DRAFT INTERPRETATION NOTE

DATE:

ACT : INCOME TAX ACT NO. 58 OF 1962

SECTION : SECTION 1(1) – DEFINITIONS OF "MINING OPERATIONS" AND "MINING"

SUBJECT : WHETHER CERTAIN QUARRYING OPERATIONS CONSTITUTE MINING OPERATIONS

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Preamble

In this Note unless the context indicates otherwise –

- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act No. 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance on whether the extraction of the following deposits from the earth constitute "mining operations" and "mining" for income tax purposes:

- Clay
- Granite
- Gravel
- Limestone
- Rock
- Sand
- Slate
- Stone

Any explanations and examples used in this Note must be read in the context of the above composites only. Whilst it is acknowledged that certain mining processes in general may involve other processes (for example, manufacture) in order to win or recover minerals from the soil, the discussion in this Note is limited to the above composites and does not apply to the winning or recovering of any mineral or substance not mentioned.

2. Background

The South African mining industry has historically received favourable tax concessions, especially in relation to its capital expenditure on mining assets which qualifies for an immediate redemption against income derived from mining operations under section 15(*a*) read with section 36. Under section 36(7E) the taxable income derived from mining operations is ring-fenced from taxable income derived from other trades.

The concession for persons carrying on mining operations was made in view of the high risk and considerable expenditure incurred in the early stages of the mining enterprise. In order to encourage the profitable exploitation of mineral resources it is vital that the initial capital expense be recovered as and when the enterprise starts generating profits. The rationale behind the capital redemption allowance available for miners is to encourage the winning (recovery) of minerals through a method or process of mining.

A strict interpretation of the relevant legislation is followed in order to ensure that only persons who are actually conducting mining operations are entitled to claim the capital redemption allowance available for miners.

This approach to interpretation was supported by the court in *Western Platinum Ltd v C: SARS*[1] in which Conradie JA stated the following:

> "[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."

A restrictive approach to interpretation must accordingly be applied when determining whether a quarrying operation constitutes a mining operation and hence entitles the operator to claim the favourable capital redemption allowances available to miners under section 15(*a*) read with section 36 in respect of such operations.

In addition, a distinction must be drawn between mining operations and a process of manufacture. This distinction has to be made in order to establish whether capital expenditure on mining assets used to extract minerals from the earth qualifies for the capital redemption allowance available to miners (see section 15(*a*) read with section 36) or alternatively the allowances available for persons carrying on a process of manufacture (see section 12C and 12E).

3. The law

Definition – "mining operations" and "mining"

The terms "mining operations" and "mining" are defined in section 1(1) as follows:

> **1. Interpretation.**—(1) In this Act, unless the context otherwise indicates—
>
> **"mining operations"** and **"mining"** include every method or process by which any mineral is won from the soil or from any substance or constituent thereof;

[1] (2004) 4 All SA 611 (SCA), 67 SATC 1 at 6.

4. Application of the law

4.1 Definition – "mining operations" and "mining"

A taxpayer's operations will qualify as "mining operations" and "mining" for income tax purposes if all the following elements are present in its operations –

- there must be a **method or process**;
- by which any **mineral**;
- is **won**;
- from the **soil**[2] or from any **substance or constituent** thereof.

4.2 Method or process

The word "method" is defined as a particular procedure used to accomplish or approach something systematically or that is established which can be a labour intensive production method.[3] The word "process" is defined as a series of actions or steps taken to achieve a particular end, for example, a systematic series of mechanized or chemical operations that are performed in order to produce something.[4]

The recovery or winning of minerals is the central point of reference in carrying on mining operations and the operations for the recovery of minerals are completed when no further processes are undertaken to separate the mineral from that in which it is embedded. These operations extend to any work done subsequent to the extraction of the mineral from the earth for purposes of completing the recovery of the mineral.[5]

In considering whether an activity falls within the meaning of "mining operations", the Full Federal Court of Australia observed that –[6]

> "at all times, the concept of the recovery of the minerals is retained as the central point of reference".

The Australian tax courts have taken the view that "minerals" has in its ordinary meaning the denotation of substances which can be won by mining.[7]

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2 See **4.5** for a discussion of the meaning of "soil" in the context of the definition of "mining operations".

3 Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].

4 Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].

5 D Davis, L Olivier and G Urquhart Juta's Income Tax [online] under South African Income Tax: Legislation and Commentary / Commentary on Income Tax / Preliminary (s 1) / 1 Interpretation, confirms this view: "The process extends to the time that the mineral is actually won, in the final form (at least in so far as the particular taxpayer is concerned)".

6 *State Rail Authority of New South Wales v Collector of Customs* (1991) 33 FCR 211 in paragraph 13.

7 As per Barwick CJ in *Federal Commissioner of Taxation v I.C.I. Australia* Limited (1972) 72 ATC 4213.

In *Wills' Mineral Processing Technology*[8] the concept of "mineral processing" is explained as follows:

> "Mineral processing is usually carried out at the mine site, the plant being referred to as a *mill* or *concentrator*. The essential purpose is to reduce the bulk of the ore which must be transported to and processed by the smelter, by using relatively cheap, low-energy physical methods to separate the valuable minerals from the waste (gangue) minerals. This enrichment process considerably increases the contained value of the ore to allow economic transportation and smelting….
>
> 'As-mined' or 'run-of-mine' ore consists of valuable minerals and gangue. Mineral processing, sometimes called *ore dressing*, *mineral dressing* or *milling*, follows mining and prepares the ore for extraction of the valuable metal in the case of metallic ores, and produces a commercial end product of products such as iron ore and coal. Apart from regulating the size of the ore, it is a process of physically separating the grains of valuable minerals, from the gangue minerals to produce an enriched portion, or *concentrate*, containing most of the valuable minerals, and a discard, or *tailing*, containing predominantly the gangue minerals….
>
> If the ore contains worthwhile amounts of more than one valuable mineral, it is usually the object of mineral processing to separate them; similarly if undesirable minerals, which may interfere with subsequent refining processes, are present, it may be necessary to remove these minerals at the separation stage.
>
> There are two fundamental operations in mineral processing: namely the release, or *liberation*, of the valuable minerals from their waste gangue minerals, and separation of these values from the gangue, this latter process being known as *concentration*."

4.3 Meaning of "mineral"

It is important to establish whether the material extracted from the earth or from any substance or constituent of that material is a mineral in order to determine whether the taxpayer's operations constitute "mining operations" and "mining" as defined in section 1(1).

The term "mineral" is not defined in the Act and should, therefore, be interpreted according to its ordinary meaning as applied to the subject matter with regard to which it is used.[9] Reliance is often placed on definitions contained in dictionaries or case law or definitions in other legislation to establish the ordinary meaning of a term when no definition has been prescribed in the Act. Words must not, however, be read in the abstract divorced from the broad context in which they are used.[10]

4.3.1 Ordinary dictionary meaning

The *Concise Oxford English Dictionary*[11] defines "mineral" as –

> "a solid inorganic substance of natural occurrence. a substance obtained by mining…".

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8 B A Wills and T J Napier-Munn (7 ed) Reprinted 2007, 2008 Julius Kruttschnitt Mineral Research Centre, The University of Queensland, Australia at pages 5 and 7.

9 See E A Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworths, South Africa Series. See also Lucas Cornelius Steyn *Die Uitleg van Wette* 5 ed (1981) Juta en Kie., Bpk at pages 4 – 7.

10 *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA).

11 Catherine Soanes and Angus Stevenson 11 ed(2006) (Revised) Oxford University Press Inc., New York.

4.3.2 Definition under the Mineral and Petroleum Resources Development Act No. 28 of 2002 (MPRD Act)

Section 1 of the MPRD Act defines "mineral" as follows:

> "[M]ineral" means any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process, and includes sand, stone, rock, gravel, clay, soil and any mineral occurring in residue stockpiles or in residue deposits, but excludes—
>
> (*a*) water, other than water taken from land or sea for the extraction of any mineral from such water;
>
> (*b*) petroleum; or
>
> (*c*) peat."

The definition of "mineral" for purposes of the MPRD Act has a wider application than that of the Act, which is concerned with collecting taxes and providing certain preferential allowances to taxpayers who conduct "mining operations" and "mining".

The legislative purpose of the MPRD Act is different from the legislative purpose of the Act. These two Acts are concerned with different aspects of the same industry. The definition of "mineral" in the MPRD Act is therefore of little consequence for purposes of interpreting the meaning of "mining operations" or "mining" for income tax purposes. What would be considered relevant for purposes of administering the MPRD Act would not necessarily be relevant for income tax purposes.[12] The MPRD Act is concerned with making provision for equitable access to, and sustainable development of, South Africa's mineral and petroleum resources and to provide for connected matters, while the Act's object relates to the recovery of taxes on persons.

4.3.3 Case law

In *Great Western Railway Company v Carpalla United China Clay Company, Limited* Fletcher Moulton LJ held as follows:[13]

> "If I were rash enough to venture a definition of 'mineral' I should say that it is any substance that can be got from within the surface of the earth which possesses a value in use, apart from its mere possession of bulk and weight which makes it occupy so much of the earth's crust. …To dig out ballast and crushed stone and earth, a mere mixture of heterogeneous portions of the earth's crust, for the purpose of making embankments, where the material goes from one position in the earth's crust to another without modification or being submitted to any process of manufacture, does not seem to me to be making use of minerals, although no doubt the things you are handling were originally within the earth's crust. Such materials have not a value in use apart from their bulk and weight, and they are only used as being capable of forming a portion of the earth's crust in a new position. On the other hand, everything that has an individual value in use appears to me to be fairly called a mineral."

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12 *Nkabinde v Nkabinde & Nkabinde* 1944 WLD 112 at 122: "One act cannot be used in another unless in pari materia" (that is, it must relate to the same matter or subject).

13 (1909) 1 Ch 218 at 231.

4.3.4 Academic resources

The *Dictionary of Mineral Technology* defines "mineral" as follows:[14]

> "Naturally occurring inorganic substance with definable structure, composition and properties. A species as distinct from a rock which may contain more than one mineral. Definition imperfect, as organic substances, such as coal, oil, natural resins and pitch, are included by common usage."

In *Wills' Mineral Processing Technology*[15] "mineral" is defined as follows:

> "Minerals by definition are natural inorganic substances possessing definite chemical compositions and atomic structures. … The term 'mineral' is often used in a much more extended sense to include anything of economic value which is extracted from the earth. Thus, coal, chalk, clay and granite do not come within the definition of a mineral, although details of their production are usually included in national figures for mineral production. Such materials are, in fact, *rocks*, which are not homogeneous in chemical and physical composition, as are minerals, but generally consists of a variety of minerals and form large parts of the earth's crust."[16]

4.4 Winning a mineral

4.4.1 Extraction for physical attributes vs Extraction for mineralogical qualities

The extraction of a material for its inherent mineralogical qualities constitutes mining operations while the extraction of a material for its physical attributes does not constitute mining operations.

Van Blerck considers the following quarrying operations as non-mining operations for purposes of the Act:[17]

- Clay (for brickmaking)
- Slate
- Stone
- Sand
- Granite

Van Blerck goes on further to add the following:[18]

> "However, it is possible that in the case of clay used for brickmaking a court could regard a quarrying operation as a mining operation, on the basis that clay is not mined merely for its bulk but because of its particular properties which makes it suitable for brickmaking."

and

> "In Australia, where the term *mining operations* is not defined, mining and quarrying are regarded as mutually exclusive activities, and the common parlance test (and, to

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14 E J Pryor *Dictionary of Mineral Technology* (1963) Mining Publications, London. As cited in *Boral Resources (NSW) Ltd & others v CEO Australian Customs Service* (1996) 24 AAR 253, (1996) 43 ALD 380 in paragraph 104.

15 Above.

16 Coal is regarded as a mineral by common usage and for income tax purposes, the extraction of coal constitutes "mining operations" and "mining".

17 Marius van Blerck *Mining Tax in South Africa* 2 ed (1992) Taxfax CC, Rivonia, South Africa, 2128 at page 7-24 under the heading **"7.3.4 The practice of the tax authorities"**.

18 Van Blerck at page 7-24 under the heading **"7.3.4 The practice of the tax authorities"**.

> a lesser extent, professional definitions and usage) has been a significant influence on court decisions. Notwithstanding, in recent years, the courts have expanded the interpretation of the term *mining operations* to include activities which were previously regarded as quarrying operations. Thus, where quarrying operations involve the mining of stone, rock or bulk material for building or roadmaking purposes, these will not be regarded as mining operations, but where the mineral or material quarried has a use other than by virtue of mere bulk (eg a chemical use as in the manufacture of cement), the extraction will be regarded as a mining operation."[19]

Having regard to the judgment in *North Australian Cement Limited v FCT*[20] SARS does not agree with Van Blerck's suggestion[21] that there is scope for arguing that the extraction of clay for brickmaking may be classified as a mining operation. A distinction must be drawn between clay used for brickmaking and fire clay which has been held to be a mineral.

In the *North Australian Cement* case the appellant carried on the business of extracting limestone for the production of cement at Calcium, North Queensland. For the years of assessment under review the appellant incurred certain capital expenditure mainly relating to the laying of roads which it sought to claim as a deduction on the basis that it was carrying on mining operations. Finding in favour of the appellant, the court held that the question whether the operations conducted by the taxpayer were mining operations was to be determined by an informed general usage, which took into account the way in which the deposits occur, the character of the material recovered, and the use to which it may reasonably be put. The following comments of Spender J in the case are noteworthy:[22]

> "None of the limestone extracted at Calcium is used as stone, whether for building or agriculturally….
>
> There can be no doubt, in my view, that the operations at Calcium by the applicant are directed at the winning of product for its chemical qualities rather than for its physical attributes such as building material or construction stone."

The court accepted the evidence by Mr James Rose, a mining engineer with impressive qualifications, in which he highlighted the need to meet tight chemical specifications when extracting limestone for cement manufacture as opposed to other uses such as building materials. According to Mr Rose building materials are extracted for their rock characteristics rather than the characteristics of the individual minerals in the rock. He contrasted this extraction with places where the winning of a mineral takes place.

The case confirmed that a mining operation is concerned with the inherent mineral qualities or characteristics of the material rather than its physical qualities. Clay is used in brickmaking because of its physical attributes and not because of its inherent mineral qualities.

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19 Van Blerck at page 7-14 under the heading ***"g.Quarrying – conclusion"***.

20 (1989) 89 ATC 4765.

21 Van Blerck at page 7-24 under the heading **"7.3.4 The practice of the tax authorities"**.

22 At 4776/7.

The *North Australian Cement* case can be distinguished from *Boral Resources (NSW) Ltd & others v CEO Australian Customs Service*[23] in which the taxpayer processed sand and gravel in order to produce coarse and fine aggregates required by customers to meet their end-use specifications, for example, customers could demand a particular size and shape of the finished product or other characteristics as detailed. Various aggregate sizes were regularly sampled to ensure compliance with product specifications before sale.

McMahon BJ held as follows:[24]

> "The activities of Boral, I find, do not constitute mining. If I am wrong in this conclusion, I would also hold that it was not minerals for which Boral was mining. Rock, sand and gravel may have certain mineral compositions... In any event, whether or not rock contains minerals, the fact is that in general usage rock is referred to as rock or stone and not as minerals.
>
> In the marketing of the product the physical properties are paramount. There was no evidence that any end user specification contained a requirement that this or that particular mineral should be present in the aggregate. What the purchaser requires in all cases is a product that will have the engineering qualities to meet the demands likely to be made upon it."

Similarly, in a case considered by the Australian Administrative Appeals Tribunal,[25] the principles set out in the *Boral* case were applied. The Tribunal held that the taxpayer carried on quarrying operations for purposes of extracting material for use in the construction and building industries, and for like purposes.

The following passage from the judgment aptly sums up the distinction between mining and quarrying:[26]

> "The tribunal also accepts that material having different mineralogy may be able to be used to form aggregate, which is then applied for the same or similar end uses, and that this distinguishes the material extracted in the quarrying process from that extracted in the mining process whereas in the latter case extraction is for material having specific mineralogical qualities. The use of the terms 'quarrying' and 'mining' in that context provides a useful and substantive point of distinction between the two industries. The tribunal is satisfied that the evidence shows that the point of distinction is recognised in the nomenclature used by those engaged in carrying out the activity of quarrying, eg the use of the term 'quarry' to describe the area where extraction occurs, the terms 'aggregate' and 'sand' to describe the material extracted, rather than by reference to its mineralogy."

To summarise, the extraction of materials for purposes of mining will only be construed as such if the extraction takes place for its inherent mineralogical composition or qualities and not merely for its physical attributes.

Examples of materials extracted for their physical attributes are –

- sand for building materials;
- slate for building purposes;

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[23] (1996) 24 AAR 253, (1996) 43 ALD 380. The *Boral* case is the benchmark for any case in which the relevant enquiry is whether a product is quarried for purposes of its physical properties as opposed to its intrinsic mineralogical qualities.

[24] In paragraphs 125 and 126.

[25] *Re CSR Ltd and Chief Executive Officer of Customs* (1997) 46 ALD 747. (1997) 46 ALD 747.

[26] In paragraph 61.

- stone for aggregates;
- limestone for building, road making, landscaping, construction or similar purposes;[27]
- limestone for agricultural purposes;[28] and
- clay for brickmaking.

Examples of materials extracted for their inherent mineralogical qualities are –

- sand for the minerals rutile, zircon or ilmenite found within the sand;
- limestone for the mineral calcium carbonate found within the limestone; and
- clay for the mineral kaolin[29] (also known as china clay or fire clay).

In *Richards Bay Iron & Titanium (Pty) Ltd and another v CIR*[30] the mining processes required for the mining of rutile, zircon, monazite and ilmenite were explained in great detail.

The processes, in broad, consist of creating in the dunes self-contained ponds of water into which dune sand is made to slump by undermining the face of the dunes. The mining process then involves –

- removing the slurry by suction with the aid of a floating dredger;
- separating the heavy mineral concentrate from the dune sand in a floating concentrator plant by means of a gravity separation process;
- separating that heavy mineral concentrate in a mineral separation plant into rutile, zircon, monazite and ilmenite; and
- beneficiating the ilmenite in a sophisticated smelter complex to yield titania slag and an iron of high purity.

4.4.2 "Value in use versus bulk" test

The "value in use versus bulk" test, as formulated in the *Great Western Railway* case,[31] is useful for purposes of determining whether the extraction of sand and stone constitutes mining operations for purposes of the Act.

According to this judgment, materials such as sand and stone extracted for building and construction purposes as a result of their possession of bulk and weight do not constitute minerals. This judgment supports the view mentioned in **4.4.1** that the

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27 In contrast to the tests conducted in the *North Australia Cement* case the chemical or mineral characteristics of the minerals found in the limestone are not relevant for purposes of determining whether the limestone is suited for building, road-making, landscaping, construction or similar purposes. In this scenario the physical attributes of the limestone are decisive.

28 In *SIR v Cape Lime Limited* 1967 (4) SA 226 (A), 29 SATC 131 the taxpayer produced lime for agricultural and other purposes. The *Cape Lime* judgment does not give any indication that the taxpayer claimed the capital redemption allowance available for miners in respect of any of its activities, including the initial extraction operations.

29 Held in *Great Western Railway Company v Carpalla United China Clay Company, Limited* (1909) 1 Ch 218 at 231 to be a mineral. The same conclusion was reached in *Boksburg Brick and Fire Clay Co Ltd v CIR* 1941 TPD 232, 12 SATC 225.

30 1996 (1) SA 311 (A), 58 SATC 55.

31 *Great Western Railway Company v Carpalla United China Clay Company, Limited* (1909) 1 Ch 218 as discussed in **4.3.3**.

extraction of materials merely for their physical properties does not constitute mining operations.

However, this judgment is less useful for purposes of determining whether, in the context of the definition of "mining operations", as defined in section 1(1), the following materials constitute minerals:

- Clay
- Granite
- Gravel
- Limestone
- Rock
- Slate

All these materials have a value in use apart from their possession of bulk and weight.

Despite all the above materials having a value in use, the conclusive test for income tax purposes is whether these materials are extracted for their inherent mineralogical qualities rather than their physical attributes. The mere fact that these materials have a value in use apart from their possession of bulk and weight does not automatically trigger section 15(*a*) read with section 36.

For example, Belfast Black granite is exported because of its high value,[32] however, it is not a mineral for income tax purposes.

In order to mine a mineral, the material must –

- be extracted from the earth;
- possess a value in use; and
- be extracted for its mineralogical qualities.

4.5 From the soil or a constituent thereof

The word "soil" as used in the definition of "mining operations" in section 1(1) is widely interpreted to mean "earth". Van Blerck comments as follows:[33]

> "The use of the word *soil* in the definition of mining operations is rather puzzling if one considers that the general description of 'soil' is the relatively thin upper layer of earth in which plants grow. Very few mining activities take place in soil and the only logical conclusion is that the term was intended to have the same meaning as the word *earth* which is generally used in other definitions of the terms *mine* or *mining*, including the definition in the Sales Tax Act (see Appendix B)."

The actual separation of a mineral from the earth is usually a small part of the mining process. Minerals are not contained in orderly pockets in the earth allowing a miner to only extract a specific mineral without also extracting the waste material attached to the mineral. All the activities by which the concentration of the valuable element in a mineral is increased can be considered to be part of winning the mineral from the earth.

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[32] **http://stone-network.com/absolute_black_granite.html** [Accessed 10 February 2015].

[33] Van Blerck at page 7-9 under the heading **"7.3.1 Statutory definitions"**.

The phrase "constituent thereof" as used in the context of the definition of "mining operations" must be interpreted to mean the gangue rock (waste) removed by the miner by way of a beneficiation process in order to recover or win the desired mineral deposits intermixed with the waste. The ultimate objective of mining operations is the final recovery or winning of the mineral lumps or particles from the waste. The gangue rock is a constituent of the host rock (that is, the earth).

In *Juta's Income Tax* the wording is interpreted as follows:[34]

> **"[A]ny substance or constituent thereof** – This wording is extremely wide and appears to extend the meaning of mining operations to processes which did not begin with extraction of something from the soil. This would include a taxpayer who purchases ore and extracts from it one or more minerals, since these have been won from the soil, or a substance or constituent thereof, although the soil from which it was won was not itself won from the earth by the taxpayer. Since, however, the method or process concerned is an inclusion within the normal meaning of mining operations, it is considered that it must begin with the soil or the earth. A process therefore carried on by two taxpayers may be a mining operation for one, but not for the other, if the process of the former begins with the extraction from the soil and the latter does not."

In ITC 1249[35] the court held that to qualify as a "mineral" a substance must be found naturally within the earth's surface. It accordingly held that the taxpayer's products, namely, pig-iron and steel products although having their origin in iron ore, do not constitute minerals and that no justification exists for extending the definition of "mineral" to include a manufactured product.

4.6 Process of mining vs Process of manufacturing

In the publication *The Mining Industries, 1899–1939: A Study of Output, Employment, and Productivity*[36] the following statement is made:

> "To one who is interested solely in distinguishing between extraction and fabrication from a purely technical standpoint, 'mining' ends as soon as the stone is extracted from the quarry bed: all further processing is considered 'manufacturing'."

The activities following the initial extraction of materials, for either their physical attributes or their inherent mineralogical qualities, consist mainly of –

- crushing;
- screening; and
- washing

of the material extracted in order to produce articles of a certain shape or size as required by customers. The crushing, screening and washing activities are undertaken in order to facilitate the better use of the material extracted for purposes of manufacture. These activities constitute a process of manufacture and not mining operations. The purpose of the aforementioned activities is not to prepare the material for the recovery of mineral deposits found within the material or to concentrate the mineral sought.

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34 Above.
35 (1976) 38 SATC 74 (R).
36 Appendix C – The Statistical Treatment of Stone Quarrying at footnote 1 on page 377.

The following is an example of the steps taken when calcium carbonate, silicon dioxide, aluminium oxide and ferric oxide are extracted from limestone for purposes of mining and the commencement of manufacturing processes for the production of cement:[37]

Step 1: Remove topsoil.

Step 2: The hard rocky limestone located beneath the topsoil is drilled and blasted and then discarded.

Step 3: The excavated limestone is stacked in two pre-crusher stockpiles.

Step 4: The material is crushed at a hammer mill.

Step 5: The material is transported by conveyors to the pre-blend building where it is stockpiled.

Step 6: Shale, sand and iron oxide are added by means of an automatically controlled proportionary system.

Step 7: The resulting mixture undergoes a series of processes to produce cement.

The recovery of the limestone is complete when the limestone is stockpiled at Step 3. The manufacturing processes commence with the crushing of the material at the hammer mill at Step 4. This conclusion is supported by the judgments in *SIR v Cape Lime Company Ltd*[38] and *Blue Circle Cement Ltd v CIR*.[39]

SARS is of the view that manufacturing in the context of the extraction of materials from the earth means producing a new product, article, or substance different from and having a distinctive nature, character or use from the raw or prepared material. Any activity or process that changes the physical or chemical identity of the ores or minerals constitutes a manufacturing process. In most cases the decision to subject a mineral to a process of manufacture is influenced primarily by market considerations or customer demands, for example, the grading, shaping and cleaning of the beneficiated product as part of preparing it to meet the purchaser's specifications.

In *Ready Mixed Concrete (WA) Pty. Ltd v FCT*[40] it was held that aggregate produced by crushing and screening stone into small pieces of standard sizes constituted manufactured goods within the meaning of section 62AA(2) of the Australian Income Tax Assessment Act. Windeyer J said that the aggregate was, in a relevant sense, a new and different thing from the block of stone from which it was made.

The court held as follows:[41]

> "It is all very well to say that it is still stone and only in small pieces instead of in big pieces. That, I think is too facile a solution of the problem".

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37 Based on the facts in *Chief Executive Officer of Customs v Adelaide Brighton Cement Ltd* 2002 AATA 688 in which Forgie SA held that the 4 minerals are recovered when they are stockpiled. Any further blending or crushing is beneficial to Adelaide Brighton Cement in its subsequent use of the 4 minerals but it cannot be said to be related to their recovery.

38 1967 (4) SA 226 (A), 29 SATC 131.

39 1984 (2) SA 764 (A), 46 SATC 21.

40 (1971) 71 ATC 4107.

41 At 4109.

Any process which, by the addition of another substance, results in a product which is essentially different in character to the raw mineral mined, will not be considered to be a mining operation.[42]

A taxpayer must prepare a separate calculation for taxable income for each trade carried on.[43] In a mining context this requirement is further entrenched under section 36(7E) which specifically provides that the taxable income derived from mining operations is ring-fenced from taxable income derived from other trades, for example, manufacturing.

A trade carried on by a taxpayer may be merely ancillary to another trade carried on by that taxpayer. This is ultimately a question of degree. In the context of mining in which a mineral is extracted, the mining component of the entire business activity, that is, the extraction operations, may be so limited in its scope that a separate calculation of taxable income derived from mining operations is not warranted.

For example, a person may produce cement by operating the whole process which commences with the extraction of the minerals required to manufacture cement right through to the final product, namely, a bag of cement. In such an operation the final product is largely attributable to the value added by the process of manufacture rather than the original extraction operations (mining operations).

4.7 Quarrying operations vs Process of manufacture

4.7.1 Meaning of "aggregates"

Construction aggregates are a broad category of coarse material used in the building and construction industry, for example, sand, gravel, and crushed stone for purposes of reinforcing and strengthening the overall composite material. The aggregates are mixed with cement and water to make concrete, mortar or plaster.

The mining industry mines for and beneficiates minerals, none of which are mined for use as construction materials. In contrast, the quarrying industry extracts rock, sand and gravel and processes it into stone and sand products, suitable for use as construction material.

The aggregates listed in **4.7.2** below are commonly extracted in bulk for their physical attributes. It is often debated whether the extraction of these materials constitutes a process of mining or manufacturing.

4.7.2 Types of aggregates

(a) Clay

Clay is defined as a –[44]

> "sticky fine-grained earth that can be moulded when wet, and is dried and baked to make bricks, pottery, and ceramics".

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42 KPMG South Africa "*A Guide to Mining Taxation in South Africa*", (June 1993) at 17.

43 *Silke on South African Income Tax LexisNexis Butterworths, Durban [online]* in § 7.2.

44 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].

A Binding Private Ruling[45] issued by SARS considered whether the extraction of clay constituted mining operations. The Commissioner ruled that it did not constitute "mining operations" as defined in section 1(1).

(b) Granite

Granite is defined as –[46]

> "a very hard, granular, crystalline, igneous rock consisting mainly of quartz, mica, and feldspar and often used as a building stone".

In *Deputy Federal Commissioner of Taxation (Queensland) v Stronach*[47] the taxpayer was a master builder and contractor who excavated freestone and granite from quarries. He worked up this freestone and granite into building materials, some of which he used in building and some of which he sold in Australia. The question was whether the freestone and granite were subject to sales tax under the Australian Sales Tax Assessment Act 1930-1935.

Starke J held as follows:

> **"…In the present case, the freestone and granite were, in a greater or less degree, worked up into building materials. They do not exist in the form or condition in which they come from the ground."**

(Emphasis added.)

In Practice Note No. 42,[48] granite quarrying and cutting and drilling granite boulders into blocks of various sizes is listed separately in Annexure B as a process of manufacture (see item 23).

(c) Gravel

Gravel is defined as –[49]

> "a loose aggregation of small water-worn or pounded stones, or a mixture of gravel with coarse sand, used for paths and roads and as an aggregate".

In a case considered by the Australian Administrative Appeals Tribunal the parties before the Tribunal were J M Kelly Builders Pty Ltd (trading as Pink Lilly Sands) and CEO of Customs.[50] The question for the tribunal was whether the operations of dredging, washing, sifting, sorting and testing of sand and gravel for construction materials constituted a "mining operation" within the meaning of that term in the Customs Act 1901. That is, in the context of this case, did the operation come within the meaning of "mining for minerals". The tribunal held that sand and gravel are not "minerals" within the meaning of that term in the Customs Act 1901 and that the activities of the applicant at Fitzroy River do not amount to a mining operation.

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45 BPR No. 68: Classification of the Extraction of Clay from the Soil – Dated 9 December 2009.

46 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].

47 (1936) 55 CLR 305(HCA).

48 Process of Manufacture, Process Similar to a Process of Manufacture and Processes not regarded as Processes of Manufacture or Processes Similar to a Process of Manufacture – Dated 27 November 1995.

49 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].

50 [2000] AATA 657.

SARS agrees with the Tribunal's conclusion that the extraction of gravel will not constitute "mining operations" as defined in section 1(1).

(d) Limestone

Limestone is defined as –[51]

> "a hard sedimentary rock, composed mainly of calcium carbonate or dolomite, used as building material and in the making of cement".

In *SIR v Cape Lime Company Ltd*[52] the taxpayer produced lime for agricultural and other purposes from raw material available on its land in the form of natural deposits of limestone. The court held that the breaking up of the raw material on the floor of the quarry into pieces of a manageable size was the commencement of the process of manufacture.

In *Blue Circle Cement Ltd v CIR*[53] the taxpayer manufactured cement from limestone. In order to transport the quarried and crushed limestone to a factory, the appellant had constructed a railway line from the quarry area to the factory. The court concluded that the taxpayer's manufacturing process started at a stage before the loading of the material onto railway trucks.[54]

In Australian Tax Office Interpretation Decision ATO ID 2006/75[55] the issue was whether the crushing of limestone, and the washing of the crushed limestone to remove clay impurities constituted operations for the recovery of minerals for the purposes of paragraph 11(1)(b) of the Energy Grants (Credits) Scheme Act 2003 (EGCSA).

The Australian Tax Office (ATO) ruled that the crushing of limestone and the washing of the crushed limestone to remove clay impurities do not constitute operations for the recovery of minerals. The limestone had to be reduced to a particular particle size in order to prepare it for subsequent calcination in the manufacture of lime.

The ATO held that the crushing represented the first stage in the manufacture of lime. Although it was accepted that the washing of the crushed limestone is undertaken in order to remove clay impurities that would otherwise affect the limestone's suitability for lime manufacture, it was considered that this activity occurred after the commencement of the manufacturing operations. Therefore, the washing of the limestone was considered to be a manufacturing process. The Interpretative Decision of the ATO corresponds with the findings in the *Cape Lime* and *Blue Circle Cement* judgments discussed above which clearly establish the principle that the activities at a lime quarry consist mainly of processes of manufacture.

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51 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].

52 1967 (4) SA 226 (A), 29 SATC 131.

53 1984 (2) SA 764 (A), 46 SATC 21.

54 The facts are similar to those in North Australian Cement Limited v FCT (1989) 89 ATC 4765 discussed earlier in this Note. However the judgment gives no indication that the taxpayer ever claimed a capital redemption allowance available for miners in respect of any of its activities, especially the initial extraction activities.

55 The ATO ID was withdrawn with effect from 1 July 2012 as a result of the repeal of the relevant legislation but remains valid for the period that the legislation was in force.

(e) Rock

Rock is defined as –[56]

> "the solid mineral material forming part of the surface of the earth and other similar planets, exposed on the surface or underlying the soil."

In *COT v Nyasaland Quarries and Mining Co Ltd*[57] the taxpayer extracted gneiss (a type of rock) by drilling holes into the rock face and loosening an area of rock by blasting. The loosened rock was then transported to crushers where it was crushed and screened to sizes suitable for the purposes for which it was required and then stored in piles until sold to purchasers.

The gneiss extracted was suitable for road-making, the making of garden paths, the mixing of concrete and other building purposes.

The High Court of Nyasaland[58] noted that an extended meaning must be given to the terms "mining operations" and "mining" and held that the taxpayer's work of quarrying constituted mining operations.[59] This case is often quoted by South African tax authors as an authority that an extended meaning must be given to the terms "mining operations" and "mining" for South African income tax purposes.[60] In fact Van Blerck incorrectly labels the case as a "South African income tax dispute".[61]

This case does not create any binding precedent in South Africa and SARS does not accept the court's conclusion that the crushing and screening of the gneiss is a mining operation. The material extracted, gneiss, was not sought for its inherent mineralogical qualities.

The process under which the extracted gneiss is altered to form products ready for sale constitutes a process of manufacture because the items quarried are subjected to a process or treatment resulting in an alteration of the form, nature or condition of the items originally extracted. This view is in line with the principle formulated in the *Cape Lime*[62] and *Blue Circle Cement*[63] cases, namely, that the process of manufacture commences on the quarry site after the extraction of the material.

It follows that for South African tax purposes a person extracting gneiss will not be considered to be carrying on "mining operations" as defined in section 1(1).

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56 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].

57 (1961) 24 SATC 579 (NY).

58 Now Malawi.

59 Defined in section 2 of the Nyasaland Income Tax Act to include every method or process by which any mineral is won from the soil or constituent thereof.

60 The Supreme Court judgment in the *Western Platinum case* held that a strict interpretation is required in determining whether mining operations are being carried on (see **2**). It is significant that the judgment in the *Nyasaland Quarries* case was not considered in the *Western Platinum* case.

61 Van Blerck at page 7-12 under the heading ***"e. Quarrying – the Nyasaland Quarries case"*.**

62 *SIR v Cape Lime Limited* 1967 (4) SA 226 (A), 29 SATC 131.

63 *Blue Circle Cement Ltd v CIR* 1984 (2) SA 764 (A), 46 SATC 21.

(f) Sand

Sand is defined as –[64]

> "a loose granular substance, typically pale yellowish brown, resulting from the erosion of siliceous and other rocks and forming a major constituent of beaches, river beds, the seabed, and deserts."

The quarrying of sand does not constitute "mining" or "mining operations" as defined in section 1(1).

(g) Slate

Slate is defined as –[65]

> "a fine-grained grey, green, or bluish-purple metamorphic rock easily split into smooth, flat plates."

The quarrying of slate is not considered "mining" or "mining operations" as defined in section 1(1).

(h) Stone

Stone is defined as –[66]

> "hard solid non-metallic mineral matter of which rock is made, especially as a building material."

In *FCT v Broken Hill Pty Co Ltd*,[67] Barwick CJ, McTiernan J and Menzies J held as follows:

> "Thus to crush bluestone in a stone crushing plant so that it can be used for road making, or to fashion sandstone so that it becomes suitable for building a wall or a town hall is not, as we see it, a mining operation. Nor would the cutting of diamonds or opals which have been recovered by mining operations fall within the description of mining operations."

In *New South Wales Associated Blue-Metal Quarries Ltd v FCT*[68] the company conducted operations for the winning and crushing of a type of stone referred to in Australia as blue-metal. The stone was won in an open-cast quarry, and crushed upon the site. The court held as follows:[69]

> "Now in the present case the material worked, bluestone, is completely outside the scope of the metals minerals or substances the winning of which is associated in thought or tradition with underground workings. Bluestone quarries are familiar sights in many parts of Australia and the expression is equally familiar in speech. No one speaks of a bluestone mine. The phrase would sound odd and incongruous. Even more odd would it be if a bluestone quarry were called a mining property."

Similarly in South Africa, the extraction of stone will not be considered "mining" or "mining operations" as defined in section 1(1).

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64 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].
65 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].
66 Online Oxford Dictionary, **www.oxforddictionaries.com** [Accessed 10 February 2015].
67 (1969) 120 CLR 240; 1 ATR 40; 69 ATC 4028; 15 ATD.
68 1956) 94 CLR 509.
69 In paragraph F17.

4.7.3 Summary of the differences between quarry operations and mining operations

The following guidelines have been formulated, based on the *Boral*[70] and *CSR*[71] decisions, to distinguish between quarry operations and mining operations:

a) The mining industry seeks and mines specific minerals which are often rare in occurrence and are commonly mined at remote locations. The mining industry and its markets are commodities based and typified by high exploration and capital costs. The minerals are commonly exported and tied to international prices.

b) The quarrying industry seeks and extracts commonly occurring rock, stone, gravel and/or sand, regardless of mineral composition (unless deleterious).

c) Minerals are mined for their specific mineral or chemical content; while quarry products are quarried for their mechanical or engineering properties such as durability, soundness, grading and shape.

d) Quarries are generally developed in closest possible proximity to product markets which fluctuate according to local forces of supply and demand. The end-product is rarely exported and is commonly sold locally on a high volume, low margin basis.

e) Mining for minerals involves the sampling, testing and analysis of the material both before and after extraction, to measure the precise levels of the desired mineral(s) contained within the material. The portion of the extracted material that does not contain the required mineral(s) in the required proportions is disregarded.

f) A mineral is a naturally occurring solid chemical substance that is formed through geological processes and that has a characteristic chemical composition, a highly ordered atomic structure, and specific physical properties. By comparison, a rock is an aggregate of minerals and does not have a specific chemical composition.

g) Geological exploration for minerals is usually far more intensive and expensive and carried out as an ongoing feature of the mining industry, whereas quarrying exploration, which typically involves relatively low expenditure and ongoing exploration, is only undertaken when a problem with a currently existing quarry is encountered.

h) A person with both mining and quarrying operations consistently reported on them differently in their annual reports. Although the mining and quarrying industries overlap, the quarrying industry is not regarded as a segment of the mining industry.

i) There is a high level of vertical integration evident in the quarrying industry in that the producer was commonly involved in the manufacture of the end-product, be it cement, concrete, asphalt etc and this was not evident in the mining industry to the same extent.

j) The crushing and screening of rock is in direct contrast with the treatment of raw material in mining, for example, with cyanide to recover gold.

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[70] *Boral Resources (NSW) Ltd & others v CEO Australian Customs Service* (1996) 24 AAR 253, (1996) 43 ALD 380.

[71] Re *CSR Ltd and Chief Executive Officer of Customs*(1997) 46 ALD 747.

k) Processing is done in quarries to achieve the highest possible yields of clean, well-shaped, sized and graded aggregates. Beneficiation in mines is done to achieve the highest possible yields of particular minerals.

l) Sand could fall into the category of industrial mineral when described by reference to its mineralogic specification (that is, in glass manufacture), but not when used in the building and construction industry where it is categorised according to size.

Practice Note No. 42 confirms that –

- quarrying operations are a process similar to a process of manufacture (Annexure A, item 51); and
- cement manufacture is a process of manufacture (Annexure B, item 22).

5. Conclusion

The terms “mining operations” and “mining” must be interpreted to mean those operations conducted by a person to win minerals from the earth for their inherent mineralogical qualities. Such operations include various activities but do not include operations to the extent that their purpose is to obtain materials from the earth for their physical properties for agriculture, building, road making, landscaping, construction or similar purposes.

Activities undertaken in respect of materials extracted for their physical attributes constitute manufacturing processes and not mining operations. The capital equipment used in both the initial extraction operation and subsequent process of manufacture qualifies for the allowance under section 12C or 12E.

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SOUTH AFRICAN REVENUE SERVICE