

Reportable**IN THE TAX COURT
JOHANNESBURG****CASE NO: 12463
DATE: 10 Dec 2008**

In the appeal of:

X (PTY) LTD

Appellant

And

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

Respondent

J U D G M E N T

JOFFE J:

1. The appellant appeals against the inclusion of the amount of R 203,205,437.00 in the appellant's taxable income in respect of the year of assessment ended 30 June 1999. This inclusion, respondent contends, represents closing stock on hand as at 30 June 1999, as contemplated in section 22 read with the definition of "trading stock" in section 1 of the Income Tax Act, 58 of 1962 ("the act"). The amount itself is the accumulated costs incurred by appellant in terms of an agreement entered

into by appellant with Y Mining Company Limited (“YMC”) to dump phosphate-bearing ore, reduced by the costs relating to the usage by appellant of such dumps.

2. The respondent imposed interest on the amount referred to above in an amount of R51 170 908,00 in terms of section 89quat(2) of the act, such amount representing interest owing to respondent as a result of the alleged underpayment of provisional tax by appellant. The appellant appeals against the imposition of the interest as well.
3. The appellant objected to the foregoing inclusion and imposition. The objections were disallowed. The appellant then appealed to this court against the inclusion of the amount of R203 205 437,00 as trading stock on hand, as well as against respondent’s failure to exercise the discretion conferred in terms of section 89quat(3) of the act, by not remitting the interest charged in an amount of R51 170 908,00.
4. The appellant adduced the evidence of two witnesses, Mr M, a geologist and its acting mine manager, and Mr V, its then public officer. Other than as set out below it is not necessary to refer to their evidence in any detail.
5. The facts relevant to this appeal are not in dispute.
6. The appellant’s main business is mining, although it derives mining as well as non-mining income. The mining income relates to the mining of phosphates,

the most important mineral being apatite, a phosphorous mineral of which the phosphorous mineral content is expressed as percentage P_2O_5 . The appellant's non-mining income relates to its secondary business, namely the recovery and marketing of baddeleyite and the production of electrofused zirconia from zircon sand.

7. During 1952 the appellant acquired rights to mine base minerals, including phosphates, from the Transvaal Ore Company Limited and from Phalabora Phosphate and Vermiculite Company Limited over the farms Wegsteek 30 LE, Loole 31 LE and Laaste 24 LU, belonging to the State.
8. During 1963 YMC obtained the exclusive right to mine copper and other base minerals, except phosphorous minerals, over some of the areas in respect of which the appellant held its rights.
9. In order to utilise the full potential of the ore body, the appellant and YMC entered into the so-called Extension - 100F agreement, and the Ancillary agreement, on 8 October 1979.
10. Over the years certain amendments were effected to the original Extension - 100F agreement and to the Ancillary agreement, but the salient features of the agreements remained the same. The essence of the agreements was that instead of appellant extracting the phosphate-bearing ore from the earth itself YMC extracted the ore from the earth and appellant bore a portion of the mining costs incurred by YMC.

11. Approximately 183 million metric tonnes of ore consisting of phosphate-bearing rock were allocated and dumped by YMC for further mining by appellant. This occurred during the period 1979 - 1998/1999, when dumping ceased due to the open pit reaching its final economic limits. Upon separation from the earth by YMC, appellant, by operation of law, acquired ownership of the aforementioned phosphate-bearing ore.

12. Appellant mines the phosphates and other minerals from the ore in the following manner:
 - 12.1 The phosphate-bearing ore is loaded and hauled to a primary crusher and then conveyed to secondary and tertiary crushers for crushing;
 - 12.2 The crushed material is then conveyed to Rod and Ball Mills for milling to liberate the minerals from the rock;
 - 12.3 The pulp containing the materials is then pumped to a flotation plant where the minerals of economic importance are separated by means of three metallurgical separation processes, which is a froth flotation process, a magnetic concentration step and a gravity separation process. During the froth flotation process certain ingredients (reagents) are added to the froth. During this process the minerals that have been released stick to the bubbles. At the end of the process the reagents are removed.
 - 12.4 The final product from these separation steps are concentrates consisting of phosphates which are then dried, stockpiled and sold

to worldwide customers, which use the minerals mainly for the manufacture of fertilisers.

13. The phosphate-bearing ore delivered and allocated by YMC to appellant are not intended to be sold. In any event, nobody would buy the ore, firstly because there is no other miner for the minerals in South Africa, and, secondly, it would not be economically viable to export the ore to any foreign miner, should any exist.
14. The amount of R203 205 437,00 which respondent included in appellant's income as "trading stock", represents the accumulated costs incurred by appellant in terms of the Extension - 100F agreement to pile ore containing high levels of phosphate and low levels of copper, reduced by the costs relating to the usage of such dumps since dumping commenced.
15. The issue pertaining to whether the ore dumps constituted trading stock also arose in the 1991 and 1992 years of assessment. After submissions were made to respondent, respondent accepted that the dumps were not trading stock. Since then, and for more than 20 years, respondent assessed appellant on the basis that the phoscorite dumps did not constitute trading stock.
16. The relevant provisions of the act are those contained in section 22 of the act and the definition of "trading stock" as they read at the relevant time.

17. Section 22(1) and (2) of the act, at all relevant times, read as follows (as far as it is relevant for present purposes):

“(1) The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of such year of assessment, shall be -

(a) in the case of trading stock other than trading stock contemplated in paragraph (b), the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock, not being shares held by any company in any other company, has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason, satisfactory to the Commissioner:....”.

(2) The amount which shall in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming) be taken into account in respect of the value of any trading stock held and not disposed of by him at the beginning of any year of assessment, shall -

(a) if such trading stock formed part of the trading stock of such person at the end of the immediately preceding

year of assessment be the amount which was, in the determination of the taxable income of such person for such preceding year of assessment, taken into account in respect of the value of such trading stock at the end of such preceding year of assessment; or

- (b) if such trading stock did not form part of the trading stock of such person at the end of the immediately preceding year of assessment, be the cost price of such person of such trading stock”.*

Prior to being amended with effect from years of assessment ending on or after 1 January 2001, the definition of “trading stock” read as follows:

“Trading stock’ includes anything produced, manufactured, purchased or in any other manner acquired by a taxpayer for purposes of manufacture, sale or exchange by him or on his behalf, or the proceeds from the disposal of which forms or will form part of his gross income, or any consumable stores and spare parts acquired by him to be used or consumed in the course of his trade, but does not include a foreign currency option contract and a forward exchange contract as defined in section 24I(1);”.

18. The definition of “trading stock” can be divided into three parts namely:

- 18.1 The first part comprising anything produced, manufactured, purchased or in any other manner acquired by a taxpayer for the purpose of manufacture, sale or exchange by him or on his behalf; and

- 18.2 the second part comprising anything the proceeds from a disposal of which forms part or will form part of his gross income; and
 - 18.2 the third part comprising any consumable stores and spare parts acquired by him to be used or consumed in the course of his trade.
19. The parties are *ad idem* that the appeal does not relate to consumable stores and spare parts. They are further in agreement that the appellant acquired the phosphate-bearing ore, as contemplated in the first part of the definition and that appellant did not acquire the phosphate-bearing ore for the purposes of sale or exchange by appellant or on appellant's behalf, as contemplated in the first part of the definition.
20. What falls to be determined as far as trading stock is concerned, is whether:
- 20.1 the phosphate-bearing ore was acquired for the purpose of manufacture, as contemplated in the first part of the definition; or
 - 20.2 the proceeds from the disposal of the phosphate-bearing ore would have formed part of the Appellant's gross income, as contemplated in the second part of the definition.
21. In regard to the definition as a whole, it was held in *De Beers Holdings v Commissioner for Inland Revenue 1986 (1) SA 1 at 33 B - C* that the definition was intended to be exhaustive.

22. In regard to the purpose requirement contained in the first part of the definition, it was held in *Richards Bay Iron & Titanium (Pty) Ltd and Another v Commissioner for Inland Revenue 1996 (1) SA 311 (A)* at 324 I - 325 A,

“As was observed in the De Beers Holdings case supra, the definition may notionally and grammatically be divided into two parts. The first part lays emphasis on the purpose for which anything may have been produced, manufactured, purchased or in any other manner acquired by a taxpayer. The specific purposes are manufacture, sale or exchange by the taxpayer or on his behalf.”

In regard to the phrase “for purposes of manufacture” occurring in the first part of the definition, the court stated the following (at 328B-C):

“It is true that the Legislature has employed the expression ‘used in a process of manufacture’ in some of the other provisions of the Act and that he did not use it in the definition of ‘trading stock’, but the Legislature does not always use exactly the same language to convey the same notion. As long as the words which it has chosen to use convey plainly and unambiguously the same notion, nothing can be made of the point. I consider that the words ‘for purposes of manufacture... by him or on his behalf’ in the definition can only mean ‘for use in manufacture’.”

It should be noted that at the time this judgment was delivered, the third part of the definition of “trading stock” was not yet included in the definition.

23. As far as the phrase “process of manufacture” used in the now defunct section 12(1) of the act is concerned, the court in *Secretary for Inland*

Revenue v Safranmark (Pty) Ltd 1982 (1) SA 113 (A) quoted at 122 G - H with approval the following dictum by Miller J in ITC 1247, 38 SATC 31:

“That the ordinary connotation of the term ‘process of manufacture’ is an action or series of actions directed to the production of an object or thing which is different from the materials or components which went into its making, appears to have been generally accepted. The emphasis has been laid on the difference between the original material and the finished product.”

The majority of the court held at 124 A - B:

“The conclusion to be drawn from the above is that not only did each of the ingredients cease to retain its individual qualities but upon completion of the process a different compound substance having a special quality as such ... has been produced ...”.

24. The act clearly distinguishes between manufacturing and mining. “Mining operations” and “mining” are defined in section 1 of the act to include ***“every method or process by which any mineral is won from the soil or from any substance or constituent thereof”.***
- “Manufacturing”, on the other hand, is not defined.
25. The difference between mining and manufacturing is well illustrated in the judgment of Harms J (as he then was) in ITC 1455, 51 SATC 111. The facts are recorded as follows at 115:

“By means of opencast mining appellant mines magnetite ore at its B mine near A. The ore is there crushed, washed and screened and then stockpiled. The ore is then transported to it’s A plant...

The A plant is an integrated iron, steel and vanadium plant. There the magnetite ore is processed to produce liquid pig iron and vanadium-bearing slag. These minerals can be used to produce finished steel and vanadium pentoxide.

In order to produce the liquid pig iron and the vanadium-bearing slag, the magnetite ore is mixed with coal and fluxes, heated in a pre-reduction rotary kiln (whereabout 60 per cent of the oxygen and the iron oxide is removed), smelted in an electric smelting furnace and then treated in a shaking ladle. The vanadium-bearing slag has a higher melting point than iron and therefore solidifies sooner. The molten pig iron is then pored from the shaking ladle and taken to a furnace where steel is made from the iron. The vanadium-bearing slag is removed in solid form from the ladle and is then sold to other steel producers.”

In the course of this judgment, Harms J found the following:

“It is tempting to compare appellant’s operation to the production of gold bullion on a gold mine. The gold ore exists in discreet particles in the rock. The mined rock is crushed and the gold is leached out. The gold ore is then heated and the bullion is poured. In ordinary parlance the latter operation will not be referred to as the manufacturing of gold but to the mining of gold ...

Another comparison is with diamond mining. It must in that context be accepted that all the acts done, whether underground or on the surface, to win diamonds will be regarded as mining operations ...

These two instances differ from the present instance in that in those cases one mines for gold and diamond. The gold and diamond is already in the earth. One merely isolates it. In the case of iron production the iron is not in the ore. Iron oxide is. The iron is produced by an industrial process and not a mining process.”

See generally Secretary for Inland Revenue v Cape Lime Company Limited 29 SATC 131; Commissioner for Inland Revenue v Stellenbosch Farmers' Winery Ltd 51 SATC 81.

26. Applying the foregoing to the common cause facts of the present appeal, it is apparent that the essence of the aforementioned processes is the extraction or winning of the phosphates, without a different finished product emerging. What is sold to customers is the phosphates originally found in the phosphate-bearing ore, and that no different substance with different qualities has been produced. All that occurs is a process which liberates the mineral particles from the ore and which separates the mineral particles.

27. It was argued on behalf of the respondent that the Richards Bay judgment *supra*, is support for a finding that the aforementioned process was a manufacturing process. At 323 B - D the court recorded the argument advanced in that matter as follows:

“An alternative argument was presented along the following lines. Even if a ‘strictly literal’ interpretation be given to the definition, the stockpiles would still not fall within it because they were not ‘created’ (counsel’s word) for the purpose of ‘manufacture, sale or exchange’ (the relevant words in the definition). None was created for sale or exchange. Stockpiles Nos 1, 2, 4 and 5 were created for the purpose of separating the contents into their constituent parts. That process is not a manufacturing process but a mining process falling within the definition of ‘mining’ in section 1 of the Act.

This argument, however, was not successful. Firstly, it was conceded in oral argument that the stockpiles were, on the particular facts, acquired for purposes of manufacture, as appears from the following remarks by the court at page 328 H - I:

“The contentions which rested upon the proposition that the stockpiles in question were not ‘produced’ or ‘manufactured’ within the meaning of the definition of trading stock but were ‘mined’ within the meaning of the definition of ‘mining’ in s 1 were not pressed in oral argument by counsel for the appellant. He conceded that, save possibly for the initial dredging operation, he could not argue with any conviction that in carrying out any of the ensuing processes which resulted in the existence of the stockpiles appellants had not ‘produced’ or ‘manufactured’ them ‘for the purposes of manufacture’ within the meaning of the definition of trading stock in section 1”. Secondly, the argument that the stockpiles were not acquired for mining purposes, was not raised in the taxpayer’s grounds of objection in the Richards Bay-case, and

the taxpayer would accordingly have been barred by the provisions of the then section 83(7)(c) of the Act from raising the contention on appeal. The court dealt with this aspect as follows at 328 J - 329 A:

“It is also unnecessary to consider the contention of counsel for Respondent that the point was not made in Appellant’s grounds of objection, that far from there being any application to the Court a quo to allow an amendment of the notice of objection, Appellant’s objection had been argued on the basis that the stockpiles in question were indeed produced by manufacturing operations, and that as a consequence Appellants are barred by section 83(7)(c) of the Act from raising the contention that the stockpiles were mining stocks.”

28. In the present appeal there is no contention, nor any bar to appellant raising this argument. On the contrary, it has always been appellant’s main contention that, having regard to the facts that the phosphate minerals naturally occur in the earth, and that it was in essence those minerals which were sold by appellant, appellant does not manufacture the minerals. Accordingly, the Richards-Bay judgment does not assist respondent in regard to appellant’s argument that the ore was acquired by appellant for the purpose of mining.
29. In the result it must be held that the phosphates sold by the appellant occurs naturally in the earth and the phosphates is not, and cannot be manufactured, just as gold or diamonds cannot be manufactured, but can only be mined. The phosphate-bearing ore was therefore not acquired for the purpose of

manufacture. Regard being had to the purpose requirement as contemplated in the first part of the definition, the ore stockpiles do not constitute trading stock in terms of that part of the definition.

30. The second part of the definition of trading stock includes ***“anything the proceeds from the disposal of which forms part or will form part of [a taxpayer’s] gross income”***. In *De Beers Holdings (Pty) Ltd v CIR* (supra) at 32 G - I, Corbett JA (as he then was) stated the following:

“Part (2) of the definition is somewhat cryptic and in its application may lead to circuitous reasoning ... Be that as it may, in my view, this part of the definition (like part (1)) relates to articles or things which (a) are disposed of (so as to produce proceeds) or (b) will be so disposed of in the future. Category (a) will cover things held at the beginning of the tax year and disposed of during the tax year; and category (b) would cover things held throughout the year but to be disposed of thereafter, Mr Welsh argued that category (b) related to, or at any rate included, things the proceeds of which would form part of the taxpayer’s gross income if he were to dispose of them, notwithstanding the fact that he had no intention of disposing of them at the time of acquisition or at any other time during the relevant tax year, i.e., postulating a notional disposal of things not to be disposed of. To my mind, the argument is unsound. Such an interpretation would do violence to the plain meaning of the words used: Words simply denoting futurity would be stretched to cover at the same time not only futurity but also a hypothetical state of affairs which in fact did not and would not come to pass.”

31. The evidence is clear that appellant never intended to dispose of the phosphate-bearing ore. There was simply no economic viable market for it.

In the Richards Bay-case, the following is stated with reference to De Beers Holdings-case (at 324 I - 325 A):

“The second part makes no direct reference to any purpose which the taxpayer must have had at the time of acquisition; it postulates an objective assessment, namely whether, if the thing under consideration was disposed of, the proceeds would form part of his gross income.”

The aforementioned dicta lead Brand J in ITC 1662, 61 SATC 357 at 361 to summarise the position as follows:

“With reference to these dicta by Marais JA it can in my view be accepted that in order to fall within the first part of the definition, the thing under consideration need not be in a disposable or marketable state. In order to fall within the second part of the definition it is essential, however, that the thing in question must be amenable to being disposed of for value. Otherwise stated, that one thing must be in a realisable state.”

32. Accordingly, the ore stockpiles do not fall within the second part of the definition of “trading stock”.

33. In the result the appeal must be upheld. It is not necessary to consider the argument in respect of the interest.

34. The following order is made:

34.1 The appeal is upheld.

34.2 The assessment for the year of assessment ended 30 June 1999 is set aside.

34.3 The assessment in respect of the appellant for the year of assessment ended 30 June 1999 is referred back to the respondent for reconsideration on the basis that the phosphate-bearing stockpiles do not constitute trading stock as defined in section 1 of the Income Tax Act 1962.

M M Joffe

Judge of the High Court

I agree

R J Heffer

I agree

P A Noble