36(11)(*a*) of the ITA, alternatively, if such expenditure is not deductible under s36(11)(*a*), whether such expenditure is deductible under s11(*a*) of the ITA.

4.4 Further and alternatively, in the event of SSN Taxpayer not succeeding in claiming the said expenditure under either s36(11)(*a*) or s11(*a*), whether it would be allowed to claim under s11(*e*) of the ITA?

4.5 Whether the Appellant should be allowed a deduction of legal costs related to the relocation of the Town B community?

4.6 Whether SARS was correct to impose USP at 50% pursuant ss222 & 223 of the TAA relying on the behavioural conduct referred to as "No reasonable Grounds for the tax position taken — Standard Case" in respect of various understatement instances?

4.7 Whether SARS correctly levied s187(1) interest in respect of USP imposed?

4.8 Whether SARS was correct to levy s89*quat*(2) interest?"

[12] That the property referred to in the table under paragraph 16 of the rule 31 statement belonged to SSN Taxpayer was resolved by an order dismissing SARS's application to amend paragraphs 4.1, 7.1, 7.2.4 and 7.2.5 and of its statement to the effect of excluding ownership or mining rights over certain of the infrastructure set out in the table. Whether SSN Taxpayer could mine where this Third-Party Infrastructure lay depends on what the mining right, read with MWP provides.

[13] As stated above, the material background facts are not in dispute and are extracted from SSN Taxpayer's rule 32 statement as follows:

"8 SSN Taxpayer embarked on the SSN Taxpayer Western Expansion Project (which is also referred to as "**SSNW**") and the Town B Relocation Project (which are collectively referred to as "**the Relocation Project**") and has incurred expenditure in this regard. It did so as part of the expansion of the mine pit, in compliance with SSN Taxpayer's obligations in terms of its approved Mining Work Programme.

9 Similar expenditure would continue to be incurred by SSN Taxpayer in the years to come as per the schedules and forecasts of the planning and major development phases of the mine in the approved Mining Work Programme. Such expenditure was therefore incurred and will be incurred on an ongoing basis throughout the life of the mine.

10 The Relocation Project involved the relocation of certain infrastructure and included existing roads, railways, electricity and water infrastructure, and a residential area (Town B). Unless relocated, these items would have prevented the expansion of the mine pit to the south, west and north-west sides of the property on which the SSN Taxpayer Mine was located.

11 Paragraph 11 of SSN Taxpayer's Converted Mining Right, read together with section 54 of the Mineral Act, obliged SSN Taxpayer to compensate third parties who suffered any damage or losses, including but not limited to damage to the surface and to any improvements which third parties may suffer as a result of, or arising from or in connection with the exercise of SSN Taxpayer's mining right and mining operations. SSN Taxpayer fulfilled its obligation to compensate the third parties by relocating the affected infrastructure at SSN Taxpayer's cost. This allowed SSN Taxpayer to continue its mining operations in accordance with its mining right.

12 The Compensation relative to the overall cost of operating the SSN Taxpayer Mine was insignificant.

13 For the most part, the Third-Party Infrastructure was located on land in respect of which SSN Taxpayer held an existing mining right. The Third-Party Infrastructure in respect of which this was not the position was located:

13.1 in the Town B township; and

13.2 on the land referred to as "the Railway Properties", as described below."

Evidence

[14] The SSN Taxpayer Mine is located in the Northern Cape. The closest towns to the SSN Taxpayer Mine are Town A and Town B. Town A is situated approximately 8 to 20km east of the mine while Town B is 600m due west of the southern part of the pit.

[15] SSN Taxpayer undertakes mining operations and its trade constitutes mining. It operates the mine, which is an open-cast mine for iron ore. The open-cast mining process entails, as a first step, waste stripping which is the removal of everything that would hamper safely accessing iron ore, such as surface vegetation, surface impediments, topsoil and waste materials (known as "overburden") under which the iron-ore lies.

[16] Once the application for a mining right is granted, the MWP forms part of the mining right and the mining right holder is obliged to comply with it.

[17] The precise locations where SSN Taxpayer begins to mine within the mining area are determined by what would be most efficient and economical, having regard to the various inputs and factors referred to above.

[18] We refer to the two projects carried out by SSN Taxpayer as "the Relocation Project", although there were two projects individually known as:

18.1. "the SSN Taxpayer Western Expansion Project" (which is also referred to as "SSNW"); and

18.2. "the Town B Relocation Project".

[19] The Relocation Project involved the relocation of certain infrastructure and included existing roads, railways, electricity and water infrastructure, and a residential area known as Town B. Unless relocated, these items would have prevented the expansion of the mine pit to the west of the property on which the SSN Taxpayer Mine was located.

[20] The expenditure in issue constituted Compensation for losses and damages which third parties suffered to the surface and improvements as a result of, or arising from or in connection with the exercise of SSN Taxpayer's mining right and mining operations i.e. as a result of the expansion of SSN Taxpayer's mine pit and its mining operations.

[21] SSN Taxpayer fulfilled its obligation to compensate the third parties by relocating the affected infrastructure at its own cost. This allowed SSN Taxpayer to continue expanding its mine pit and continue its mining operations in accordance with its mining right.

[22] Prior to the Relocation Project, the Third-Party Infrastructure was located on land in respect of which SSN Taxpayer held an existing mining right, or was located in a position which hampered SSN Taxpayer's mining operations. In the case of the Third-Party Infrastructure located:

22.1. in the Town B township, this prevented the mining of the buffer zone; and

22.2. on the narrow strip of land referred to as "the Railway Properties", this prevented the expansion of the pit westwards.

[23] The bulk of the SSNW infrastructure was located on the Railway Properties. This runs approximately 10km in length and is approximately 30 meters wide. The Railway Properties ran through the SSN Taxpayer property (with the SSN Taxpayer Mine Pit originally located to the east of the Transnet railway line).

[24] SSN Taxpayer entered into agreements with the relevant authorities, including Eskom, Sedibeng Water, Northern Cape Province, the EFG municipality and the former residents of Town B. The agreements governed the relocation and compensation payable, and did not give SSN Taxpayer rights to use the Third-Party Infrastructure for its mining operations. The relocated assets were not part of the mining plant belonging to or controlled by SSN Taxpayer.

[25] Had SSN Taxpayer not entered into agreements with the relevant third parties for the removal of their infrastructure and the reconstruction thereof, it would not have been able to continue with its mining operations.

The Town B township and buffer zone

[26] The Town B township was located adjacent to the boundary of the mining right area.

[27] In terms of the Safety Act, SSN Taxpayer was required to maintain a 500m buffer zone between the mine pit and the Town B residential area.

[28] As the mine pit progressed, the 500m buffer zone moved correspondingly.

[29] SSN Taxpayer acquired the Town B property and undertook the Town B Relocation Project so that it could undertake mining operations up to the boundary of its mining right area, and therefore into the original 500 metre buffer zone adjacent to the Town B township boundary. This was in accordance with its approved Mining Work Programme and within the parameters of the Safety Act.

29.1. SSN Taxpayer acquired Town B in order to cut away the slope to form the required angle which enabled access to the iron ore in the buffer zone.

29.2. The relocation of Town B allowed SSN Taxpayer access to iron ore otherwise sterilised by the 500m buffer zone.

29.3. The primary purpose of acquiring the Town B property was to enable SSN Taxpayer to mine the buffer zone by means of extending the existing mine pit. It was not to mine the Town B property *per se*.

[30] In terms of the agreements with the property owners, SSN Taxpayer acquired the properties and in exchange, the Town B property owners obtained a similar-sized property in Town A, in the suburb of Suburb SS, or in a few exceptional cases, elsewhere in accordance with the owner's choice, registered in their names and with similar infrastructure reconstructed there. It was a requirement imposed by the Northern Cape provincial government that the Town B residents be given a substitute property and not a cash settlement.

[31] In order to compensate the owners of the Town B properties:

31.1. SSN Taxpayer constructed new infrastructure for the Town B residents on property owned by SSN Taxpayer in Town A;

31.2. SSN Taxpayer exchanged the properties in Town B for the newly developed properties in Town A;

31.3. Ownership of the Town A properties was transferred to the private owners as well as to institutional owners.

[32] In total 155.8Mt was the potential ore body for the entire area (being the pink, green and orange shaded areas), but due to the requirement of the buffer zone, the ore in these areas was not accessible. 102.5Mt of ore was available in the buffer zone alone and a further 46.3Mt in the green shaded area and a further 7Mt in the orange shaded area.

[33] The approval from Company Z and Company X for the relocation of Town B was based on the ore SSN Taxpayer could access within its mining right, which was the 102.5Mt in the pink shaded area. The value of the 102.5Mt was considered against the cost of relocating Town B.

[34] The value of the ore in the base case was in the order of USD12 billion (USD120 per ton x 102.5Mt). The nett present value (NPV) of the Town B Relocation Project was R7.9 billion (only for 102.5Mt) and the cost of the Town B Relocation Project was R4.2 billion. The benefit from relocating Town B was twice as much as the cost of the relocation. This was the justification for the relocation of Town B.

[35] In summary, in order to gain access to the 102.5 Mt, the Town B residents and all the infrastructure on the Town B properties were required to be relocated. The Town B residents would otherwise be exposed to safety and health risks, including rock falls and dust from blasting, unacceptably poor air quality and noise pollution. The Town B Relocation Project added a further 15Mt per year between 2017 and 2023.

[36] It takes approximately two to three years from the start of a mining phase until SSN Taxpayer reaches the ore but this is dependent on various factors including the depth of the ore and the equipment that is available.

[37] A shovel bucket holds 100 tons of material. A haul truck carries 300 tons. The trailing cable provides electricity to the shovel. It operates in a similar way to any electrical appliance with a cable and plug. The trailing cable lies flat on the ground inside the mine. When it exits the mine, it connects to the fixed portion of the electrical cable.

[38] Poles forming part of the fixed electrical 66KV line, which carry the electricity cables into the pit for the electric shovels, are necessary to keep the plant safe as the load trucks pass under the cabling which is at a safe height.

[39] The railway line that was relocated by SSN Taxpayer was on the western side of the pit, between the current pit (black lines) and the waste dumps (green rectangular blocks). It was situated between Town B and the pit at the time. The railway line therefore impeded the pit expansion to the west.

[40] All mining operations only take place on property over which SSN Taxpayer has a mining right.

[41] It was not possible for the infrastructure to remain in their old positions (as depicted in the left-hand side image) and for SSN Taxpayer to continue its mining operations for three primary reasons:

41.1. There are operational complexities that come with synchronising SSN Taxpayer's mining operations with Transnet's train schedule so that SSN Taxpayer is only blasting when a train is not passing and when the railway line can be crossed safely. SSN Taxpayer would also have to check the railway line after every blast to ensure it has not been damaged. This would cause significant operational constraints that would have prevented SSN Taxpayer from mining optimally.

[42] Town B and the buffer zone intersected with three mining phases, namely those labelled 12, 13 and 14. These phases have a relatively low stripping ratio in comparison with other phases. The relocation of Town B constitutes the removal of overburden as Town B needed to be relocated in order to gain access to the ore in the buffer zone. As such, the area sought to be mined was effectively burdened with a higher stripping ratio than what it would otherwise have had (to account for the additional costs to relocate Town B).

[43] The requirement of the 500m buffer zone is set out in the regulations to the Safety Act. It prohibits blasting activities within 500m of any public infrastructure.

[44] On each occasion that the mine pit is progressed, waste stripping occurs and any overburden i.e. anything which impedes access to the ore, must be removed. This is an ongoing and continuous process which is fundamental to the mining method of opencast mining.

[45] The mining area is the area or properties where SSN Taxpayer has a right to mine in accordance with the definition of 'mining area' in the Mineral Act read with SSN Taxpayer's mining right - which incorporates the Mining Work Programme. The mine pit is located within the demarcated mining area. It is expanded through the various development phases of the mine, but it remains within SSN Taxpayer's defined mining area in compliance with SSN Taxpayer's Converted Mining Right and Mining Work Programme. The mining area was only increased when SSN Taxpayer acquired the mining rights over Town B, which took place after the Relevant Years in dispute.

[46] Exhibits 7 to 10 were included in the Mining Work Programme in order to clearly illustrate how SSN Taxpayer intended to develop the mine and how the mine pit would be progressed in future based on the underlying premise that SSN Taxpayer had to optimally mine the iron ore reserve. The exhibits illustrate that the relocation of Town B and the Third-Party Infrastructure was necessary for the westward expansion of the pit.

[47] The primary purpose of SSNW was to enable SSN Taxpayer to continue with the expansion of the mine pit in a westerly direction on property owned by SSN Taxpayer and included in a mining right already held by SSN Taxpayer. Thus the relocation of the Transnet railway line constituted the removal of overburden. The relocation of the railway line was also necessary to enable SSN Taxpayer to dump the waste material to the west of the railway line.

[48] As a result of the Compensation for Third-Party Infrastructure (including the relocation of Town B):

48.1. The amenities of the third parties essentially remained the same after the Relocation Project, but with the location thereof having changed in order that SSN Taxpayer could carry on its mining operations and exploit its mining right.

48.2. The owners of the Third-Party Infrastructure gave up their existing rights – which were replaced by rights to other land and/or infrastructure – so that SSN Taxpayer was not prevented from extending the mine pit, including into the former buffer zone – as it was obliged to do in terms of its approved Mining Work Programme.

[49] If SSN Taxpayer had not relocated the Third-Party Infrastructure, it would not have been able to mine across the properties on which the Third-Party Infrastructure was located, as required by the approved Mining Work Programme and which formed part of the mining area.

[50] We refer to the summary of the evidence regarding the graphs in exhibits 5 and 6. If SSN Taxpayer had not relocated both SSNW and Town B, a reduction in output by 2018 to as low as 15Mt would have been the outcome, which would more than halved the output of the mine. SSN Taxpayer would not have been able to execute its undertaking to adhere to the Mining Work Programme, including to exploit the ore reserve optimally. The purpose of the relocation was thus in order to maintain productivity and sales volumes.

The 66Kv line

[51] The mining operations carried on at the SSN Taxpayer Mine are extensive and SSN Taxpayer makes use of a large fleet of conventional open-pit mining equipment comprising of inter alia electrical blast hole drilling rigs and electric face shovels. This equipment is powered using electricity supplied by the 66KV line.

[52] The 66KV line is a tangible asset forming part of the apparatus or plant belonging to SSN Taxpayer and which was necessary to carry on its open-cast mining operations. It forms part of SSN Taxpayer's electrification system. Masts and pylons are a permanent supporting

structure that is erected in the mining area with the 66KV lines suspended therefrom (there are many such electrification line although only one was relocated).

[53] The purpose of the 66KV line is to connect the SSN Taxpayer Mine with the main power supply from the service provider, Eskom. The 66KV line is used to continue distributing power into the SSN Taxpayer Mine from the point where Eskom's supply terminates. The 66KV line therefore ensures that the power supply from Eskom reaches the mine pit in order to power the electrical equipment in the pit.

[54] At each stage where there is a transfer of electricity and regulation of the voltage, there is a transformer and a substation. Thus, the point at which the power supply is transferred from Eskom to SSN Taxpayer's 66KV line, there is a transformer and substation and again where the voltage is stepped down from the 66KV line in order for a trailing cable from the mine pit to be plugged in and power the equipment in the pit which require a lower voltage.

[55] The relocation of the 66KV line was for the purpose of enabling SSN Taxpayer to operate its electrical mine equipment as the mine pit progressed. The 66KV line was moved 2km to the west as the mine pit progressed and as the need to operate mine equipment in different locations in the mine pit changed, in accordance with SSN Taxpayer's approved Mining Work Programme.

[56] Moving the 66KV line as the mine pit progressed and as the need arose was part of SSN Taxpayer's ordinary mining operations, and the time and cost implications for SSN Taxpayer were relatively insignificant in relation to SSN Taxpayer's operations.

[57] During 2012, the construction of the fixed portion of the 66KV line involved erecting pylons. The fixed portion of the 66KV line was constructed for safety reasons. It was specifically designed for the electrifying line and could not be used for anything else.

[58] The process by which the movable portion 66KV line was relocated and the new fixed portion 66KV line was constructed entailed the old line and masts being dismantled, and that part of the equipment as could be reused, being reinstalled, together with some new parts, in the new location.

The parties' contentions

[59] SARS contends as follows:

> "7 In so far as it relates to the SSNW Project, SARS distinguishes between "The Railway Properties" (Transnet Properties) and "Third-Party Infrastructure" located on "Other Properties". The issue of mining rights in respect of the above is dealt with hereunder under paragraphs 26 – 35 below.

8 Issues pertaining to sections 187(1), 222 of the TAA and section 89 quat (2) interest of the ITA, to the extent that their imposition on SSN Taxpayer's taxable income is dependent on findings to be made in respect of the principal issues (Third-Party Infrastructure/Town B Issue and the 66KV Electricity Line), their treatment will be pursued under the rubric that deals with the "Applicable Legislative Framework and Submissions In Respect Thereof".

9 The facts giving rise to the dispute are in large part common cause, save that the construction placed on the same set of facts leads to different findings/conclusions by both parties. The only stand out factual issue relates to whether SSN Taxpayer had mining rights in respect of those areas where Third-Party Infrastructure was located and subsequently relocated elsewhere. SARS contends that SSN Taxpayer had no mining rights in respect of those areas where Third-Party Infrastructure was located.

10 SARS contends that the so called relocation costs incurred by SSN Taxpayer in respect of the Transnet Properties for the 2012, 2013 and part of 2014, Other Third-Party Infrastructure and the Town B Community, were not incurred pursuant s36(11)(e) of the ITA as such expenses were not incurred "… in terms of a mining right…". SSN Taxpayer argues the converse.

11 SARS further contends that the incurral of the said disputed CAPEX (Capital Expenditure) was "not in terms of a mining right" as SSN Taxpayer did not have mining rights in respect of the properties in contention (Transnet Properties/Other Properties where "Third-Party Infrastructure" was located and the Town B Property where the Town B community resided.

12 In respect of the 66Kv Electricity Line, SARS contends that the 66Kv Electricity line is part and parcel of SSN Taxpayer's electrical infrastructure, as such electrification system was used as part of SSN Taxpayer's infrastructural edifice to conduct its vast mining operations in respect of those areas where it held mining rights. SSN Taxpayer contends that the said item constitutes equipment and consequently, qualifies as a deduction under s36(11)(*a*) read with s15(*a*) of the ITA.

13 In the alternative, SSN Taxpayer contends that if the 66Kv line is not deductible in terms of s36(11)(a), then it is deductible in terms of s11(*a*) of the ITA (General Deduction Formula). This, according to SSN Taxpayer, will hold as the expenditure was closely linked to and incurred for the purpose of conducting its income earning operations and formed part of the cost of its income earning operations.

14 Further and alternatively, if SSN Taxpayer fails on either of the said two grounds, then depreciation allowances should be granted pursuant s11(e)5 of the ITA. SSN Taxpayer does not however specify in what manner the 66kv line accords with the requirements of the said s11(*e*).

15 In respect of legal costs incurred by SSN Taxpayer when relocating the Town B community, SARS contends that such legal costs were capital in nature and therefore not deductible pursuant the general deduction formula. The reasoning behind that

finding is anchored in the view that undertaking a capital project of that magnitude, entailing the relocation of a community in order to expand the mining area is capital in nature and therefore not deductible in terms of s11(*a*) of the ITA.

…

17. It is contended by the Respondent that the issues for determination are to a lesser degree factual, and to a greater degree, a matter of legal interpretation flowing from established facts. To succeed, the Appellant has to persuade the court that (i) it had mining rights in respect of those areas where expenditure was incurred as part of the relocation project (ii) that it had mining rights in respect of those areas where reconstruction of Third-Party Infrastructure/Town B Community occurred and (iii) that all such activities constituted the conducting of mining operations in terms of a mining right. (iv) that its interpretation of the relevant provisions is more probable than that of the Respondent pursuant s102 of the TAA.

18 In order to succeed, the Respondent has to successfully show the court that the expenditure incurred was not incurred in terms of a mining right as SSN Taxpayer had no mining rights in respect of those areas where activity giving rise to the expenditure occurred. The "in terms of a mining right" requirement is the core of the case and constitutes the axis around which everything pivots."

[60] SSN Taxpayer, on the other hand, contends that:

"36. The Relocation Project and consequent Compensation for Third-Party Infrastructure, including the Town B relocation expenditure, were specifically addressed, scheduled and the costs forecasted as part of the planning and major development phases of the mine.

37. The approved Mining Work Programme forms part of the mining right.

38. The approved Mining Work Programme includes the obligation to extract the proven and probable iron ore reserves during development phases over a 30-year period.

39. The approved Mining Work Programme:

39.1 specifically states that in order to extract the proven and probable iron ore reserves, "the mine will enter a number of specific development phases during the next 25 years" and made provision for the initiation of the Relocation Project at an early stage;

39.2 obliged SSN Taxpayer to undertake mining activities across the railway strip of land over which a portion of Transnet's HP railway line was located and also over the other areas where the Third-Party Infrastructure was located;

39.3 provides for mining within the buffer zone.

…

40.2 Unless the Third-Party Infrastructure was relocated, SSN Taxpayer would not have been able to execute its undertaking to adhere to the Mining Work Programme, including to exploit the ore reserve optimally.

…

55. The purpose of the relocation of the Third-Party Infrastructure and the Town B Relocation Project was to ensure efficient and optimal mining over the mining area in respect of which SSN Taxpayer holds a mining right. This is expressly required by SSN Taxpayer's mining right which also incorporates its Mining Work Programme."

[61] SSN Taxpayer contends in brief for the deductibility under section 36(11)(*e*), alternatively section 11(*a*) of Third-Party Infrastructure since the project was "in terms of a mining right" and the expenditure was in respect of *"infrastructure"* as contemplated in section 36(11)(*e*). Alternatively, that the expenditure was linked to its income earning operations in terms of section 11(*a*)

Discussion

[62] The main pillar of SARS's argument is that everything that SSN Taxpayer did was not done in terms of a mining right, partly because it had no mining right ever, particularly Town B and Town A areas, and that the right over the buffer zone and under the Third-Party Infrastructure was sterilised.

[63] As to SSN Taxpayer's main claim under section 36(11)(*e*), SARS contends that the expenditure for the infrastructure had to be on SSN Taxpayer's own infrastructure, not of third parties, and in relation to claims under section 11(*a*) or section 11(*e*) claims for revenue generating expenditure has to meet the *"in terms of a mining right"* criterion.

[64] In respect of the 66Kv line claim SARS contends that it was part of SSN Taxpayer's infrastructure and can therefore not be claimed as expenditure under section 36(11)(*a*), section 11(*a*) or section 11(*e*).

[65] In order to give a proper characterisation of the SSNW project, including the relocation of Town B it is necessary to establish whether everything was done *"in terms of a mining right"* read with SSN Taxpayer's MWP.

[66] SSN Taxpayer's mining right is held in terms of item 7 of Schedule II of the MPRD Act and was awarded on 11 November 2009. Annexure C3 thereto sets out the mining area over which the right attaches. Section 2 of the Conversion Act grants SSN Taxpayer "the sole and exclusive right to mine, and recover the minerals in, on and under the mining area …". The right is for a period of 30 years ending 10 November 2039.

[67] On 28 February 2014 the right was amended to the effect of including 104, 2281 hectares of portions of ACA 468, EFG 541 and SSN Taxpayer 543, together referred to as "the Railway Properties".

[68] In terms of section 23(1)(*a*) of the MPRD Act a mining right may be granted by the Minister of Mineral and Energy if "the mineral can be mined optimally in accordance with the mining work programme". Section 25(2)(*c*) provides similarly. A mining right is granted on the basis and strength of a MWP presented at the time of application for the right. The definition of MWP in the Act is:

> "the planned mining work programme to be followed in order to mine a mineral resource optimally."

[69] The MWP will elucidate what the Minister permitted when granting the right to its holder. In order for a holder to mine, i.e. to conduct "any operation or activity incidental thereto …", its mining operation, i.e. "any operation relating to the act of mining and matters directly incidental thereto" would be set out in the MWP. The MWP provided for the Town B relocation, and Third-Party Infrastructure compensation. It specifies as follows:

> "39. The approved Mining Work Programme:
>
> 39.1 specifically states that in order to extract the proven and probable iron ore reserves, "the mine will enter a number of specific development phases during the next 25 years" and made provision for the initiation of the Relocation Project at an early stage;
>
> 39.2 obliged SSN Taxpayer to undertake mining activities across the railway strip of land over which a portion of Transnet's HP railway line was located and also over the other areas where the Third-Party Infrastructure was located;
>
> 39.3 provides for mining within the buffer zone."

[70] SARS's case is that the SSNW project, including the relocation of Town B, were not costs incurred "in terms of a mining right" and therefore do not qualify for deduction in terms of section 36(11)(*e*), as SSN Taxpayer did not have a mining right in respect of the Transnet Properties and other properties where Third-Party Infrastructure was located and over Town B property.

[71] In respect of the 66Kv electricity line SARS contends that it is part and parcel of SSN Taxpayer's electrical infrastructure edifice and is therefore not deductible under section 36(11)(*a*), or section 11(*a*), or section 11(*e*).

[72] It is common cause that:

72.1. SSN Taxpayer had no mining right over Town B area, nor over Town A township where the community of Town B was relocated to. The question is whether the relocation was "directly incidental" to SSN Taxpayer's "act of mining", and in terms of a mining right.

72.2. SSN Taxpayer had no mining right in respect of the Railway Properties during the relevant tax years.

72.3. The mining right in respect of the buffer zone (the 500m buffer area between Town B and mining operations) could not be exercised and therefore sterilised as dictated by the Safety Act.

72.4. Under the table setting out Third-Party Infrastructure relocation expenditure (036-66), ownership of such infrastructure is also identified.

[73] SSN Taxpayer's submissions are that the Income Tax Act, 58 of 1962 (ITA), allows the deductions that SARS has objected to. It submits that in addition to the relevant definitions in the MPRD Act, the ITA 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".

[74] Whereas the MWP sets out all that SSN Taxpayer will do in order to mine the mineral optimally over the period of 30 years the question is whether all that would be done in terms of the MWP is, or would be methods or processes by which a mineral is won from the soil. SARS says all the claimed deductions were not incurred in terms of the exercise of a mining right as such expenses were not or did not constitute methods or processes through which a mineral is won from the soil. SSN Taxpayer contends for the opposite.

[75] A "mining area" is, "in relation to a mining right … the area on which the extraction of any mineral has been authorised and for which that right or permit is granted". The right to extract any mineral is granted in terms of section 23(1) which stipulates conditions for the grant of the right within the "mining area".

[76] It is SSN Taxpayer's contention that all that it did in respect of the SSNW project and relocation and resettlement of Town B was in compliance with various legislative obligations and as approved in the MWP.

[77] It now remains to be determined whether the SSNW project and the removal relocation of Town B formed part of conducting "mining operations" as envisaged by the ITA.

[78] The purpose of SSNW and relocation of Town B was to make available the mining area which was inaccessible as a result of the buffer zone and Third-Party Infrastructure that had sterilised the minerals therein or thereunder whereas the undertakings in the MWP were that the whole mining right area would be mined in order to achieve optimal extraction of the mineral.

[79] Section 47 imposes a sanction of either cancellation or suspension of the mining right if SSN Taxpayer, *inter alia*:

79.1. failed to honour or carry out any agreement, arrangement, or undertaking on which the Minister relied for the conversion of SSN Taxpayer's old order mining right to the Converted Mining Right;

79.2. breached any material term and condition of the Converted Mining Right;

79.3. conducted mining operations in contravention of the provisions of the Mineral Act.

Section 36(11)(*e*) claim

[80] SSN Taxpayer's contention is that the compensatory expenditure incurred in respect of the relocation of the Third-Party Infrastructure and the Town B project is in line with section 54 of the MPRD Act and is also part of the usual operating costs incurred in opencast mining which involves the removal of overburden on the mining area. Overburden is the impediment to reaching the mineral such as rock, soil layer, vegetation or similar matter. SARS concedes that SSN Taxpayer was obliged to pay compensation to the third parties.

[81] SSN Taxpayer contests for a broad interpretation of the words "infrastructure" in section 36(11)(*e*) and "every method or process" to encompass the relocation of the Third-Party Infrastructure and removal and relocation of Town B. SARS contests for a narrow interpretation.

[82] In respect of whether the expenses fall under section 36(11)(*e*) the starting point is the common cause fact that SSNW properties and Town B area were infrastructure in the hands of those third parties. 66Kv electricity line will be considered separately. The question is whether to treat these properties as infrastructure as envisaged under section 36(11)(*e*). SSN Taxpayer submits that this is so despite having merely compensated the third parties for the relocation of the infrastructure instead of *"acquiring"* the infrastructure for itself. SSN Taxpayer seeks deductions as part of its capital expenditure, alternatively, revenue generating expenditure or production of income.

[83] SSN Taxpayer submits that the Third-Party Infrastructure should be treated as "the special capital deduction … applicable to taxpayers who conduct mining operations … premised on important policy considerations". This interpretation is to the effect that the expenses incurred by a taxpayer who conducts mining operations in respect of *"infrastructure"* which does not belong to it nevertheless qualifies for deduction in terms of section 36(11)(e), alternatively section 11(*a*) because the infrastructure is being used in its mining operations in the sense that its operations would not proceed or succeed without having conducted the relocations.

[84] SSN Taxpayer submits in paragraph 68.5 of its heads of argument that "[t]he expenditure was not incurred for purposes of acquiring infrastructure. The benefit was to continue mining operations". The question as asked by SARS is whether this falls within the definition of "in terms of mining right".

[85] Both parties invoke *Natal Joint Municipal Pension Fund v Endumeni Municipality*[1] for the approach to be applied in interpreting section 36(11)(*e*).

[86] Section 15(*a*) provides for the deductions from income derived from mining operations and provides for the utilisation of section 36(11)(*e*). Section 36(11)(*e*) defines "capital expenditure in connection with mining operations" as "… any expenditure incurred in terms of a mining right …".

[87] SARS submits that because the section 36(11)(*e*) benefit is specific to mining operations it must be interpreted strictly. Reliance for the submission is based on *Western Platinum v CSARS*[2] which states that in respect of the allowance to deduct certain categories of capital expenditure from income derived from mining operations a strict construction of the empowering legislation must be adopted. It states that that is the golden rule to be followed.

[88] The question is whether *Endumeni* loosens this strict interpretation extolled by *Western Platinum*. Section 36(11)(*e*) refers to "mining right". If a strict interpretation is adopted then SSN Taxpayer has to prove that the expenditure were in terms of a mining right.

[89] *Endumeni* and *Bothma-Batho Transport*[3] have introduced a unitary process of interpretation which must take into consideration "the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production" in order to arrive at an objective interpretation. Sight must not be lost that *Endumeni* refers to the

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1 *Natal Joint Municipalities v Endumeni Municipality* 2012 (4) SA 593 (SCA).
2 *Western Platinum v CSARS* Case No 294/03 (27 September 2004).
3 *Bothma-Batho Transport (Edms) Bpk v S Bothma & Seun Transport (Edms) Bpk* 2014 (2) SA 494 (SCA).

inevitable point of departure being "the language of the provision itself, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document".[4]

[90] As discussed above in relation to various definitions contained in the legislative framework the grant is in respect of a defined mining area, to mine it by extracting any mineral by employing a method or process by which the mineral is won from the soil. Since the Town B community was not within the mining area, the demolition thereof (if it has taken place) and relocation do not constitute employing a method or process of mining, the project was not in terms of exercising a mining right. As it is common cause that the Transnet Properties had not been transferred to SSN Taxpayer at the time of the relevant tax periods, what was done in regard to them in terms of the SSNW project is not deductible expenditure. In respect of other properties the SSNW project does not constitute a method or process of extracting a mineral in the exercise of a mining right. I find therefore that the Town B relocation and SSNW project were not matters directly incidental or sufficiently closely connected to the mining operations relating to the act of mining. The expenditure was not in respect of SSN Taxpayer's own infrastructure and therefore not as envisaged in section 36(1)(*e*).

[91] The interpretation contended for by SSN Taxpayer is not sustainable. It means that a taxpayer who is conducting mining operations can gain from the benefit of a deduction when it utilises a Third-Party's Infrastructure. It contends at paragraph 67 of its heads of argument that:

> "From the above, it is clear that the special capital deduction provisions applicable to taxpayers who conduct mining operations are premised on important policy considerations. This purpose must bear some weight when interpretation the reference to "infrastructure". The purpose is served by interpreting the word "infrastructure" to be that used in the mining operations, not that purchased for third parties as compensation for their damaged or lost infrastructure. The latter interpretation would frustrate the purpose of the provisions."

[92] Compensating third parties for their infrastructure which SSN Taxpayer had to remove or relocate in order to conduct its own operations is not tantamount to expending on its own infrastructure. The Third-Party Infrastructure was not being used in its own operations and therefore is not infrastructure contemplated in section 36(11)(*e*). The expenditure was not incurred for purposes of acquiring infrastructure for SSN Taxpayer's use but for enabling its mining operations by removing obstacles in the way.

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4 At [18] – [19].

[93] It is further contended that in order to avoid damages against Third-Party Infrastructure, or avoid paying such damages after the damage was caused, SSN Taxpayer complied with statutory obligations to compensate third parties. This would be deductible expenditure even though it is capital infrastructure payment for its own infrastructure.

[94] SSN Taxpayer has confirmed that its expenditure was capital expenditure in nature but not that it was in terms of exercising a mining right and that section 36(11)(*e*) should be broadly interpreted as to consider this as expenditure deductible from its revenue.

Alternative grounds

[95] In its contention that if the deduction is not permitted under section 36(11)(*e*) it must be permitted under section 11(*a*), SSN Taxpayer makes the following submission:

> "92. Indeed, the Compensation has all the hallmarks of expenditure of a revenue and not a capital nature, as:
>
> 92.1 the purpose is to benefit third parties rather than the taxpayer directly;
>
> 92.2 it results in no addition to the taxpayer's income-earning structure; and
>
> 92.3 it is required to carry on the income-earning operations in a lawful manner."

Claim under section 11(*a*)

[96] SSN Taxpayer submits, in brief, that everything done in terms of the MWP is sufficiently closely connected to its income producing operations[5] to qualify under "in terms of a mining right".

[97] Particular reliance is placed on *Commissioner for the South African Revenue Service v Mobile Telephone Networks Holdings (Pty) Ltd*[6] for the contention that statutorily imposed expenditure, such as by section 54 of the MPRD Act in this case, is deductible in the taxpayer's income-earning operations.[7]

[98] Our legislation requires that SSN Taxpayer's expenditure should have been in terms of exercising its mining right. In other words it must have been in the process of exercising its mining right. The narrow meaning of *"in terms of"* was endorsed in Brian Angus.[8]

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5 *SIR v Cadac Engineering Works (Pty) Ltd* [1965] 2 All SA 547 (A); *Port Elizabeth Electric Tramway Co Ltd v CIR* 1936 CPD 241 at 245, 8 SATC 13.

6 *Commissioner for the South African Revenue Service v Mobile Telephone Networks Holdings (Pty) Ltd* 2014 (5) SA 366 (SCA).

7 At [11].

8 *Registrar of Pension Funds National Union of Metal Workers of South Africa v Brian Angus NO and Others* [2007] ZASCA 48.

[99] As I have concluded above that SSN Taxpayer's expenditure was not in terms of exercising a mining right it is difficult to know how the alternative claim under section 11(*a*) would have been a revenue generating expense in respect of a mining activity in a mining area. The expense was in Town B and Town A and in compensating third parties for damages that could ensue if SSNW proceeded without relocating their infrastructure. The expenditure was not money used in the employ of a method or process to extract the income-earning ore from the soil. The alternative claim is unsustainable. There is no sufficiently close link to the act of producing income as envisaged in *Port Elizabeth Electric Tramway*. The statutory compliances, before, during or after operations have started are capital expenditures on behalf of third parties, not income generating.

66Kv Electric Line

[100] In respect of the 66Kv electric line it is submitted that it is mine equipment as contemplated in section 36(11)(*a*) and that therefore the expenditure in is respect is deductible under section 11(*a*) as it is not of a capital nature. Alternatively, that it qualifies for the depreciation allowance under section 11(*e*).

[101] The 66Kv line was equipment that attaches to an electric substation and could be moved to different parts of the mining area depending on the locations of the mining pits. Costs would be incurred each time the line was brought to the proximity of the point where ore was being extracted and moved away from the pit. This was activity closely linked to the employ of a method or process to extract a mineral in a mining area. This activity was part of SSN Taxpayer's income-earning activities.

[102] I conclude that the 66Kv electric line expenditure is deductible under section 11(*a*), read with section 36(11)(*a*). Dr Un's (SSN Taxpayer's witness) concession that the line is part of the infrastructure was not properly made.

Legal costs

[103] Having found that the removal and relocation of the Town B area is not deductible under section 36(11)(*e*) or section 11(*a*), the legal costs incurred in the process were also not incurred in terms of exercising a mining right as SSN Taxpayer had no mining right over Town B and Town A and the two areas were not within the mining area that SSN Taxpayer held a mining right over. The costs were not incurred "in the course of or by reason of the ordinary operations undertaken by the taxpayer in the carrying on of the taxpayer's trade" as contemplated in section 11(*c*).

Understatement penalties

[104] Section 221 of the Tax Administration Act defines *"understatement"* to mean:

> "any prejudice to SARS or the fiscus as a result of—
>
> (*a*) failure to submit a return required under a tax Act or by the Commissioner;
>
> (*b*) an omission from a return;
>
> (*c*) an incorrect statement in a return;
>
> (*d*) If no return is required, the failure to pay the correct amount of 'tax'; or
>
> (*e*) an 'impermissible avoidance arrangement'."

and section 222(1) provides as follows:

> "In the event of an "understatement" by a taxpayer, the taxpayer must pay, in addition to the "tax" payable for the relevant tax period, the understatement penalty determined under subsection (2) unless the 'understatement' results from a *bona fide* inadvertent error."

[105] SARS justifies imposing a 50% understatement penalty on the basis that SSN Taxpayer had no reasonable grounds to assume that the contested expenditure for the relevant tax years could be claimed as capital expenditure. Whether SSN Taxpayer could claim deductions for expenses incurred outside the mining area or where it had no mining rights became a hotly contested issue in this case. These expenses had been incurred in respect of discharging SSN Taxpayer's undertakings in the MWP. It was not unreasonable to take a tax position that such expenditure is deductible as capital expenditure under section 36(11)(*e*) or as capital expenditure under section 36(11)(*a*) or as revenue generating expenditure under section 11(*a*).

[106] The effect of the conclusions on the main issue is to the effect that SSN Taxpayer was liable for the deductions which it effected for the relevant years. However, as it was reasonable for it to assume that the tax was deductible on the merits of its contentions, and on the provisions of section 223(3) of the TAA. Section 223(3) provides for the remittal of such penalty if the position taken by the taxpayer was supported by an opinion obtained from an independent registered tax practitioner in the circumstances stated in para (b) thereof.

[107] In the circumstances I find that SSN Taxpayer did not understate its tax liabilities as contemplated in the TAA. Its omission from the return stands to be remitted in terms of section 223(3)(*b*) of the TAA.

Interest on understatement penalties

[108] In view of the conclusion that there was no understatement of SSN Taxpayer's tax liabilities the imposition of interest on understatement penalties in terms of section 187(*a*) of the TAA and in terms of section 89*quat*(2) of the ITA.

Costs

[109] SARS has substantially succeeded in this appeal and costs should follow the result. The issue of whether the penalties should have been pursued vigorously does to detract from applying the normal costs order.

Conclusion

[110] In the circumstances the following order is made:

1. The appeal is dismissed except in the following respects:

    1.1. The 66Kv Electric line expenditure is deductible.

    1.2. The understatement penalties and interest on the understatement penalties imposed by the respondent in terms of section 187(1) of the TAA and section 89*quat*(2) of the ITA, respectively, are set aside.

2. No order as to costs.

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G MALINDI

JUDGE OF TAX COURT

Coram:

Malindi J

S S Matlhoma Accountant member

N Mazubane Commercial member