An analysis of the South African income tax implications on mine rehabilitation funding vehicles

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Mini-dissertation submitted in partial fulfilment of the requirements for the degree Magister Commercii in South African and international taxation at the Potchefstroom Campus of the North-West University

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May 2016
DECLARATION

I declare that: “An analysis of the South African income tax implications on mine rehabilitation funding vehicles” is my own work; that all sources used or quoted have been indicated and acknowledged by means of complete references, and that this mini-dissertation was not previously submitted by me or any other person for degree purposes at this or any other university.

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ACKNOWLEDGEMENTS

I would like to thank the Lord our Father for the opportunity to further my studies. In addition, I would like to extend my gratitude to my study supervisor, Professor Pieter van der Zwan, who was incredibly patient throughout the process and provided me with very valuable guidance and constructive feedback.

Thank you to my husband for his continued support and encouragement throughout the process. My parents have always been very supportive and have laid down an incredible foundation for my education, for which I would like to thank them. Thank you to my family as well for their encouragement.
KEYWORDS

Insurance policies
Mining
National Environmental Management Act 108 of 1998
Rehabilitation
Rehabilitation trust
Section 37A of the Income Tax Act 58 of 1962
ABSTRACT

Mines can have significant consequences for humans and nature, and can affect anyone. The use of tax policy to encourage investment in natural resources is contentious as some taxpayers obtain a benefit not available to all. To be effective, a regulatory system for mine site rehabilitation should provide incentives to minimise damage, ensure sufficient funds are available to finance the rehabilitation, develop clear standards for rehabilitation and “ensure that mining companies receive equitable tax treatment with respect to the costs incurred”.

This comparative study aimed to understand how the income tax implications of rehabilitation funding vehicle options compare to each other and to those of similar vehicles identified in Australia and Canada. In order to obtain this understanding, a number of objectives were identified. The first objective was to obtain an understanding of the rehabilitation funding vehicle options available per the Minerals and Petroleum Resource Development Act 28 of 2002 (MPRDA)/NEMA. The second objective was to obtain an understanding of the commercial terms of these funding vehicles. The third objective was to understand the tax implications of the funding vehicles identified from a South African tax perspective. The fourth objective was to conduct a comparison between the income tax implications of the South African rehabilitation funding vehicles to income tax implications of similar vehicles available in Australia and in Canada. In this mini-dissertation, the tax implications of the funding options are analysed and compared to one another. A further comparison of the South African income tax implications to those of Canada and Australian is done.

This study concludes that there are some gaps in the South African income tax implications of some of the rehabilitation funding vehicles, which has resulted in some recommendations. One of the findings is that is the Canadian authorities provide for interest income where the deposit funding vehicle option is chosen where South African legislation does not provide for this interest. A recommendation is made that South African authorities should consider providing for this interest in order to encourage mining companies to use this option. Another finding was that in Canada, where the trust funding vehicle is chosen, and there are remaining funds in the trust, the mining company can transfer the funds back to the contributor but the funds are to be included in the contributors gross income. This option is not available in South Africa as the remainder of mine rehabilitation trust funds can either be transferred to another company or trust at the approval of the Commissioner or can be transferred to any other company approved by the Commissioner. The recommendations should be considered in order to ensure that a tax advantage is provided to companies to ensure that they continue to take responsibility for their environmental requirements, which will assist the government in
maintaining its commitment to ensure that every citizen of the Republic has access to an environment that is protected, pollution free, and sustainable, by enacting certain regulations.
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<tbody>
<tr>
<td>DEA</td>
<td>Department of Environmental Affairs</td>
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<td>DM</td>
<td>Department of Minerals</td>
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<td>DME</td>
<td>Department of Minerals and Energy</td>
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<td>DMR</td>
<td>Department of Mineral Resources</td>
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<tr>
<td>DWS</td>
<td>Department of Water Affairs</td>
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<tr>
<td>DWAS</td>
<td>Department of Water Affairs and Sanitation</td>
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<tr>
<td>EMP</td>
<td>Environmental Management Plan</td>
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<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
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<td>IFRS</td>
<td>International Financial Reporting Standard</td>
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<td>ITA</td>
<td><em>Income Tax Act 58 of 1962</em></td>
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<td>ITAA</td>
<td><em>Income Tax Assessment Act of 1997</em></td>
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<td>ITAC</td>
<td><em>Income Tax Act Canada</em></td>
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<td>MA</td>
<td><em>Minerals Act of 1996</em></td>
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<td>MPRFA</td>
<td><em>Minerals and Petroleum Resource Development Act 28 of 2002</em></td>
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<td>MWA</td>
<td><em>Mines and Works Act 27 of 1956</em></td>
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<td>NEMA</td>
<td><em>National Environmental Management Act 10 of 1998</em></td>
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<td>OECD</td>
<td>Economic Cooperation and Development</td>
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<td>PGMs</td>
<td>Platinum Group Metals</td>
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<td>QET</td>
<td>Qualifying Environmental Trust</td>
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<td>SARS</td>
<td>South African Revenue Services</td>
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<td>UN</td>
<td>United Nations</td>
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<td>WWF</td>
<td>World Wide Fund for Nature</td>
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CHAPTER 1: INTRODUCTION

1. Introduction

1.1 Background to research and literature review

South Africa is one of the world’s and Africa’s most important mining countries in terms of the variety and quantity of minerals it produces. It has the world’s largest reserves of chrome, gold, vanadium, manganese and platinum group metals (PGMs). South Africa is the leading producer of nearly all of Africa's metals and minerals production apart from diamonds (Botswana and the Democratic Republic of Congo (DRC)), uranium (Niger), copper and cobalt (Zambia and the DRC) and phosphates (Morocco) (Mbendi, n.d.). South Africa has been, and is still, relying on mining activities to generate wealth that could be translated into economic development, infrastructure and employment. Mining and quarrying in South Africa contributes for about 8.3 percent of the growth domestic product (GDP) (Trade Economics, 2015).

Mining in South Africa started in 1661 but the first attempts to regulate it only began in 1903, with the Transvaal Mining Laws. These only dealt with safety aspects. Between 1931 and 1951, mining was governed by Mines, Works and Machinery regulations. The Mines and Works Act was promulgated in 1956 and under this law rehabilitation work was limited to topsoil treatment and vegetation recovery. In 1991, the Minerals Act¹ (MA) was promulgated and there was a rising awareness of the environmental impact that mining had. It made provision for mining companies to take financial responsibility for rehabilitation. There had to be consultation on closure of a mine, with the closure plan managed by the State, and there were life cycle planning guidelines (Adams, 2010).

The Constitution of the Republic of South Africa 108 of 1996 Chapter 2, the Bill of rights section 2, advocates the importance of sustainable economic development and justifiable environmental consciousness by business. The government needs to enact certain regulations to ensure that every citizen of the Republic has access to an environment that is protected, pollution free, and sustainable (Constitution, 1996).

In order to ensure that every citizen has access to an environment that is protected, pollution free and sustainable as required by the Constitution, mining industries have a significant responsibility to ensure that mines are rehabilitated at the end of their life. The Chamber of

¹ of 1996
Mines defines rehabilitation from the mining industry perspective as putting the land impacted by the mining activity back to a sustainable, usable condition (Chamber of Mines, 2007).

There are more than 5 700 derelict and unrehabilitated mines of all types in South Africa (Chauke & Nzimande, 2012). Mining areas that are not rehabilitated have significant negative consequences for the environment. Human exposure to these elements leads to various acute or chronic illnesses, such as cell mutation, cancer, respiratory diseases, and many more. Apart from health problems, these consequences can also cause injuries and pollution, such as destruction of buildings during floods or heavy rains, and pollution of ground and surface water (Aucamp et al., 2005).

Under the One Environmental System (OES)\(^2\), the requirements for financial provision for the environmental impacts of mining operations are to be regulated under the National Environmental Management Act\(^3\) (NEMA) and no longer under the Mineral and Petroleum Resource Development Act\(^4\) (MPRDA) (Erasmus, 2015). On 31 October 2014, the Minister of Environmental Affairs gave notice to the public of her intention to make regulations pertaining to the financial provision for the rehabilitation of mines in the National Environmental Management Act by means of the Government Gazette (2014:3). Members of the public were given an opportunity to comment on the intended promulgation. Once the intended amendments come into effect the financial provision will no longer be regulated under the Mineral and Petroleum Resource Development Act but under the National Environmental Management Act.

In order to ensure that mine areas are rehabilitated at the end of their lifespan, a holder must determine and make financial provision for the rehabilitation and management of negative environmental impacts from prospecting, exploration, mining or production operations to the satisfaction of the minister responsible for mineral resources (South Africa, 2014).

Section 8 of Chapter 2 of the Notice (South Africa, 2015) prescribes that payment for rehabilitation be funded through one of the following methods:

   (a) A contribution to a trust fund established in terms of applicable legislation

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\(^2\) Initiated by the South African Government to streamline the licensing processes for mining, environmental authorisations and water use

\(^3\) 108 of 1998

\(^4\) 28 of 2002
(b) A financial guarantee from a bank registered in terms of the *Banks Act*, or from a financial institution registered by the Financial Services Board

(c) A deposit into an account specified by the minister responsible for mineral resources.

The requirements per regulation 54 of the MPRDA are the same as those above with an additional phrase being “any other method as the Director-General may determine”. This option will no longer be applicable under NEMA. If the rehabilitation funds are kept in a trust fund (paragraph (a) of the section referred to above), they can only be withdrawn for rehabilitation purposes (or used for purposes set out in section 37A), and many mining companies have opted to solely provide for rehabilitation through insurance policies rather than to establish rehabilitation trusts. In some instances, mining companies have gone so far as to transfer funds out of already established rehabilitation trusts into the aforementioned insurance policies. The South African Revenue Services (SARS) does not favour such transfers and has indicated that application of the penalty provisions provided for in section 37A (which would lead to a penalty in excess of 200 percent of the value of the funds in the rehabilitation trust) would be strictly applied to any transfer that contravenes the provisions of section 37A (Van Zyl, 2014). The contravention would occur if the company or trust distributes property from that company or trust for a purpose other than:

- a) rehabilitation upon premature closure
- b) decommissioning and final closure
- c) post-closure coverage of any latent or residential environmental impacts
- d) transfer to another company, trust or account established for the purpose contemplated in subsection (1)(a) of section 37(1). The reason that there would be a penalty on the transfer is that any funds contributed to the trust fund are deductible for tax purposes and should only be used for rehabilitation purposes (McMeekin & Strydom, 2011).

### 1.2 Motivation of topic actuality

As alluded to earlier, non-rehabilitation of mines can have significant consequences for humans and nature. Mining companies in South Africa are required to make a financial provision in terms of the Notice (South Africa, 2015) for the rehabilitation of the mining areas on which mining activities are conducted. For companies that merely provide for payment of
rehabilitation through a rehabilitation trust, this would imply that a cash contribution of the entire shortfall amount would need to be made towards the rehabilitation trust. Commercially, many mining companies (especially junior mining companies defined as mining exploration companies that are not producing and are relying on the market for financing) are not in a position to make such contributions as this would lead to cash flow constraints for the already cash strapped mining companies (Van Zyl, 2014).

The study aimed to compare the income tax implications of the methods of providing payment, as provided in the Notice (South Africa, 2015). A number of factors that are unique to the mining sector need full consideration in the design of mining tax regimes. One of them is post-mining: after mining ceases and there is no income, projects often incur significant rehabilitation costs and also in some instances extended liabilities for site management. The typical response is to provide tax deductibility to encourage companies to set aside funds progressively during the production phase. Some have suggested that tax relief for such funds should not apply because rehabilitation is a social responsibility (Mitchel, n.d.). The study further aimed to understand the international income tax implications of rehabilitation provisions as funding vehicles as well as to understand the types of rehabilitation funding that are available.

A study by the World Wide Fund for Nature (WWF), published in August 2012, suggests that South Africa’s environmental rehabilitation obligations are underfunded by about R30 billion (according to a study done by the Auditor-General (Nogxina, 2010)), mainly as a result of the underfunding of the remediation of acid mine drainage and the rehabilitation of derelict and ownerless mines (PricewaterhouseCoopers (PwC), 2012:39). The Davis Tax Committee (DTC) has recommended that an investigation be conducted to provide appropriate tax relief in respect of all the funding mechanisms available in terms of NEMA, subject, of course, to the application of due care in not opening any doors to tax avoidance (DTC, 2015:98). The study can be beneficial for startup mines that are unsure about which option to choose, based on the tax implications.

The Australian Federal Government uses taxation policy to encourage environmental responsibility. This is consistent with numerous others, such as the Organisation for Economic Cooperation and Development (OECD) and the United Nations (UN). The World Bank also advocates the use of “economic incentives to correct market failure in the management of natural resources and the control of pollution”. The use of tax policy to encourage investment in natural resources is contentious as some taxpayers obtain a benefit not available to all. Yet the tax system has also been described as an appropriate tool with which governments can
implement policies to achieve specified policy goals (Joseph, 2013). To be effective, a regulatory system for mine site rehabilitation should provide incentives to minimise damage, ensure sufficient funds are available to finance the rehabilitation, develop clear standards for rehabilitation and “ensure that mining companies receive equitable tax treatment with respect to the costs incurred” (Andrews-Speed & Rodgers, 1999:222).

2. Problem statement

The research was conducted to answer the following question: “How do the income tax implications of rehabilitation funding vehicles allowed per the MPRDA, compare to each other and to funding vehicles available in Australia and in Canada?”

3. Objectives

The comparative study aimed to achieve the following objectives:

- Obtain an understanding of the rehabilitation fund payment options available per MPRDA/Notice (South Africa, 2014) and the commercial terms of the payment options (addressed in Chapter 2)
- Understand the South African income tax implications of using direct deposit to DMR, by bank guarantee, through use of an insurance policy and by setting by a rehabilitation trust as a vehicle for mine rehabilitation funds (addressed in Chapter 3)
- Obtain an understanding of the methods available for providing for rehabilitation funds in Australia and Canada and compare the South African income tax implications of vehicles as provided in MPRDA/Notice (South Africa, 2014) and the income tax implications of similar funding vehicles available in Australia and Canada (addressed in Chapter 4)

4. Research design/method

The chosen design of the research is descriptive. Descriptive studies aim to describe a phenomenon whereas exploratory studies generate speculative insights, new questions and hypotheses; descriptive studies aim to describe phenomena accurately, either through narrative-type descriptions, classification or measuring relationships (Durrheim et al., 2006a:44). The nature of the research is qualitative. Qualitative researchers collect data in the form of written or spoken language or in the form of observations that are
recorded in language, and they analyse the data by identifying and categorising themes (Durrheim et al., 2006b:47).
Sources that have been consulted during the study include:
- journals in industry
- internet websites
- books
- relevant legislation.

5. Research layout

The objective of Chapter 2 was to obtain an understanding of the requirements of the MPRDA and the Notice (South Africa, 2014) in relation to rehabilitation funding and the vehicle funding options that are available to mine companies in South Africa. Each of the options’ nature/characteristics, advantages, disadvantages and cash flow implications have been explored.

Chapter 3 aimed to understand the South African income tax implications of each of the funding vehicles as identified in Chapter 2. A comparison of each of the funding options and their income tax implications is also conducted in Chapter 3. The objective of Chapter 4 was to identify whether the South African rehabilitation funding vehicles are available in Canada and Australia and identify their income tax implication on the mining company. Where comparison is possible based on the funding options that are available, the South African income tax implications of the funding vehicles were compared to those identified in Chapter 4. Chapter 5 concluded on the comparison of the income tax implications of rehabilitation funding vehicles available in South Africa and the income tax implications of rehabilitation funding vehicles that are available in Australia and in Canada. Legislation and amendments to existing legislation enacted up to 31 December 2015 was taken into account in the research.
CHAPTER 2: MINE REHABILITATION FUNDING PER MPRDA/NEMA

2.1 Introduction

According to the MRPDA, mineral and petroleum resources are the common heritage of all people of South Africa and the state is the custodian thereof for the benefit of all South Africans. In order to ensure that the State fulfils its role of custodianship, the Minister must ensure the sustainable development of South Africa's mineral and petroleum resources within a framework of national environmental policy, norms and standards, while promoting economic and social development. The MPRDA is the primary legislation that governs the mining industry and its activities. It repealed the MA and the environmental regulations of the Mines and Works Act\(^6\) (MWA) that remained in force under the Minerals Act of 1996. The Act does not make provision for a savings clause for the MWA regulations that regulated matters pertaining to the environment and rehabilitation (Hartzer, 2009:29).

Section 38 of the MPRDA imposes a duty on holders of rights in terms of the MPRDA to rehabilitate the affected environment when mining has ceased. It means, by implication, that if a person is not a holder of a mining right, he or she is not obliged to rehabilitate a mine (Hartzer, 2009:30). An Environmental Management Plan (EMP) must be approved before mining may commence (Hartzer, 2009:29). An EMP outlines the environmental impacts, the mitigation measures, roles and responsibilities, timescales and cost of mitigation (Department of Environmental Affairs and Tourism, 2010). Per regulation 52 of the MPRDA, the Environmental Management Plan must contain, among others, financial provision which must include:

(i) the determination of the quantum of the financial provision contemplated by regulation 54
(ii) details of the method for providing for the financial provision contemplated in regulation 53.

Section 41 of the MPRDA requires an applicant for a prospecting right, mining right or mining permit to make a prescribed financial provision for the rehabilitation or management of negative environmental impacts before the minister approves the EMP (Chamber of Mines, 2015). Rehabilitation must take place during and after mining, and rehabilitation plans must therefore be included in the EMP in order to obviate irremediable

\(^6\) 27 of 1956
impacts on the environment and to ensure that the site will be usable in future. The Department of Minerals will only approve an EMP if the applicant provides proof of the capacity to rehabilitate and manage any negative effects on the environment (Hartzer, 2009:29).

The Department of Mineral Resources, Department of Water Affairs and Sanitation and Department Environmental Affairs released a statement on 6 December 2014 confirming that the Government would commence the rollout of the much anticipated One Environmental System (OES) on 8 December 2014. This system will result in far greater integration of environmental regulation needed for mining (Erasmus et al., 2015:2). For effective implementation of the One Environmental System, the ministers responsible for the Department of Environmental Affairs, Department of Water Affairs and Sanitation and DMR have agreed that the requirements for making financial provision for the management, rehabilitation and remediation of environmental impacts from mining operations will be regulated under NEMA and no longer under the MPRDA (Chamber of Mines, 2015). Section 28 of NEMA places a retrospective duty of care on persons who cause, have caused or may cause significant pollution or degradation of the environment (Bond-Smith et al., 2012:8). Draft Financial Provision and Closure Regulations were published for public comment in October 2014 (South Africa, 2014).

The finalisation of the development of the financial provision for rehabilitation regulations in terms of NEMA is still pending. Until such regulations are finalised, the MPRDA regulations will remain in force in this regard (DME, 2014). The Draft Financial Provision and Closure Regulations have more onerous and detailed provisions regarding financial provisions, rehabilitation and the required reports than those previously in the MPRDA. Failure to comply with these Regulations would result in a fine of R10 million under NEMA.

Under the proposed transitional provisions:

- existing financial provisions must be regarded as having been approved
- a holder that operates under an approved financial provision must review and align it with the Draft Financial Provision and Closure Regulations
- a holder must within 15 months after the coming into effect of the Draft Regulations assess and adjust the financial provisions in accordance with the procedure contained in these Regulations and submit a revised sum to the Minister for approval. If the holder fails to comply with this requirement, the existing financial provision will lapse after 45 days after the expiry of the 15-month period (Erasmus et al., 2015:2).
The next section will analyse the process that needs to be followed to calculate the amount of the rehabilitation provision which needs to be funded.

2.2 Financial provision process

Once an EMP is approved, the financial provisions and associated rehabilitation and closure plans need to be reviewed annually by the mining company and adjusted if necessary. As with initial estimates, DMR verification and approval are required in keeping with the ongoing monitoring mandate of the DMR (Bond-Smith et al., 2012:27). The financial provisions process requires mining entities to re-assess and adjust their provisions on an ongoing basis to the satisfaction of the authorities (DMR) (Bond-Smith et al., 2012:11). The EMP, financial provisions amount and financial instrument are checked and approved by the DMR using DMR guidelines. The mining process will only commence once the financial provisions agreement is signed and the financial instruments are put in place.

The scope of the financial provision must include the following:

- Rehabilitation and remediation
- Decommissioning and closure activities at the end of prospecting, exploration, mining or production operations
- Remediation and management of latent or residual environmental impacts, which may become known in the future, including the pumping and treatment of polluted or extraneous water (Chamber of Mines, 2015).

The process of actually calculating adequate financial provisions for closure is challenging, as the calculations must provide clarity on what actions must be taken, together with the cost estimations in respect of such actions, which estimations are based primarily on experience built up over time. As a result, some of the larger mining companies and their environmental consultants have developed rehabilitation and closure cost estimation models that can be applied in this regard. The DMR also has a “Guideline document for the evaluation of the quantum of closure-related financial provision provided by a mine” released in 2005, which is based on work commissioned by Golder Associates (2004) and includes specific guidance with regard to cost estimation. The guideline document is not only used by DMR officials when reviewing the financial provisions of mines but also by miners and consultants who don’t have their own closure cost estimation models. It is thus central to the estimation and ongoing
monitoring of adequate financial provisions, both from a mining company and state authority perspective (Bond-Smith et al., 2012:15).

Closure provisions are measured at the present value of the expected future cash flows that will be required to perform the decommissioning. The “best estimate” may be determined by taking into account all possible outcomes and using probabilities to weight these outcomes. There are a number of tools available in calculating the best estimate for the provision (PwC, 2012:93).

The cost of the provision is recognised as part of the cost of the asset for accounting purposes when it is put in place and depreciated over the asset’s useful life. The total cost of the fixed asset, including the cost of closure, is depreciated on the basis that best reflects the consumption of the economic benefits of the asset (typically units of production). Provisions for closure and restoration are recognised even if the closure is not expected to be performed in the near future, for example, after a period of more than 50 years. The effect of the time to expected closure will be reflected in the discounting of the provision. The discount rate used is the pre-tax rate that reflects current market assessments of the time value of money. Miners with multi-national operations should select an appropriate discount rate for locations with materially different risks (PwC, 2012:93). The mining right holder must annually assess his or her environmental liability and increase his or her financial provision, with ministerial approval. The minister may retain a portion of the financial provision to rehabilitate any latent or residual environmental effects from the closed mine (Tucker, 2014).

2.3 Financial provision funding vehicles

Per regulation 53 of the MPRDA, the financial provision required in terms of section 41 of the MPRDA to achieve the total quantum for the rehabilitation, management and remediation of negative environmental impacts must be provided for by one or more of the following methods:

(a) An approved contribution to a trust fund as required in terms of section 10(1)(cH) of the Income Tax Act\(^\text{7}\) (ITA) and must be in the format as approved by the Director-General from time to time

(b) A financial guarantee from a South African registered bank or any other bank or financial institution approved by the Director-General guaranteeing the financial

\(^{7}\) 58 of 1962
provision relating to the environmental management programme or plan in the format as approved by the Director-General from time to time

(c) A deposit into the account specified by the Director-General in the format as approved by the Director-General from time to time

(d) Any other method as the Director-General may determine.

Section 10(1)(cH) was repealed by the Revenue Laws Amendment Act\(^8\) and it is submitted that the reference therefore should read “section 10(1)(cP), which refers to the receipts and accruals of a company or trust contemplated in section 37A” (Bond-Smith et al., 2012:31). The amendments unified the deduction contribution rules of section 11(hA) and the exemption rules of section 10(1)(cH). The rehabilitation payment requirements per NEMA will be the same as the first three as provided for in Regulation 53 of the MPRDA. The payment method in (d) above will no longer be applicable once NEMA has been approved.

Each of the guarantee methods offers distinct benefits and disadvantages in terms of

- cash flow impacts
- cost
- tax implications
- flexibility
- investment opportunities (Momentum, 2015).

The choices open to mines in South Africa for making financial provisions introduce flexibility, which offers mining entities choices among financial service providers that would in all probability provide for more cost effectiveness in making the financial provision (Bond Smith et al, 2012:31). The different methods, from DM's perspective, ensure that the risk of default is spread and diversified among more entities, thus reducing the risk of default. Some of the instruments are quite complex (Idiglo, n.d.). Each of the financial funding vehicles will now be discussed with specific reference to their advantages and disadvantages.

### 2.3.1 Cash deposits

#### 2.3.1.1 Nature

The cash option involves the deposit of funds with the DMR, which are kept in a pool of funds. The investment income accrues to the DMR. This option is rarely favoured

\(^8\) 20 of 2006
(Holtzhausen et al., 2010). According to section 8(5) of the NEMA, if the bank transfer/deposit option is selected, interest earned on the deposit will be used by the Minister for the management and auditing of the account or any other activity related to environmental management and protection.

2.3.1.2 Advantages

This option presents a low risk to the DMR, subject to the proviso that the quantum of such cash is sufficient to undertake the requisite remedial work and subject to our observations below as to the position on insolvency (Bond-Smith et al., 2012:32).

2.3.1.3 Disadvantages

The cash option of placing an amount of cash on deposit with the DMR is the least used due to the constraints it places on the working capital requirements of the mining entity (Bond-Smith et al., 2012:32). Another disadvantage of this option is that overfunding may occur resulting in unnecessary losses, and also the option is not very flexible (Marsh, 2015). In practice, mines say, it is easier to put funds into the DMR account than take them out (Financial Mail, 2012), so this option may therefore create difficulty in obtaining a refund for the rehabilitation expenditure incurred once the mine has been rehabilitated.

Other than the initial cost of transferring the funds to the DMR’s bank account, the mining company would not incur any costs in relation to this cash deposit. However, it can place a cash flow constraint on business cash flow as the amount of the deposit may be significant, based on the size of the mine. Since the funds would be in a DMR bank account, the mining company loses out on potential investment income, which would have been earned if the funds were still in the mining company’s name as in the bank guarantee option to follow.

2.3.2 Bank guarantee

2.3.2.1 Nature

A guarantee is derived from a relationship between the principal debtor and the creditor (beneficiary). This relationship is referred to as the underlying relationship or contract. In order to safeguard the employer or buyer (referred to as “creditor”) against non-performance or late defective performance by the supplier or contract (referred therein as “debtor”), international contracts usually contain a clause that demands that the debtor provide a guarantee in favour
of the creditor. Pursuant to this clause, the debtor instructs his bank to issue a guarantee with the terms and conditions as specified by him. The relationship between the debtor and the bank thus embodies an internal mandate. Of course, the bank is not obliged to carry out this instruction unless it has agreed to do so, and it will require funds to be deposited or to have other provision made to cover its prospective liability under the guarantee. Under this relationship, the debtor becomes the principal, the bank the guarantor and the creditor the beneficiary. Should the bank be called to pay under the guarantee, the bank must pay, provided that the demand and other documents (if any) conform to the terms and provisions of the guarantee and in the absence of fraud or other exculpatory grounds. The bank will then claim reimbursement from the principal under its counter-indemnity contract (Kayembe, 2008:13).

All guarantees serve basically the same overall purpose, namely, protection against non-performance. However, it has been deemed appropriate to have separate guarantees for particular phases of performance rather than to have a single guarantee covering all the stages of performance (Kayembe, 2008:24). In the case of bank guarantees, the creditworthiness of the counterparties involved plays a key role, as does the ability of the counterparty to on-sell a portion or all of the risks it has assumed by means of credit derivatives (Bond-Smith et al., 2012:6). Types of charges would be an establishment fee, an additional fee if the structure is not standard, a quarterly administration fee, an amendment fee if necessary, and a cancellation fee if necessary (Standard Bank, 2015).

2.3.2.2 Advantages

An advantage of a cash-covered bank guarantee compared to the cash deposit option is that a company can earn interest on money, as the company can choose from a number of investment accounts, including term deposits, to earn interest on its secured cash (CommonwealthBank, n.d.). Paragraph 66 of the International Accounting Standard 1 (IAS) requires an entity to classify an asset as current when the asset is cash or cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period. This means that the guarantee will be restricted and displayed as either a current or non-current asset that contributes positively to financial ratios of the entity that uses assets in the formula or calculation. Another advantage of this option is that the cost of a guarantee where 100 percent collateral is provided is low, since there is no risk to the bank (Marsh, 2015).
2.3.2.3 Disadvantages

A disadvantage of this option is that banks often require collateral in a cash investment upfront, which may place constraints on the company’s cash flow requirements based on the size of the company (previously banks did not require collateral, but took cession of the assets as security). This option ties up the bank credit lines to the client or may limit access to additional credit lines (Marsh, 2015).

2.3.3 Insurance guarantee

2.3.3.1 Nature

The concept of rehabilitation has become part of South African Environmental Law (Madalane, 2012). Normally these capital outlays are enormous and can often be enough to put off junior miners. Over time, this can be a huge financial liability on the mine’s Statement of Financial position sheet as the onus is on the mining company to rehabilitate the environment at the end of the life of the mine, which can end up costing hundreds of millions of rand. The insurance mining rehabilitation guarantee is a viable alternative and is approved by the DMR (Udemans, 2011:9). The way it works is that while the liability grows over time, the insurance guarantee carries the cost of the risk without the onus of tying up much needed working capital at various stages of the life of the mine, and allows the mining house to grow the funds as the mining operation grows. Effectively, insurance brokers facilitate insurance guarantees with a reputable insurer who provides the required guarantee as required by the DMR up front, and this allows mining houses to build up the rehabilitation funds over time so that clients have the amount needed for environmental rehabilitation at the end of the mine’s life (Juma, 2015).

There are two types of insurance guarantees, namely a conventional insurance guarantee and a risk finance insurance guarantee. The main difference between the two is that with the risk finance guarantee, the mining company builds reserves into a contingency policy and the insurance vehicle generates investment returns, while the conventional insurance guarantee does not provide this advantage (Marsh, 2015). With the conventional option the funding payments would be payable monthly to ensure full funding in a five-year rolling period. Should the mining company cancel the conventional option, they would not get any funds from the insurer, but should a company cancel the policy for the risk finance guarantee, they could receive a discretionary bonus net of the insurer’s cost. The risk finance guarantee option does not require cession of assets as security, while the conventional insurance guarantee needs...
to be backed by security – a deed of indemnity and cession over security funds (Mafoko, 2015).

According to binding class ruling BCR049 which is valid for five years from 15 July 2016, relating to the financial provision that an applicant (mining company) must provide for the rehabilitation of land in respect of which mining activities are conducted, one of the options of providing funding for the financial provision can be in the form of an insurance policy. The insurance policy would be guaranteeing the availability of the sufficient funds to undertake the agreed work programmes and to rehabilitation the prospecting, mining and reconnaissance, exploration or production areas as the case may be. The applicant for the binding class ruling developed a product to enable mine owners to provide the DMR with the required financial provision. The guarantee consists of:

- A guarantee insurance policy (as defined in the Short Term Insurance Act No. 53 of 1998) to be issued by the Applicant to the mine owner; and
- A guarantee, in the prescribed form, to the extent of the liability as determined in the EMP for three years, to be issued by the Applicant to the DMR, in terms of which the Applicant will assume the liability for the cost of the environmental rehabilitation obligation on behalf of the mine owner.

The DMR may also call for payment in terms of the underlying guarantee when:

- the mine owner ceases to conduct prospecting operations;
- the mine owner is sequestrated;
- the mine owner surrenders his estate, in terms of the Insolvency Acts that are applicable in South Africa or;
- the applicant, as Guarantor, notifies the DMR that it wishes to withdraw from the guarantee.

The mine owners are not guaranteed to be repaid any of the premiums contributed. If any money is paid, the payment is seen as a discretionary bonus. The mine owners have no control over the manner and the investments in which the premium are invested. In the case of termination, early termination or special cancellation of the policy, the insurer shall determine any losses, if there are any, and the losses need to be paid to the insurer by the mining company. After expiry of the term of the insurance contract set at inception, the policy may either be cancelled or renewed or transferred and the following events may happen:
If the policy is not renewed, it will pay back the experience bonus balance, subject to insurance calculations.

If the policy is renewed, the mining company will be paid the experience bonus as above and the risk will again be underwritten with the insured/mine paying a premium for the new renewal period.

The bonus paid out shall be limited to the insurance premiums paid (Mafoko, 2015).

During the first quarter of 2009, the Department of Minerals and Energy suspended the practice in which mining companies obtained environmental rehabilitation guarantees from insurance companies. The Department based its decision on its belief that cash or bank guarantees provided greater security. It said that insurance guarantees expose the state to the risk of a guarantee not being honoured in cases where the mining company did not disclose material facts, neglected to pay premiums, or did not meet its obligations in terms of the contract of insurance (Holtzhausen et al., 2010). The reason provided for this is that insurance products expose the Department of Minerals and Energy to guarantees not being honoured because the mining company did not comply with the policy conditions. This then left only the other three options available for mining companies (AON, n.d.). This resulted in intense consultations between all stakeholders, including the Department, insurers, the National Treasury, the Chamber of Mines, the Financial Services Board and the South African Insurance Association (Van Wyngaardt, 2011).

During the first quarter of 2011, the DMR lifted the moratorium on the acceptance of insurance guarantees for mining rehabilitation. The conditions remained the same as before the moratorium was imposed, except that the Department has now specified only a limited, few short-term insurance providers from which guarantees for liabilities relating to environmental rehabilitation will be accepted (Schoeman, 2011). The Financial Services Board (FSB) must also confirm the financial standing of the insurers operating in this space, before insurance guarantees for mining rehabilitation will be accepted by the DMR (Strydom, 2011). At the time the moratorium was lifted, insurance companies had been providing insurance rehabilitation guarantees for mining rehabilitation for the previous 12 years (Strydom, 2011). There appears to be a certain level of discomfort surrounding the use of insurance products in the context of section 41 of the MPRDA. Concerns range from so-called “unscrupulous fly-by-night operators” to the fact that the products are not actually insurance products but performance guarantees disguised as insurance products. The use of insurance products certainly has conceptual appeal but they are relatively untested and only really used in SA and the USA (Bond-Smith et al., 2012:8).
2.3.3.2 Advantages

Compared to a bank guarantee and a cash deposit, the benefit of these insurance products is that although the guarantee is received upfront, the mining companies have a longer period during which the actual premiums can be paid as the insurance policies typically extend over three years (which could be extended further), thereby easing the cash flow constraints. Due to the funds contributed to a rehabilitation trust being restricted and only being withdrawn for rehabilitation purposes (or used for purposes as set out in section 37A), many mining companies have opted to rather solely provide for rehabilitation through insurance policies than to establish rehabilitation trusts (i.e. mining companies regard the insurance products as a more effective method to provide for future rehabilitation expenditure) (Van Zyl, 2014). As alluded to earlier, the risk finance insurance guarantee option builds reserves in a vehicle that generates returns and it is an easy process to release proceeds or an overfunding portion back to the client (Marsh, 2015).

2.3.3.3 Disadvantage

The main disadvantage of this option is that the conventional insurance guarantee requires security and does not build reserves in an insurance vehicle that can be released back to the client if there is overfunding (Mafoko, 2015). Another disadvantage of this option is that there are very few products currently available on the market and there is also reluctance by some larger insurers to cover environmental liability risks (World Bank, 2008).

2.3.4 Setting up a rehabilitation trust

2.3.4.1 Nature

In South Africa the trust has developed into one of the most frequently used institutions. The impressions often gained are that whenever a legal or other impediment exists, a trust could be formed to solve the problem. This seems to be a worldwide phenomenon (Honiball & Olivier, 2011:14). The Companies Act\(^9\), defines a trust as a juristic person, including a foreign company and a trust, irrespective of whether it was formed within or outside the Republic. The Trust Property Control Act\(^10\) defines a trust as “the arrangement through

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\(^9\) 71 of 2008  
\(^10\) 57 of 1988
which the ownership of property of one or more persons is by virtue of a trust instrument made over or bequeathed

(a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument for the achievement of the object stated in the trust instrument

(b) the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instruments for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument, but does not include the case where property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Estates Act\textsuperscript{11}.

The trust deed is the governing document and similar to the terms of an agreement. In addition to the trust deed, the Trust Property Control Act imposes requirements and governing of the ownership and control of property and the duties of the trustees. The common-law duties of trustees imply that trustees must maintain meticulous records in respect of trust affairs and should always be in a position to account to the Master or the beneficiaries when called upon to do so (Retief, 2012). Trust funds are commonly used, particularly by well-established mining companies. The trust structure may be inflexible and few junior companies have the financial resources to create rehabilitation trusts (Holtzhausen \textit{et al.}, 2010).

Section 37A of the ITA will be analysed in detail in Chapter 3 but part one of the section prescribes requirements of the structure of a rehabilitation trust to which the section applies after 2 November 2006. The first requirement is that the sole object of the trust is to apply property for rehabilitation upon premature closure, decommissioning and final closure and post-closure coverage of any latent and residual environmental impacts on the area covered in terms of any permit, right, reservation or permission to restore one or more areas to their natural or predetermined state. The company or trust must also hold assets purely for the purpose of the mine and must also only make distributions for the purpose of mine rehabilitation. The person who owns the closure company or trust must be the holder of a permit or right in respect of prospecting, exploration, mining or production, an old order right or OP26 right as defined in item one of Schedule II, or any reservation or permission for or

\textsuperscript{11} 66 of 1965
right to the use of the surface of land as contemplated in item 9 of Schedule II to the MPRDA, or is engaged in prospecting, exploration, mining or production in terms of any permit, right, reservation or permission as contemplated above.

2.3.4.2 Requirements for the trust per MPRDA/NEMA

Section 8(3) of the Notice (South Africa, 2015) requires that the deed trust should be established per the format set out in Appendix 1 of the Notice (South Africa, 2015). Part 5 of Appendix 1 of the Notice (South Africa, 2015) provides guidance on the administration of trusts. The trustees shall administer the trust and shall not receive any remuneration from the trust. Part 13 of the Notice (South Africa, 2015) requires that the trustees keep proper records of the trust and appoint independent auditors to report on the financial statements for each financial year of the trust. All costs and charges of the trust will be borne by the trust. These costs should be provided for out of the money of the income of the trust in that financial year. The balance of any income remaining after deducting such costs, charges and expenses shall be the net income of the trust. The trustees are not permitted to distribute any of the funds of the trust to any person and shall utilise the trust solely for the object for which the trust was established, which is rehabilitation. No surplus shall be refunded to the founder.

The obligation on the beneficiary mining entity to make contributions to the trust to fund such future rehabilitation should perhaps be dealt with contractually (i.e. not in their capacity qua beneficiaries) as follows:

- The trust deed provides that the books of account of the trust are to be audited by independent auditors. This should be amended to ensure that assurances are given as to compliance with the statutory obligations, terms of the trust deed, etc., as this would essentially entail greater self-regulation, thereby alleviating resource constraints within the DMR. Such an environmental assurance report is to be submitted to the DMR directly by the independent assurance provider and the trust deed should accordingly clearly state that such obligation would be a term of engagement.
- The provisions in the trust deed do cater for a limitation of investments that may be made.
- The trust deed contains references to the repealed section 10(1)(cH) of the Income Tax Act, which would need to be replaced by section 10(1)(cP), read with section 37A.
- The trust deed states that losses of the trust are to be “debited to the account of beneficiaries”, which appears to be in contradiction to section 25B of the Income Tax Act and the general legal status of beneficiaries not being liable for losses of the trust in
law in their capacity as beneficiaries. Such liability for losses, it is submitted, should be dealt with by means of alternate legal means (Bond-Smith et al., 2012:33-34).

Part 17 of the Notice (South Africa, 2015) states that the trust can only be terminated after all the beneficiary’s statutory obligations in respect of all its mining operations at any time have been met to the satisfaction of the Minister of Mineral Resources.

The use of trusts as a means of achieving improved compliance with section 41 of the MPRDA would be improved if the following aspects are given further attention:

- Greater clarity as to the legal mechanisms by which funds earmarked for rehabilitation will be accessible for use by the DMR in the event of the provisions of section 41(2) of the MPRDA becoming applicable, both from a going concern perspective and in the event of an insolvency
- Improved and greater provision for liability of trustees to be aligned with section 34 of NEMA, section 38 of the MPRDA, section 77 of the Companies Act and section 9 of the Trust Property Control Act. In addition, trustees should become personally liable if the provisions of the trust deed are not complied with
- In similar vein, while the Master of the High Court would probably not allow unrehabilitated insolvents or persons previously removed from offices of trust for reasons such as fraud or dishonesty from being appointed as trustees, it would be preferable for the trust deed explicitly to preclude certain people from the office of trustee (Bond-Smith et al., 2012:33-34).

2.3.4.3 Advantages

Contributions into this trust are not limited and there is potential for higher investment returns because of the flexible investment strategy. Another advantage would be that the trust could be used for future mining activities should the company open additional mines (Marsh, 2015).

2.3.4.4 Disadvantages

In the instance of a trust fund, the ability of the DMR to access the funds as contemplated in section 41(2) of the MPRDA may be problematic. In addition, it seems that the standard trust documentation prescribed by the DMR purports to impose obligations on the mining entity in its capacity as beneficiary, which is problematic in law. The wording of the trust deed and the
MPRDA must be aligned with the provisions of the ITA due to the former making reference to repealed sections of the ITA (Bond-Smith et al., 2012).

Furthermore, distributions made by mining entities to shareholders where unfunded environmental obligations exist may not always be subject to the protection afforded by section 4 of the Companies Act imposing a solvency and liquidity test before the making of distributions as defined (Bond-Smith et al., 2012). With the trust option, overfunding may occur, which can result in unnecessary losses for the mining companies. Once rehabilitation has been completed to the satisfaction of the Minister of Minerals and Energy, the fund is obliged to transfer its assets to a similar company or trust, or to an account of a company or trust prescribed by the Minister and approved by SARS (McMeekin & Strydom, 2011). In this way the DMR can utilise any excess funds for rehabilitation of other mines that are not part of the client’s mining activities. SARS and the DMR need to approve the payments into the trust. The process of removing overfunding amounts from the trust is also a very complicated procedure (Marsh, 2015).

2.4 Summary

In summary, the MPRDA is legislation set up to govern the mining industry, its activities and the rehabilitation of the mined area during and beyond the useful life of the mine. More specifically, regulation 53 and 54 of the MPRDA currently regulate the rehabilitation funding vehicles. In an effort to create One Environmental System inclusive of mine rehabilitation, the South African Government is in the process of making an amendment to NEMA that will see mine rehabilitation provisions and funding options included under NEMA. Regulation 53 and 54 of the MPRDA will, however, remain in effect until such time that the amendment to the legislation is passed.

A provision for rehabilitation must be made and funded by a mining company to ensure that the mine is able to perform rehabilitation not only at the end of the life of the mine but also during the course of its useful life. There are four funding vehicle options available to mining companies per regulation 53 of the MPRDA that were discussed in this chapter, namely:

(a) Cash deposit to the DMR
(b) Bank guarantee from an approved financial institution
(c) Providing an insurance guarantee
(d) Setting up a trust as required per section 37A of the ITA.
The cash deposit option is used the least as once the transfer has been made to the DMR, any interest earned on the funds accrues to the DMR and not the mining company. The cash is also not displayed as part of the entity’s assets. The bank guarantee requires cash security and will be displayed on the entity’s records; interest earned on the guarantee accrues to the mine entity and can be utilised. However, bank guarantees may tie up the mining company’s facilities.

Guarantees issued by banks are the most commonly used form of providing for rehabilitation funding and insurance companies have proven to be an attractive option for mining companies. The insurance guarantee option provides an alternative to often more expensive cash or bank guarantees. In many cases, particularly junior mining firms provided for a portion of the rehabilitation fund with the insurers underwriting the balance. This enables smaller companies to use their capital to grow their operations (Holtzhausen et al., 2010).

The trust option is used mainly by larger organisations as the option is restrictive and regulated. Gaining access to the funds may be complicated and the remainder of the funds may be used to rehabilitate mines that are not even part of the company. Section 37(1) of the ITA prescribes certain characteristics that a rehabilitation trust should have. There is no restriction placed on the choice of funding vehicle a mining company may choose to use and some companies may even choose to use a combination of funding vehicles that are available. Each option has its own benefits and disadvantages in terms of cash flow, cost, flexibility, investment opportunity and tax implications. The latter, namely “income tax implications” of each of the funding options, will be discussed in Chapter 3.
CHAPTER 3: SOUTH AFRICAN INCOME TAX IMPLICATIONS OF FUNDING OPTIONS

3.1 Introduction

Risks inherent to the mining sector include long exploration periods with uncertainty on geological outcomes, high sunk costs, uncertain future revenues due to very volatile and unpredicted mineral prices, tax liabilities that may constitute a substantial and primary benefit to the host country, a long period of production to reach break-even point, the exhaustibility of resources, and potentially significant mine rehabilitation and community support costs (Goldsworthy & Hogan, 2010). The unique nature of the mining sector tends to result in special tax dispensation that includes a wide variety of fiscal instruments, such as corporate income taxes, royalties, resource rent taxes, windfall taxes and state ownership (PMG, 2013:9). It is hardly surprising that the first serious attempts to raise significant income taxes were aimed at the mining sector and that these taxes have historically always been more onerous than those imposed on other sectors (Van Blerk, 1992:1-2). A core focus area of SARS appears to be closure rehabilitation companies and trusts, with mining groups being asked to defend not only the exempt status of their rehabilitation vehicles, but also the deductibility of the contributions made to these vehicles. On review of the tax legislation pertaining to these rehabilitation vehicles, the issue that is currently under scrutiny is the compliance of the underlying rehabilitation vehicle with the South African ITA. More specifically, SARS is considering whether the rehabilitation vehicle holds only conforming investments, makes appropriate distributions, and whether the Trust Deed or Company Constitution incorporates the specific provisions of Section 37A, which was introduced in 2006 (PwC, 2011:32).

In order to contribute to answering the research question, this chapter commences with an analysis of the income tax implication of transferring cash to the DMR as a form of security, the value of which will be based on the estimated cost of rehabilitating the land on which mining activities are being performed. The income tax implications of the initial transfer of the cash to the DMR, charges incurred, rehabilitation costs and release of the security will be analysed. The second part will analyse the income tax implications of creating a bank guarantee for the benefit of the DMR as security, costs incurred, and implications on any income that is earned on the funds of the guarantee, rehabilitation funds and release of the guarantee once rehabilitation has been completed. The third part will analyse the income tax implications of using an insurance policy as a form of guarantee for security of the rehabilitation costs. Implications of costs incurred to create the policy, rehabilitation costs and any income earned on the policy will also be analysed. The latter part of the chapter will
analyse the income tax implications of using a rehabilitation trust as a form of funding vehicle for providing security for rehabilitation of a mine at the end of its life.

3.2 Bank transfer: Income tax implications

3.2.1 Transfer of funds to the DMR

Transfer of the rehabilitation funds to the DMR results in an outflow of resources. According to section 11(a) of the Income Tax Act (ITA), which contains the general deduction formula, an amount is only deductible for purposes of calculating taxable income of a taxpayer if the taxpayer has actually incurred the expense or loss when engaged in the carrying on of a trade, incurred in the production of income, and the amount must not be of a capital nature. The first requirement is that the company must be carrying on a trade. Section 1 of the ITA defines “trade” as including every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and including the use of a grant or permission or any patent or design, or trademark or copyright, (as defined in the Patents Act\textsuperscript{12}, Trade Marks Act\textsuperscript{13} or Copyright Act\textsuperscript{14}) or any other property, which, in the opinion of the commissioner, is of a similar nature. Section 1 of the ITA defines “mining operation” or “mining” to include every method or process by which any mineral is won from the soil or from any substance or constituent thereof. In the case \textit{Burgess v CIR}\textsuperscript{15} it was held that the definition of “trade” should be given a wide interpretation and includes a “venture”, being a transaction in which a person risks something with the object of making a profit. One of the objectives of a mine is to generate a profit and contribute to the country’s economy, thus mining meets the definition of trade. The second requirement is that the expenditure or losses must actually be incurred. In the case \textit{Port Elizabeth Tramway Co v CIR}\textsuperscript{16} it was held, as per Watermayer AJP, that “… the words of the stature are ‘actually incurred’ not ‘necessarily incurred’”. The use of the word ‘actually’ as contrasted with the word ‘necessarily’ may widen the field of deductible expenditure. For instance, one man may conduct his business inefficiently or extravagantly, actually incurring expenses which another man does not incur; such expenses therefore are not ‘necessary’ but they are actually incurred and therefore deductible.

The term expenditure is not defined in the ITA but the Oxford Dictionary’s meaning of the term is defined as “expending of money”. Case law will be consulted as the term is not defined in

\textsuperscript{12} 37 of 952
\textsuperscript{13} 62 of 1963
\textsuperscript{14} 63 of 1965
\textsuperscript{15} (1993) 55 SATC 185 (Appellate Division)
\textsuperscript{16} 1936 CPD 241
the ITA. In *Stone v SIR*, Corbett AJA said that “the problem which arises when deductions are claimed is, therefore, usually whether the expenditure in question should properly be regarded as part of the cost of performing the income-earning operations or as part of the cost of establishing or improving or adding to the income-earning plant or machinery”. The security is a statutory requirement per the MPRDA. Without the provision of security, the mining licence will not be granted to the mining company. The funds are held by the DMR on behalf of the mining company and the transfer does not result from an expenditure what was occurred. As this requirement of the general deduction formula has not been met, the payment will not be deductible.

3.2.2 **Related expenses incurred**

Bank charges would be incurred on the payment of the funds to the DMR. The bank charges will be deductible if they meet the requirements of the general deduction formula in section 11(a) of the ITA. It is in terms of the provisions of this section that the deductions from income to which a taxpayer is entitled is determined. That is to say, in order for a taxpayer to be entitled to most of the deductions that are available in the ITA in respect of income, the relevant losses and/or expenditure must meet the requirements of this section (Mota, 2012). Deductions are allowed in determining taxable income by any person carrying on any trade if the expenditure or losses have actually been incurred in the production of income and should not be of a capital nature. Bank charges are an expense and would be incurred by the company. The second requirement is that the expenditure must be incurred in the production of income. A mining company would be in operation to generate income so that requirement would also be met. Mining rehabilitation is an activity that is required as part of the mining operation and is a statutory requirement. As mines mainly want to produce income, the expenses would be incurred to produce income.

The last requirement of section 11(a) is that an amount of expenditure or loss incurred should not be of a capital nature for it to be deductible. Usually, expenditure of a capital nature produces some identifiable asset or long-term advantage to the taxpayer’s business, for example, the construction of a building. But this is not always the case. In *SIR v Cadac Engineering* and in *CIR v African Oxygen* expenditure that improved the taxpayer’s competitive position in the market but produced no identifiable asset was held to be of a capital nature.

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17 1974 (3) SA 584 (A), 36 SATC 117
18 1965 (2) SA 511
19 1963 (1) SA 681 (A)
nature. The expense incurred would not be of a capital nature and would be deductible under section 11(a) of the ITA as it does not create an identifiable asset nor does it improve the taxpayers competitive position.

Section 11(a) of the ITA should be read with section 23(g), which stipulates what may not be deducted, which hence provides a negative test (Stiglingh et al., 2015:139). The taxpayer will most likely incur bank charges on the transfer of the funds from the mine bank account to the DMR nominated bank account. The subsequent expenses are the bank charges that would be incurred on the new bank account. These bank charges would be paid from the interest income earned on the funds invested by the DMR.

### 3.2.3 Capital gains tax

Liability for capital gains tax is determined in terms of the Eighth Schedule to the ITA. According to the Eighth Schedule, the disposal of an asset is the event that triggers the liability for capital gains tax. Paragraph 1 of the Eighth Schedule, read together with paragraph 11, defines “disposal” as any event, act, forbearance or operation of law that results in the creation, variation, transfer or extinction of an asset. The reference to “operation of law” means that the consequences referred to in paragraph 11(1) of the Eighth Schedule are effected as a result of common law or statutory law, and not as the result of the conduct of any person (Strydom & Wilcocks, 2002).

According to the Eighth Schedule of the ITA, the term “disposal” should be considered in relation to an “asset”. An asset is defined in paragraph 1 of the Eighth Schedule as property of whatever nature, whether movable or immovable, corporeal or incorporeal excluding currency but including coins made mainly from gold or platinum. A right or interest of whatever nature to such property would also meet the definition of an asset. The definition of an asset specifically excludes currency, so the transfer of the rehabilitation funds to the DMR would not constitute a disposal of an asset and no capital gains tax would be applicable to the mining company.

### 3.2.4 Income earned

Section 1 of the ITA defines gross income in relation to any year or period of assessment for a resident as the total amount, in cash or otherwise, received by or accrued to or in favour of a resident. Further interest income is taxable per section 24J of the ITA if the requirements per the section are met. The interest definition contained in section 24J(1) specifically includes
a "discount or premium payable or receivable in terms of or in respect of a financial arrangement". An interest-bearing arrangement or debt meets the definition of an “income instrument” per section 24J(1) of the ITA. Section 24J of the Act applies the principle that interest received is deemed to accrue to a taxpayer at a constant compound rate of interest over the term of an instrument. The specific amount of interest included in the income of a taxpayer is calculated in terms of the various formulas contained in section 24J of the Act (Reifarth, 2015). According to section 8(5) of the Notice (South Africa, 2015), if the bank transfer/deposit option is selected, any interest earned on the deposit accrues to the minister responsible for mineral resources for the management and auditing of the account or any other activity related to environmental management and protection. Since the interest does not accrue to the mining company, the mining company cannot be taxed on the funds.

3.2.5 Rehabilitation costs

Section 37B(6) of the ITA provides for the deduction of expenditure and losses in relation to the decommissioning, remediation or restoration after production has ceased. Environmental expenditure of this nature incurred while the taxpayer is carrying on a trade would be deductible in the normal course of business. The environmental expenditure must be incurred in complying with any law of the Republic that provides for the protection of the environment upon cessation of trade and is not otherwise allowable as a deduction (Le Roux, 2008). As the rehabilitation is required by the MPRDA and the Notice (South Africa, 2015), the expenditure would meet the requirements of section 37B and would be deductible when incurred. The only challenge at the stage at which the rehabilitation expenditure is deducted is that the mining company will not be generating income against which to utilise the deductions.

3.2.6 Refund of costs

Even though as mentioned before it is easier to put funds into the DMR account than take them out (Financial Mail, 2012), once the mining area has been rehabilitated, a refund of the costs incurred should be obtained from the DMR from the funds previously transferred to the DMR bank account. The amount of the refund will be taxable if it meets the requirements of the gross income definition in section 1 of the ITA or must be specifically included by section 8 of the ITA. The amount must be due to or accrued to the taxpayer in a year of assessment, in cash or otherwise and the amount must not be of a capital nature. The funds received from the DMR once the rehabilitation is complete are the same funds that were deposited in the DMR bank account, which was discussed in section 3.2.1 above. The funds were merely held
by the DMR on behalf of the mining company and the amount was not deductible on payment as it did not meet the requirements of section 11(a). The funds received do not meet the requirements of the gross income definition as there is no actual receipt; this is a mere refund of the funds deposited into the DMR account.

3.2.7 Summary

The transfer of the funds to the DMR will not be deductible for tax purposes as the payment does not meet the requirements of section 11(a). The mining company will not be taxed on interest income earned on the funds deposited in the DMR bank account as the interest on the funds does not accrue to the mining company as required by the gross income definition. To further corroborate the fact that the mining company will not earn the interest, the company also does not hold the financial instrument (cash) in its own name, so the interest income does not meet the requirements of section 24J of the ITA. Rehabilitation expenditure incurred will be deductible per section 37B(6) as an environmental expenditure at the end of the life of the mine. Once the rehabilitation is complete the mining company will receive a refund of the security provided to the DMR which will not be taxable.

3.3 Bank guarantee: Income tax implications

3.3.1 Introduction

The income tax implications that will be analysed are of the transfer of funds to a financial institution as collateral when a bank guarantee is created, costs incurred by the mining company, implications on any income earned on the guarantee and the implications when the guarantee is released from the financial institution once rehabilitation has been concluded. A bank guarantee involves setting up an agreement for the benefit of the DMR as required by the Appendix 2 of the Notice (South Africa, 2015).

3.3.2 Creation of the bank guarantee

The only cash flow implication of creating a bank guarantee is the transfer of funds from a current bank account to the account that has been opened by the mining company per the guarantee conditions. There are no income tax implications on the transfer of funds from one account to another as the funds are not an expense that has been incurred per the requirements of section 11(a) of the ITA. Such a transfer is similar to the cash deposit transfer to the DMR and the same income tax implications would apply.
### 3.3.3 Expenses incurred

If there are initial bank charges on the transfer of the funds to the guarantee account, the same income tax implications identified in the cash deposit option would be applicable to this option. The payment guarantee options attracts a number of costs that would be payable to the financial institution. These costs can be summarised as follows:

- Establishment fee (fee is different if the guarantee is not standard)
- Administration fees, which can be quarterly
- Amendment fee should you require amendments to be made to an existing guarantee
- Cancellation fee if you cancel the guarantee (Standard Bank, 2015).

Such expenses will be deductible from taxable income if they meet the conditions of section 11(a). Section 11(a) must be read with section 23(g), which defines what cannot be deducted (Bannatyne, 2013). The requirements stipulated by section 11(a) are that the expense must actually be incurred while carrying on a trade; there must be an intention to produce income from the trade and the expense must not be of a capital nature. The expense would actually be incurred if charged to the mining company by the bank. The principle laid down in *Port Elizabeth Electric Tramway Co. v CIR*\(^{20}\) is that an amount is deductible in terms of section 11(a) if the purpose of the taxpayer in doing the act which entailed the expenditure was to produce income and if that expenditure was so closely linked to that act as to be regarded as part of the cost of performing it. The last requirement is that the expense must not be of a capital nature. In *Bourke’s Estate v CIR*\(^{21}\) it was held that when section 11(a) prohibits a deduction of expenditure of a capital nature, it is referring to fixed capital and not floating capital. Expenditure which is part of the cost of performing the income-earning operations is revenue expenditure; expenditure which establishes, improves or adds to the income-earning machinery is of a capital nature. This economic distinction is a useful guide in matters of income tax, but its application is very often a matter of great difficulty, for what is principle or tree in the hands of one man may be interest or fruit in the hands of another (Olivier, 2012). It is submitted that it can be argued that the expense would be incurred if charged by the bank and it is closely related to the mining company generating income and is not part of creating an income earning structure and would therefore be deductible per section 11(a) of the ITA.

\(^{20}\) SATC 13

\(^{21}\) SATC 86 at 94
3.3.4 Income earned

A taxpayer’s income for a particular year of assessment is levied on his “taxable income” as defined in the ITA. The starting point in determining a taxpayer's taxable income is to ascertain gross income as defined in section 1. Income that is earned on bank guarantees is interest income and it will be included as part of the taxpayer’s gross income if it meets the definition of gross income. Section 1 of the ITA defines gross income in the case of a resident as the total amount in cash or otherwise, received by or accrued to or in favour of such year of assessment excluding receipts or accruals of a capital nature.

Further interest income is taxable per section 24J of the ITA if the requirements per the section are met. The interest definition contained in section 24J(1) specifically includes a “discount or premium payable or receivable in terms of or in respect of a financial arrangement”. An interest-bearing arrangement or debt meets the definition of an “income instrument” per section 24J(1) of the ITA. Section 24J of the Act applies the principle that interest received is deemed to accrue to a taxpayer at a constant compound rate of interest over the term of an instrument. The specific amount of interest that is included in the income of a taxpayer is calculated in terms of the various formulas contained in section 24J of the Act (Reifarth, 2015). The interest exemption per section 10(1)(i) of the ITA only applies to a natural person and a company is not a natural person, so the interest income will not be exempt. If the interest earned on the bank guarantee meets the definition of gross income, it will be included in the gross income of the company that sets up the bank guarantee for the rehabilitation provision. The company will be taxed on the interest income. The taxpayer would be able to withdraw interest income that has been earned on the bank guarantee account for other uses and can also be used to pay the tax on the interest income. The guaranteed amount cannot be withdrawn as it is restricted but the interest income is available cash.

3.3.5 Rehabilitation costs

As with the previous funding option, section 37B(6) of the ITA provides for deduction of expenditure and losses in relation to the decommissioning, remediation or restoration after production has ceased. Environmental expenditure of this nature incurred while the taxpayer is carrying on trade would be deductible in the normal course of business. The environmental expenditure must be incurred in complying with any law of the Republic that provides for the protection of the environment upon cessation of trade and is not otherwise allowable as a deduction (Le Roux, 2008). As the rehabilitation is required by the MPRDA and the Notice
(South Africa, 2015), the expenditure would meet the requirements of section 37B and would be deductible when incurred.

3.3.6 Release of the guarantee

Once rehabilitation expenditure has been incurred at the end of the life of the mine, the mining company would be able to obtain the guarantee document from the DMR and submit it to the financial institution that provided the guarantee. The funds would be released to the mining company (Chamber of Mines, 2015). The income would be of a capital nature as when the amount was paid to the bank it was not deductible as the cost was of a capital nature. The mining company would therefore not be taxed on the refund of the capital amount of the guarantee.

3.3.7 Summary

The transfer of funds from the mining company to the financial institution providing the bank guarantee would not be deductible for tax purposes as the payment does not result from an expenditure that was incurred, which contravenes the requirement of section 11 (a) of the ITA. Interest income on the bank guarantee will be included as per the company’s income per section 24J of the ITA. There is no exemption of interest income for companies, so the interest income is part of the income earned by a company and the company will be taxed on the income. The expenses incurred on the bank guarantee will be deductible for tax purposes per section 11 (a) of the ITA. The rehabilitation costs incurred will be deductible per section 37B(6) of the ITA as environmental expenditure. Refund of the funds to secure the guarantee provided by the financial institution once the guarantee document has been returned to the financial institution would not be taxable as it is a mere refund of the funds that were previously provided to the DMR as security for the rehabilitation.

3.4 Insurance policies: Income tax implications

3.4.1 Introduction

The sections in the ITA that are relevant for analysis of this section from the ITA are section 11 (a) read with section 23(g), 23H and 23L and will be analysed in order to determine the income tax implications of the insurance policy expense incurred. The tax implications of the rehabilitation expense and any refunds from the insurance policy will be also be analysed.
3.4.2 Section 11(a) read with section 23(g)

According to section 11(a) read with section 23(g) (negative test) of the ITA, an amount is only deductible for purposes of calculating the taxable income of a taxpayer if the taxpayer has incurred the expense or loss when engaged in the carrying on of a trade and the amount is not of a capital nature. Section 23(g) provides a negative test for deductions of expenses. When premium payments to insurance policy are made, the mining company would be carrying on a trade in order to earn profit and if the expense does not contribute to the income earning structure of the mine then the expense would meet the requirements of section 11(a). In *New State Areas LTD vs CIR*\(^{22}\), the taxpayer company carried on the business of gold mining. The company was required by law to install a system of water-borne sewerage and to link up with the local authority’s system. The system was installed at the cost of the local authority but the cost was recovered by way of charges payable by the company over 60 months for the cost of the system on its own property (which would become its own property) and over 180 months for the cost of the system not located on its own property (to remain the property of the local authority). It was held that the internal sewers formed part of the equipment of the mine and when paid for, became the property of the taxpayer, hence the charge paid over 60 months, though recurrent was expenditure of a capital nature and not deductible. The sewers paid for over 180 months never became the property of the taxpayer; consequently, by paying the instalments the taxpayer acquired no asset of any kind and the cost was not of a capital nature and was deductible (Williams, 2009:312). The payment of the insurance policies does not result in the mining company owning an income-generating asset so the expenses are not of a capital nature and would be deductible under section 11(a) of the ITA. There is no specific prohibition on the deduction of the expense in the calculation of income tax.

3.4.3 Section 23L

Section 23L was promulgated by the *Taxation Laws Amendment Act, 2012* and came into operation on 1 January 2013. Section 23L has been amended with effect from 1 April 2014 and applies in respect of premiums incurred by a person in terms of a policy and policy benefits received or accrued on or after that date (Stiglingh *et al.*, 2015:154). Section 23L(1) defines a policy as a policy of insurance or reinsurance other than a long-term policy defined in section 1 of the *Long-Term Insurance Act*\(^{23}\). An insurance policy falls under section 23L if it is

\(^{22}\) 1946 AD 610, 14 SATC 155

\(^{23}\) 52 of 1998
not an insurance contract as defined in International Financial Reporting Standard (IFRS) 4 (Mazansky, 2012). Appendix A of the IFRS 4 defines an insurance contract as a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. Appendix B of IFRS 4 defines the term “uncertain future event” to be: Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:

(a) Whether an insured event will occur
(b) When it will occur
(c) How much the insurer will need to pay if it occurs.

Section 23(L)(2) states that no deduction is allowed in respect of any insurance premium incurred by a person in terms of a policy to the extent that the premium is not taken into account as an expense for the purpose of financial reporting in pursuant of IFRS in either the current year of assessment or a future year of assessment (Stiglingh et al., 2015:154). The limitations contained in section 23L of the ITA have their origin in deterring certain tax abuses that were prevalent in relation to insurance products prior to enactment of the section (DTC, 2015: 98).

In order to analyse the impact of the requirements of section 23L(2), the two types of insurance expenses discussed in Chapter 2 will be analysed, the first option being the conventional insurance cost in an operating mine and the second one being the risk-based insurance policy expense. As mentioned in Chapter 2, with the conventional insurance option, the insurance policy contributions are not deposited in an investment fund by the insurer. If the mining company cancels the insurance policy, there would not be a refund of any portion of the insurance contributions. On the contrary, the risk-based insurance option may provide for a bonus pay out as mentioned in Chapter 2. Section 23L applies to investment policies that are disguised as short-term insurance policies. The insurance policy contributions to the conventional insurance policy options would therefore be deductible for tax purposes but the insurance policy contribution of the risk-based option could have a risk of limitation on deduction if SARS sees the policy as more of an investment policy than an insurance policy. The payments into the policy could therefore not be deductible for tax purposes.

Section 23L(3) provides that where policy benefits are received by or accrued to a person in terms of an investment policy, such amounts must be included in the person’s gross income. At that time, the premiums that were paid on that policy that were not deductible under s23L(2) of the ITA, must then be allowed as a deduction against the benefits received
(Croome et al., 2013:224) and the aggregate amount of policy benefits in respect of the policy that was included in the gross income of that person during previous years of assessments (Stiglingh et al., 2015:55).

With regard to the conventional insurance policy, no income is earned by the mining company as discussed in Chapter 2 and therefore there would not be any income tax implications on the mining company. The contingent bonus receivable with the risk finance option are taxable at the earlier of accrual or receipt (definition of gross income in section 1) however when the proceeds are used for rehabilitation, the expense incurred is tax deductible (Marsh, 2015).

When rehabilitation expenditure is incurred, section 37B(6) of the ITA provides for deduction of expenditure and losses in relation to the decommissioning, remediation or restoration after production has ceased. Environmental expenditure of this nature incurred while the taxpayer is carrying on trade would be deductible in the normal course of business. When the expenditure is incurred the mining company would be able to obtain a refund of the expenditure from the insurer, which must be included in its taxable income as required by section 23L after deduction of previous premiums that were not deductible against the policy.

3.4.4 Section 23H

If the premium per the policy is payable for a couple of years in advance, section 23H will be applicable. Section 23H of the ITA applies to certain types of expenses incurred in respect of

- goods or services, all of which will not be supplied or rendered during the year of assessment in which the expenditure is incurred (section 23H(1)(b)(i))
- any other benefit, the period to which the expenditure relates extends beyond the end of that year of assessment (section 23H(1)(b)(ii)).

The intention of the legislator is clear in regards to this section. Where the section provides for “any other benefit”, it is intended to look at the direct benefits received in exchange for the consideration paid (Du Plessis, 2009). What is therefore required is that the taxpayer must match his deductions to any year with the benefit derived during the year. The prepaid portion in respect of which the benefits will only be received or enjoyed in a future year will therefore only be deducted in that future year. The prepaid portion is that which is limited by section 23H by not being able to deduct it immediately (Stiglingh et al., 2015:147). The provisions of section 23H do not apply if all the goods and services are supplied or rendered within six months after the year of assessment during which the expenditure was incurred, where the aggregate of the expenditure incurred by such a person which would be limited by this section does not exceed R 100,000, if provisions of section 24K or 2L of the ITA apply or if the
expenditure actually paid in respect of unconditional liability to pay an amount imposed on by legislation.

3.4.5 Terminating an insurance policy

When a conventional insurance guarantee policy is terminated, the original guarantee needs to be returned to the insurance provider and there are no further implications as no returns are obtained on termination. With regard to the risk finance insurance guarantee option, if a discretionary bonus is granted by the insurer, the proceeds would be taxable per section 23L(3), but a deduction would be obtained for contributions that were previously not deductible in the current or prior year of assessment. Section 8(4)(a) of the ITA could also be applicable as the amount received is linked to an expense – insurance premium – that was previously allowed as a deduction under section 11(a).

3.4.6 Summary

When payments to an insurance company for an insurance policy are made, the mining company would be carrying on a trade in order to earn profit and if the expense does not form part of the income-earning structure of the mine then the expense would meet the requirements in section 11(a) and there is no specific prohibition on the deduction of the expense in the calculation of income tax per section 23(g). There are two types of insurance policies, the conventional and risk-based finance option. Section 23L places a restriction on the deduction of premiums paid in to investments that are disguised as insurance policies which could be applicable to the risk-based finance option. If the insurance policy requires the mining company to pay the premiums in advance for more than one year of assessment, then the mining company should take note of the limitation of deduction of prepaid expenses in the year of payment or in the year the expense is incurred, which is limited by section 23H of the ITA.

Section 23L(3) provides that where policy benefits are received by or accrued to a person in terms of an investment policy, such amounts must be included in the person's gross income. At the time the premiums are paid on that policy, which were not deductible under section 23L(2) of the ITA, a deduction against the benefits received must be allowed (Croome et al., 2013:224). With regard to the conventional insurance policy, no income is earned by the mining company as discussed in Chapter 2. There would therefore not be any income tax implications on the mining company. With regard to the risk finance insurance guarantee option, one of the advantages of this option was that a discretionary bonus on the
policy could be payable and such proceeds are taxable; however, when the proceeds are utilised for rehabilitation, the expense is tax deductible (Marsh, 2015). Section 8(4), which deals with recoupments of expenses previously deducted from gross income due to allowances from specific sections of the ITA including section 11(a), could be applicable as it could be seen as a recoupment of previous insurance premium deductions claimed per section 11(a).

3.5 Setting up a rehabilitation trust: Income tax implications

3.5.1 Introduction

The origins of the current legislative provisions dealing with the income tax treatment of trusts can be found in a decision by the Supreme Court in 1991. In Friedman and others NNO vs CIR24 it was found that a trust is not a legal person, it cannot be a taxable entity for the purpose of section 5(1), the charging section of the ITA (Honiball & Olivier, 2011:135). Section 5(1) of the ITA reads as follows:

5(1) Subject to the provisions of the Fourth Schedule there shall be paid annually for the benefit of the National Revenue Fund, an income tax (in this Act referred to as the normal tax) in respect of the taxable income received by or accrued to or in favour of
(c) any person (other than a company) during the year of assessment ended the last day of February each year and
(d) any company during every financial year of such company.

3.5.2 Income Tax Act definition of a trust

Section 1 of the ITA defines a trust as any trust fund consisting of cash or other assets that are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person. A special trust is taxed at the same rates as a natural person, but is not entitled to a primary abatement (Stein, 2012). All other trusts are taxed at 41 percent from March 2015 (SARS, 2015).

24 1991(2) SA 340(W)
3.5.3 Section 25B

Section 25B of the ITA, read together with section 7(1), essentially codified the conduit-pipe principle first articulated in *Armstrong v CIR* case. In this regard, income received by, or accrued to, a vesting trust is taxed in the hands of the vested beneficiary/ies, i.e., the trust is transparent for tax purposes. However, income received by, or accrued to, a discretionary trust will be taxed in the hands of the trust unless it is distributed before the fiscal year end of the trust, in which case it will be taxed in the beneficiary's/ies' hands (Farrand, 2015). Under section 25B(1), two different taxpayers are envisaged, namely, the trust and the beneficiaries. Where income is not derived for the immediate or future benefit of an ascertained beneficiary, the trust will pay tax on such income. However, to the extent that income is derived by the trust for the immediate or future benefit of an ascertainable beneficiary, such beneficiary will be taxed on the amounts so received. This provision is in line with the general rule that when a person is entitled to an amount (i.e. the amount has accrued), a tax event for income tax purposes arises (*Lategan v CIR*; *CIR v People’s Stores (Walvis Bay)(Pty) Ltd*) (Honiball & Olivier, 2011:136).

3.5.4 Section 37A

The tax legislation is designed to cater for the costs attendant on rehabilitating a mine on closure so as to minimise the adverse environmental impact that results from operating a mine over its lifetime. The law provides a tax exemption from normal tax of certain bodies, trusts or companies which have as their objective the accumulation of funds set aside to fulfil the closure rehabilitation obligations entrenched with any right issued in terms of the MPRDA (DTC, 2015:49).

Section 37A was introduced in terms of the *Revenue Laws Amendment Act* of 2006 and, according to the explanatory memorandum, is established for the purposes of streamlining the administration of funds held by a rehabilitation fund. The so-called rehabilitation funds will be applied towards the environmental rehabilitation upon closure of certain activities, including prospecting, exploration and mining. Prior to the introduction of section 37A, the ITA did provide for the claiming of deductions for monies paid by a taxpayer engaged in mining, prospecting, quarrying or similar operations to a company, society, association of persons or trust referred to in section 10(1)(cH) (subsequently deleted). The provisions of section 37A of

25 1938 AD 343
26 1926 CPD 203
27 1990 (2) SA 353 (A)
the ITA create the framework for deduction of payments made to a closure rehabilitation company or trust commencing on or after 2 November 2006, thereby integrating environment regulatory enforcement and tax deduction approaches. Section 37A, as currently worded, applies in the instance of prospecting, exploration or mining and as such the available deduction is limited to taxpayers undertaking these particular types of activities. The section does provide a simplified approach to the claiming of deductions in that the cumbersome formula that was previously included in section 11(hA) (Napier & Parker, 2007).

Section 37A of the ITA provides for the deduction for income tax purposes of contributions made to a qualifying rehabilitation trust. This deduction would not necessarily benefit mining companies that are not in a tax-paying position. Instead, additional funding would need to be obtained to, firstly, fund the operations and, secondly, fund the rehabilitation trust (Van Zyl, 2014). However, under this approach, the deduction is allowed well in advance of the date that the expenditure is actually incurred; the mine company thus gets the benefit of the deduction when it is earning income from mining against which the deduction can be offset.

The ability to take the deduction at the time that the contribution is made gives a timing advantage to the operator. However, the trade-off for the government is that it provides an incentive for the operator to make adequate financial provision for the decommissioning mine site (Choudhury et al., 2015:26). It also provides visibility and assurance to the government concerned that funds will be available at the end of the project life. This section of the ITA serves to align tax policy with environmental regulation and regulates mining rehabilitation funds created with the sole object of applying their property for the environmental rehabilitation of mining areas (section 37(1)). Since the ITA grants a tax deduction for payments made to dedicated mining rehabilitation funds, it requires the funds to be strictly utilised in accordance with their objectives (McMeekin & Strydom, 2011). Furthermore, in order to qualify for a tax deduction, rehabilitation contribution must be paid to a registered rehabilitation trust as required by section (37)(1)(a). Such trusts can typically be accessed only on mine closure, making it harder to perform rehabilitation activities during care and maintenance phases (Saloojee, 2014:21). Another consideration of the contributions and tax is that contributions to the fund must be in line with an approved schedule connected with the agreed decommissioning plan and within the approved cost estimates. This will ensure that the decommissioning fund does not become a tax deferral vehicle (Choudhury et al., 2015:26).

Section 37A(2) of the ITA places restriction on the type of investments or instruments that the trust can hold. Non-compliance with section 37A carries penalties – income tax is imposed on the mining company and/or the rehabilitation fund, if section 37A is contravened. In some
instances, SARS has a discretion to reduce the income tax so imposed (proviso to section 37A(8)) (Integritax, 2012). As a general principle and in accordance with section 10(1)(cP) of the ITA, any income earned by the fund on investment of contributions should be treated as exempt income. This is on the basis that the purpose of the fund is to provide for decommissioning, and any increase in its overall balance should be intended for the same purpose (Choudhury et al., 2015).

The effect of the amended section 37A(7) is to clarify that if any rehabilitation company or trust contravenes the provisions of section 37A(1)(b) by distributing property from that company or trust for a purpose other than the rehabilitation purposes provided for in section 37A, an amount equal to the market value of the property so distributed must be deemed to be taxable income that accrued to such company or trust during the year of assessment in which such distribution occurred. Such a company or trust will thus lose the tax deduction offered to rehabilitation companies or trusts and will be taxed in the normal course (Dale, 2007).

Should the mining company wish to terminate or amend the terms of the rehabilitation fund (for example, to allow for the transfer of funds to a fund which is not a section 37A fund), the provisions of the constitutional documents, which typically are drafted in line with section 37A, will have to be amended in order to change the objects of the rehabilitation fund and the purpose for which the rehabilitation fund was established (McMeekin & Strydom, 2011). Section 37A(3) places a restriction on what can be done with the trust assets once the mine has been wound up and liquidated. First option is that the trust assets can be transferred to another company or trust as approved by the Commissioner. If there is no other company or trust established by the existing mining company then the funds must be transferred to a company or trust as approved by a cabinet member. If the rehabilitation fund distributes its property for purposes other than the prescribed rehabilitation, section 37A(7) states that an amount equal to the market value of the property that was so distributed, is deemed to be taxable income of the rehabilitation fund for that year of assessment. The inclusion of the market value of the property so distributed is peremptory and SARS has no discretion to waive the inclusion (Integritax, 2012).

3.5.5 Dividends tax

According to section 64F(d) of the ITA, any dividend is exempt from dividends tax if the beneficial owner of the dividend is a trust contemplated in section 37A of the ITA, to the extent that the dividend does not constitute a dividend *in specie.*
3.5.6 Summary

Compared to the other options, the rehabilitation trust option is the most complex. The provisions relating to this funding vehicle are detailed in section 37A of the ITA. Per above, section 37A provides for the deduction of contributions to the rehabilitation trust. There are certain limitations on which type of investments the mining company can make. The legislation further provides for the exemption from normal tax of any investment income made by such body, trust or company from the investment of such funds. In turn, the contribution in cash will rank as a section 37A(1) deduction in the hands of the contributing company. Certain investment limitations are imposed on such a rehabilitation entity, as well as mechanisms to combat possible avoidance activities (DTC, 2015:49). Transfer of funds into the trust or transfers out of the rehabilitation trust for purposes other than rehabilitation purposes and any other contravention of section 37A will result in twice the market value of all property held in the rehabilitation fund, on the date of contravention, to be included in the rehabilitation fund’s taxable income. Once rehabilitation is complete, at the end of the life of the mine, rehabilitation expenditure incurred can be claimed from the trust. Any balance of funds in the vehicle must either be transferred to a similar vehicle of the same company, or if there are no other mines in the group, the DMR can decide where the funds should be transferred to.

3.6 Conclusion

Tax relief is granted to mining enterprises that make financial provision for rehabilitation in the form of trust funds. This relief entails a deduction for reserves as well as the tax-free build-up of those reserves (SARS, 2006:12). The bank transfer option does not provide for deduction when calculating taxable income when the payment is made to the DMR as required by section 11(a) of the ITA. This same treatment also applies with the bank guarantee option as both options are in effect a mere transfer of funds from one bank account to another and the payments would not have resulted from an expenditure that was incurred. Any bank charges incurred with the bank transfer and guarantee options are deductible per section 11(a) of the ITA. The insurance guarantee option has become attractive especially among the smaller mines. There are two types of insurance policies which are the conventional and risk-based insurance options. The insurance premiums are deductible as they meet the requirements of section 11(a) but the deduction could be restricted by section 23L if the insurance policy is actually an investment that is disguised as an insurance policy; this restriction could be applicable to the risk based finance option. If the premium is paid in advance for more than one year’s assessments, the deduction limitation contained in section 23H could be applicable. With the rehabilitation trust option, the contributions in cash will rank as a section 11(a)
deduction in the hands of the contributing company and will therefore be deductible against mining income for tax purposes. The insurance policy and the rehabilitation trust therefore provide for deductions on contributions made to the funding vehicles and these deductions can be utilised against other taxable income. The cash deposit and the bank guarantee options do not provide for this immediate deduction.

The bank transfer option does not provide for any interest income as the interest earned on the DMR account accrued to the DMR and not the mining company. The mining company will therefore not be taxed on any investment income. With the bank guarantee option, the account where the bank guarantee is held earns interest income that accues to the mining company and the mining company will be taxed on the income. The interest income can be withdrawn by the mining company and can be used to pay income tax. The discretionary bonus earnings on the risk finance insurance guarantee option are taxable. With the conventional insurance option, no funds would be earned as it is not an investment vehicle. The legislation further provides for exemption from normal tax of any investment gains made by a rehabilitation trust or company from the investment of such funds. Certain investment limitations are imposed on such a rehabilitation entity, as well as mechanisms to combat possible avoidance activities (DTC, 2015:49). For all the options, rehabilitation costs are deductible under section 37B as an environmental expenditure when they are incurred.

With the bank transfer option, once the rehabilitation activities are complete, the mining company can claim the rehabilitation expenses incurred from the DMR and the funds will not be included in gross income as it is just a refund of the deposit previously made to the DMR. The same applies with the bank guarantee option: once rehabilitation has been conducted as per the EMP and a closure certificate is issued by the DMR, the guarantee arrangement will be terminated and the bank will release the restricted funds to the mining company. This does not result in inclusion of the funds in gross income as it is just a release of a guarantee – transfer of funds from one bank account to another. With the insurance option, per section 23L, the proceeds when claiming from the insurance policy would be taxable but if there were any insurance premiums that were disallowed as a deduction per the limitation in section 23L, such premiums would be deductible when the proceeds from the insurance are received. With the rehabilitation trust option, once rehabilitation is complete at the end of the life of the mine, rehabilitation expenditure incurred can be claimed from the trust. Per section 37A, any balance of funds from the rehabilitation trust must either be transferred to a similar vehicle of the same company, or, if there are no other mines in the group, the DMR can decide where the funds should be transferred to. The overall difference between the funding vehicle
options is timing of the deduction that is available, eventually all the options provide a deduction of rehabilitation costs once the rehabilitation costs are incurred.
CHAPTER 4: REHABILITATION FUNDING OPTIONS IN AUSTRALIA AND CANADA

4.1 Introduction

In Chapter 3, the South African income tax implications of the rehabilitation funding vehicles, being a bank transfer, bank guarantee, insurance policy and rehabilitation trust, were analysed. In order to achieve one of the objectives of this research, Chapter 4 will analyse the income tax implications of similar rehabilitation funding vehicles available for use by mining companies in Australia and Canada. The reason that the two countries were chosen for the comparison is that according to a study performed in 2012, they both form part of the world’s top ten most resource rich countries (247Wallst, 2012) and just like South Africa they have a challenge with abandoned mines. The income tax implications of the bank transfer option identified in South Africa (discussed in section 3.2) will be compared to the bank transfer option in Australia and Canada. The income tax implications of the bank guarantee option identified in South Africa (discussed in section 3.3) will be compared to the income tax implications of the bond/bank guarantee option identified in Australia. The income tax implications of the rehabilitation trust option identified in South Africa (discussed in 3.5) will be compared to the income tax implications of the qualifying environmental trust in Canada. Each analysis will include, where applicable, tax implications on creation of the security vehicle, on any income earned through the vehicle, costs incurred on the vehicle, tax implications that arise when rehabilitation expenditure is incurred, and, lastly, tax implications on termination of the rehabilitation vehicle. Before the income tax implications of mine rehabilitation vehicles are discussed, the background on mining and mine rehabilitation will be discussed for each country.

As mentioned in Chapter 2, the use of insurance products certainly has conceptual appeal but they are relatively untested and used in South Africa and by some states in the USA. Concerns range from so-called “unscrupulous fly-by-night operators” to the fact that the products are not actually insurance products but performance guarantees disguised as insurance products. The scepticism surrounding the use of insurance products for mining rehabilitation is also evident in Western Australia (Bond-Smith et al., 2012). Yukon, a province in Canada, makes use of the insurance as a funding option mechanism but very limited information is available on this option and it is merely background information. This option will therefore not be discussed in this chapter.
4.2 Background on mining in Australia and Canada

4.2.1 Background: Australia

Australia currently has one of the largest mineral sectors, by value of production, in the world. The Australian mining industry has benefited from a global boom in demand for minerals in recent years, and is expanding as a result of a high demand for raw materials from China and other parts of Asia. Australia has the world’s largest reserves of lead, nickel, uranium and zinc. It is the world’s leading producer of bauxite, alumina and diamonds (by volume), the second largest producer of uranium, lead, zinc and nickel, and the third largest producer of iron ore, silver, magnesium and gold (Livesly, 2010).

In 1901, the Australian Constitution established Australia as a federal system. Under this system, powers are distributed between a national government (the Commonwealth) and the six states – New South Wales, Queensland, South Australia, Tasmania, Victoria and Western Australia. The three territories – the Australian Capital Territory, the Northern Territory and Norfolk Island – have self-government arrangements. The Australian Constitution defines the boundaries of lawmaking powers between the Commonwealth Constitution and their State Constitution. A commonwealth law overrides any inconsistent state law. In practice, two levels of government cooperate in many areas where states and territories are formally responsible. Mining regulation in Australia is state and territory based. The starting point is that most minerals are owned by the state or territory in which the minerals are located. State and territory governments also have certain taxation powers, for example, to collect resource royalties and stamp duty (Ashurst, 2013).

The details of legislative licensing regimes vary between jurisdictions but all have common features. All of the regimes comprise at least two stages, exploration and production. Some regimes include a third intermediate stage, allowing retention of an area after discovery until commercial production is feasible. Tenement holders are often required to lodge security deposits when licenses are granted to ensure the performance of environmental and rehabilitation obligations (Ashurst, 2013:9-10). The total number of abandoned mine records within Australia is 52,534 although it is recognised that this is likely to be an understatement because many of the state data sets are incomplete (Edraki et al., 2012).
In order to address this problem of abandoned mines, the Mining Act\textsuperscript{28} introduced a requirement that firms need to provide financial surety to the regulator (DMP, 2011). Australia has a number of rehabilitation funding options across its provinces and territories that include bank guarantees, cash, bonds, mining rehabilitation funds or any other form that the decision maker deems appropriate. The main form of security generally accepted from the resources sector is a bank guarantee or a combination of bank guarantees and cash sufficient to cover the full cost of rehabilitation should an operator fail to meet their obligations (Department of Environment and Heritage Protection, 2014:8).

### 4.2.2 Background: Canada

Canada is now a world leader in mining and mineral processing. In 2006, products from mining accounted for 17.5 percent, or Can$71.9 billion of the country's domestic exports. Canada ranks among the top five countries in the production of 14 major minerals and metals. In 2006, Canada ranked first globally in production of potash and uranium, second in nickel and cobalt, third in aluminium, gypsum, magnesium, platinum-group metals, and titanium concentrate, fourth in asbestos and cadmium, and fifth in zinc and molybdenum (Mining Association of Canada, 2008). Exploration, development and extraction of mineral resources, the construction, management reclamation and closure of mine sites are all preliminary within the jurisdiction of provinces of Canada, the Yukon and Northwest territories. In Nunavut and certain areas of the Northwest Territories, public lands and natural resources are governed and administered by federal government (Abel-Barr & MacMillan, 2015.).

The approval of mine closure plans to rehabilitate and restore properties after completing mining operations is provided for in the mining legislation of most Canadian jurisdictions. Most jurisdictions require financial security or a guarantee and an approved closure plan to be filed prior to mine production. Certain jurisdictions require the closure plan to be filed prior to any activities being undertaken (Abel-Barr & MacMillan, 2015). A range of securities are accepted by governments across Canada, including cash, cheque, letter of credit, surety, government bonds, treasury bills, investment certificates, term deposits, sinking funds, trust funds, pledging assets, third party guarantees and self-assurance. In British Columbia, bearer bonds, parent company guarantees and captive insurance are not accepted as securities, nor are surety and self-assurance accepted for sites where there are long-term water quality and liability concerns (CCSG Associates, 2001:iii).

\textsuperscript{28} of 1978
Often, governments – encouraged by the industry – are eager to promote regional economic development through mineral extraction, and keeping regulations to a minimum is often seen as the best way to attract investment. Substantial subsidies and tax breaks are also developed to encourage mines to continue, even when operators themselves might believe them to be uneconomical (CCSG Associates, 2001:2).

4.3 Cash transfer option

4.3.1 Cash transfer option: Canada – British Columbia

British Columbia’s world-class reclamation laws ensure that, once operations cease, mine site lands are returned to a useful and productive state. Before any work on a new mine site can commence, the company or individual doing the work must post a security that is held in trust by the Ministry of Energy and Mines. This security is only returned once the mine site has been reclaimed to a satisfactory level and there are no ongoing monitoring or maintenance requirements. If a mine site has not been reclaimed properly, the security money may be used by the Province to complete the remediation work (Ministry of Mines and Petroleum Resources, 2009:). The requirements above are consistent with the South African requirements for the bank transfer option as the security is provided before any mining work can commence and is refunded only once rehabilitation is complete.

The security is set at a level that reflects all outstanding reclamation and closure obligations. For example, mines that require long-term drainage treatment for metal leaching and/or acid rock drainage require full security to cover outstanding liability and ongoing management (Ministry of Mines and Petroleum Resources, 2009). The reclamation bond is a type of surety bond whereby the mining company deposits a sum within a reclamation fund established by government. This bond acts as security against the reclamation of the mine site. Once the site has been reclaimed, the Ministry may draw on the mine reclamation fund and refund the company, including any interest earned in the bank. However, if not reclaimed, the Ministry can draw on all or part of the fund for the purpose of having the site reclaimed (PwC, 2011:23).

Section 12 of the Minerals Act\textsuperscript{29} of Canada states that the Lieutenant Governor in Council may, by regulation, establish a fund to be known as the mine reclamation fund into which security in the form of money must be paid by the owner, agent or manager of a mine. Money

\textsuperscript{29} of 1996
received from an owner, agent or manager must be credited to a separate account in the fund in the name of the mine. The Minister may requisition payments from an account in the fund to refund money and interest earned on it to the owner, agent or manager of a mine from time to time if in the opinion of the chief inspector it is no longer required for mine reclamation and protection of, and mitigation of damage to, land and watercourses affected by the mine, or to pay for the cost of work required under section 10(8)(b). Section 10(8)(b) states that if the owner, agent, manager or permittee fails to perform and complete the programme for reclamation or comply with the conditions of the permit to the satisfaction of the chief inspector, the chief inspector, after giving notice to remedy the failure, may apply all or part of the security toward payment of the cost of the work required to be performed or completed.

The payment of the bond amount to the government results in an outflow of cash resources. The payment is not deductible for tax purposes (Anderson, 1990:6). For any bank charges to be deductible, there must be a sufficient relationship between the expenditure and the taxpayer’s income-earning process and the taxpayer should be carrying on a business as held in CIR v Banks. The expenditure need not be linked with a particular item of income and income need not have been produced in the year of expenditure as held in CIR v Banks. The expense incurred should also not be of a capital nature. Whether the expenditure is a once and for all payment producing assets, or advantages that are of an enduring benefit, expenditure will be regarded as capital where it brings into existence an asset or advantage for the enduring benefit of the business as held in British Insulated and Helsby Cables Ltd v Atherton. The expense is just like any other bank charges incurred on any payment made by the mining company and will therefore be deductible and, as the company would be carrying on a business, the expense is not of a capital nature as it does not create an enduring benefit.

As stated in section 12 of the Canadian Minerals Act, a separate account is to be opened for the company and interest earned on the account may be included in the income of the owner (Mine Company). Section 12(1)(c) of the Canadian Income Tax Act states that any amount received or receivable by a taxpayer in the year as, on account of, in lieu of payment of or in satisfaction of, interest was not included in computing the taxpayers income for a preceding taxation year shall be included in the taxpayer’s income. Such income earned by the mining company will thus be taxable.

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30 [1978] 2 NZLR 472 (CA)
31 [1925] All ER Rep 623 (HL) at 629
32 of 1996
33 of 1985
In Canada, federal and provincial corporate income tax payments are based on the Tax Act. In general, the Tax Act only allows expenditures that are actually incurred as deductions from taxable income (Anderson, 1990:13). Historically, this has been after the mine has ceased production and is no longer generating income. Consequently, taxpayers in the mining industry have often been placed in a position where they have no income against which to deduct the reclamation expense (KPMG, 2011:20).

4.3.2 Cash transfer option: Australia – Northern Territory

In Australia’s Northern Territory, the department’s policy is that 100 percent of the cost for rehabilitation of disturbances is required as a security. Security payments can be in the form of cash, credit card, cheque, money order or bank guarantee. The first tax implication to consider is as a result of the payment of the cash security to the government. Section 8-1 of the ITAA\textsuperscript{34} states that you can deduct from your assessable income any loss or outgoing to the extent that it is incurred in gaining or producing your assessable income or it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income. A company cannot deduct a loss or outgoing under this section to the extent that it is a loss or outgoing of capital or of a capital nature or if a provision of the act prohibits a company from deducting it. Section 40.760 of the ITAA prohibits deduction from income in a year for a bond or security for performing environmental protection activities at the time the bond is paid. The security cash payment to the government will therefore not be deductible for income tax purposes.

While the Territories’ Mining Management Act details the requirement to provide a security deposit, it does not provide for interest payable on such deposit. The money held by the Department is in trust and remains in stasis (Department of Mines and Energy – Northern Territory, 2007). The mining company would therefore not include any interest as part of ordinary or statutory income as required by section 6 of the ITAA since none will be earned.

In addition to providing the security, section 44A and 44B of the Northern Territories’ Mining Management Act requires each operator that carries out mining activities under authorisation to pay an annual levy. The levy is calculated as 1 percent of security provided above and is a tax which provides revenue for the fund and also for the effective administration of this Act in

\textsuperscript{34} 38 of 1997
relation to minimising or rectifying environmental harm caused by mining activities. The levy is non-refundable to the operator and was introduced from October 2013 (Cohen et al., 2013). The 1 percent levy introduced by the Northern Territory is an environmental tax (Swanepoel, 2013).

In return for the levy, operators will receive a 10 percent reduction in the level of security they need to lodge with the Department of Mines and Energy (Harris, 2013). Since the 1 percent levy was introduced in 2013, existing mining companies would have already contributed 100 percent of their security as would have previously been required. Once the mining company pays the 1 percent levy it will result in a refund of 10 percent of the security held. As section 20-A of the ITAA includes an amount of recoupment in assessable income only if the recoupment or refund is obtained in relation to expenses incurred which were deductible for purposes of calculating assessable income, the refund of the 10 percent previously paid would not be included in the assessable income of the mining company. While the Mining Management Act details the requirement to provide security deposits, it does not provide for interest payable on such deposits. The cash security held by the government is in trust and remains so. The mining company will therefore not earn any interest on the cash security provided to the Northern Territory government (Northern Territory Department of Energy and Mines, 2007).

Section 40.735 of the ITAA allows a company to deduct expenses incurred for the purpose of rehabilitation of a site on which mining operations were previously being carried out. Once the required rehabilitation has been undertaken on a specified mine, a partial security may be refunded to the operator. This may require a site visit by Mining Officers to confirm that planned rehabilitation has been completed. The contingency fund portion of the security will be maintained by the Department for an agreed period, or until mining officers from the Performance Group have confirmed, after consultation with the Technical Support, that rehabilitated areas on the site have met agreed closure criteria and that no further remediation works, site visits, or monitoring will be required (Northern Territory Department of Energy and Mines, 2008). As section 20-A of the ITAA includes in assessable income an amount that an entity receives as recoupment by way of insurance, indemnity or other recoupment if it is for an expense that is deductible and is not otherwise an assessable income, the refund of the security would be included in the company’s assessable income. A recoupment is defined in section 20-25 of the ITAA as any kind of recoupment, reimbursement, refund, insurance, indemnity or recovery however described in respect of a loss or outgoing.
4.3.3 Comparison: Cash deposit

With the cash deposit option in South Africa, the DMR keeps the funds deposited in a pool of funds and does not provide any interest income to the mining company. The interest income accrues to the DMR and will be used to defray any costs incurred on the account or to audit the account. The mining company can thus not be taxed on the interest income earned on the funds as the income does not accrue to the mining company and does not meet the requirements of the gross income definition in section 1 of the ITA nor does it meet the requirements of section 23J. In Australia, the Territories’ Mining Management Act does not provide for interest payable on such deposits. The money held by the Department is in trust and remains in stasis (Department of Mines and Energy – Northern Territory, 2007). The mining company would therefore not be required to include any interest as part of ordinary or statutory income as required by section 6 of the ITAA. In Alberta, Canada, the funds are kept in a separate account in the name of the mining company and interest income accrues to the mining company. With the bank transfer option, legislation in both South Africa and Australia does not provide for interest income with this option. Canada, however, does provide for interest income as the funds are kept in a different account. The DMR could consider placing the funds in a separate account for each mining company and provide for interest income on the funds. This could encourage South African mines to use this option if they receive interest income. As mentioned in Chapter 2, one of the disadvantages of this option in South Africa is that the DMR does not provide for interest income, yet this option provides the best security for the DMR as the funds are in their bank account.

Expenses incurred on rehabilitation are deductible in South Africa in terms of section 37B(6) as the provision allows for deduction of expenditure incurred on the decommissioning, remediation and restoration arising from trade previously carried on by the taxpayer. In Australia, as mentioned in the guarantee/bond option, section 40.735 of the ITAA allows a company to deduct expenses incurred for the purpose of rehabilitation of a site on which mining operations were previously being carried out. In Canada the Tax Act only allows expenditures that are actually incurred as deductions from taxable income (Anderson, 1990:13). Historically, this has been after the mine has ceased production and is no longer generating income. Consequently, taxpayers in the mining industry have often been placed in a position where they have no income against which to deduct the reclamation expense (KPMG, 2011:20). The deduction of rehabilitation expenditure against taxable income is consistent across all three countries, which is once the expenditure is incurred.
Once rehabilitation is complete and the security is refunded to the mining company, it was concluded that any funds received would not be taxable in South Africa as the funds do not meet the requirements of the gross income definition in section 1 of the ITA. The funds are a mere refund of funds previously transferred to the DMR. In Australia, once the rehabilitation is complete refund of the security will be received. Section 20-A of the ITAA includes in assessable income an amount that an entity receives as recoupment by way of insurance, indemnity or other recoupment. If it is for an expense that is deductible and is not otherwise in assessable income, the refund of the security would be included in the company’s assessable income. A recoupment is defined in section 20-25 of the ITAA as any kind of recoupment, reimbursement, refund, insurance, indemnity or recovery however described in respect of a loss or outgoing. In Canada, income is usually classified as business income if a certain degree of commercial activity is present. Property income is derived from more passive activities such as the collection of interest, dividends, rents and royalties (Gowlings, n.d.). The cash deposit of the security is a cash refund that qualifies as property as it generated passive income such as interest. The income will therefore not be included in the business income in calculation of the taxable income of the mining company. The tax treatment in South Africa and Canada have the same effect on taxable income but is different in Australia, as the funds are taxable in Australia. As the payment of the deposit was not initially deductible, the treatment in South Africa and Canada when the refund is obtained is appropriate for this transaction.

In addition to providing security, Australia’s Northern territory has a 1 percent levy on the security provided. The 1 percent levy introduced by the Northern Territory is an environmental tax (Swanepoel, 2013). In return for the levy, operators will receive a 10 percent reduction in the level of security they need to lodge with the Department of Mines and Energy (Harris, 2013). South Africa and Canada do not have a similar additional tax. The levy is collected by the DMP under the MRF Act 2012. The rate of the levy is set at 1 percent of the rehabilitation liability. This is pigouvian tax that South Africa and Canada do not have currently. Although not defined as such, since the DMR retains the interest earned on the cash deposit option, this could be seen as a form of a tax. The DMR could consider formally treating the interest income retained as a pigouvian tax, which would assist the government in rehabilitating abandoned mines and would provide mining companies with a discount on the rehabilitation funding, which could provide the company with more funds for capital investment instead of

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35 A tax levied to counter an economic negative externality, for example taxing producers of industrial pollution in order to encourage pollution control.
providing 100 percent security for the life of the mine as rehabilitation security as it does affect mines’ cash flow negatively.

4.4 Bank guarantee option

4.4.1 Bank guarantee bond: Western Australia

The current policy in Western Australia requires major banks to stand surety for the environmental bonds through an unconditional bank guarantee (Doole & White, 2013). An unconditional bank guarantee will usually state that the bank will unconditionally pay on demand, any amount demanded by the proprietor, up to the maximum amount of the guarantee (Forde, 2012). The provision of a bond as a means of security is a process that is very simple in theory, but around the world the experience has been that bonds have often been set at levels that are inadequate to fund the necessary rehabilitation when a mining site is abandoned by the responsible company (Davis, 2015). The unconditional performance bonds levied on resources and energy companies for the rehabilitation of mining operations cover only 25-30 percent of Western Australia’s contingent liability for the rehabilitation of abandoned mine sites and mining operations. On the back of a review conducted by the Department of Mines and Petroleum in 2010, the State has since increased unconditional performance bonds in an effort to minimise this liability, with the aim of having those bonds cover 50 percent of closure liability by 2014 (Franz & Fulcher, n.d.). The financial institution issuing the instrument (usually one of the major banks) receives an annual service charge for the bond, typically between 0.5 and 3 percent of the bond amount. The service charge is set based on the firm’s insolvency risk rating (Doole et al., 2012).

Environmental bonds, ensure that funds are available for rehabilitation in the event of non-compliance. Section 40.760 of the ITAA prohibits deduction from income in a year for a bond or security for performing environmental protection activities at the time the bond is paid. This means that payment of the funds for bond purposes by a mining company to a financial institution would therefore not be deductible for income tax purposes. Section 40.745 of the ITAA prohibits deduction of expenditure incurred on acquiring land or an interest in land or rights, power or privilege to do with land, bond or security expenditure for performing mining site rehabilitation, and lastly on any expenditure incurred for housing and welfare. As alluded to earlier, the financial institution that provides the instrument charges an annual service charge in Australia. This cost would therefore not be deductible for income tax purposes.
As mentioned in Chapter 2, in the discussion relating to the advantages of a cash-covered bank guarantee compared to the cash deposit option, interest will be earned on the funds that have been paid by the mining company to the financial institution. The Australian Taxation Office states that a business should include interest earned on investments in its assessable income. Income that is subject to taxation in Australia is called assessable income (Australian Taxation Office, 2015).

When rehabilitation expenditure is incurred, according to section 40.735 of the ITAA, a company may deduct for an income year expenditure incurred to the extent that it is on a mining site rehabilitation of a site on which mining and quarrying operations were carried out, exploration and prospecting was conducted or where ancillary mining activities were carried out. The reasons as to why a special deduction for mine site rehabilitation expenditure was warranted were provided by the explanatory memorandum of the Taxation Laws Amendment Act (No 2) 1991. It acknowledged that the majority of rehabilitation expenditure is capital in nature and therefore does not qualify for deduction under the general deduction provision. For capital expenditure to be deductible, it is restricted to expenditure incurred in the process of extracting minerals. This clearly excludes rehabilitation expenditure. And, in any event, such expenditure is generally incurred once the income earning operations have ceased and therefore is excluded from deductibility as not being incurred for the purpose of producing assessable income (Joseph, 2013).

The Victoria State Government states that bonds will be returned when the Department is satisfied the land has been rehabilitated in accordance with the rehabilitation plan or code of practice following completion of a consultation process. The Department will undertake an assessment of the rehabilitation to verify that the land is safe and stable, non-polluting and the re-vegetation cover is likely to be self-sustaining, prior to releasing the bond (Victoria State Government, 2014). Per section 20-A of the ITAA, if an amount of expenditure previously deducted from income is recouped by way of insurance, indemnity or other means, the amount may be included in assessable income if that amount is for deductible expenditure and it is not otherwise assessable income. Once the bond has been returned to the mining company, it will be included in income as it is a refund for the expenditure incurred by the mining company for rehabilitation.

The deposit will be returned once reclamation has been completed and a reclamation certificate has been obtained (Brocke & Chymko, 1990). Income is usually classified as business income if a certain degree of commercial activity is present. Property income is derived from more passive activities such as the collection of interest, dividends, rents and
The cash deposit of the security is a cash refund that qualifies as property as it generated passive income such as interest. The income will therefore not be included in the business income in calculation of the taxable income of the mining company.

4.4.2 Comparison: South African bank guarantee and Australian bank guarantee/bond

On payment of the cash to back the guarantee or bond, consistent with the payment of the funds to government, no deduction is allowed in South Africa, as the payment is not made as a result of an expenditure being incurred; it is merely a transfer of funds from one bank account to another. Payment therefore does not meet the requirements of section 11(a) of the ITA. In Australia, section 40.760 of the ITAA specifically prohibits deduction from income in a year for a bond or security for performing environmental protection activities. The tax treatment on creation of the guarantee is consistent between South Africa and Australia.

In South Africa it was concluded that expenses incurred in relation to the guarantee are deductible per section 11(a) of the ITA. In Western Australia, section 40.745 of the ITAA prohibits deduction of bond or security expenditure for performing mining site rehabilitation. The income tax implication of the expenses is therefore not consistent in South Africa and Australia. The treatment in South Africa is appropriate, as the bank charges meet the requirements of section 11(a) of the ITA. The mines in Australia are at a disadvantage when the two tax treatments are compared, as the expenditure is closely related to mining operations.

The rehabilitation expenses are deductible in South Africa and Australia, as mentioned in the cash deposit option, and the tax treatment is therefore consistent. Once the rehabilitation has been completed, the guarantee would be released and the amount is not included in gross income in South African ITA as it is a refund of funds previously provided to the DMR. In Australia, per section 20-A of the ITAA, if an amount of expenditure previously deducted from income is recouped by way of insurance, indemnity or other means, the amount may be included in assessable income if that amount is for deductible expenditure and it is not otherwise assessable income. There is therefore a difference in the income tax treatment of the two countries. The tax treatment in South Africa is appropriate as the payment of the guarantee was not allowed as a deduction and it would not be appropriate to include the refund of the funds in gross income.
4.5 Rehabilitation trust option

4.5.1 Qualifying Environmental Trust: Canada

Qualifying Environmental Trusts (QET) are single-purpose trusts that are maintained for the sole purpose of funding reclamation obligations (EY, 2014:2). According to section 20(1)(tt) of the Canadian Income Tax Act, a taxpayer is entitled to deduct consideration paid for the acquisition of an interest as a beneficiary under a QET, excluding consideration that is the assumption of a reclamation obligation in respect of the trust.

Under the ITAC the company is allowed to deduct the amount placed into a Qualifying Environmental Trust from their income in the current year (Dixon et al., 2012). A Qualifying Environmental Trust is the only vehicle that enables a corporation to claim a tax deduction in the year for amounts set aside for future reclamation (Alberta Treasury Board and Finance, Tax and Revenue Administration, 2013). There is no limitation on the amount that a taxpayer may contribute to a QET and to qualify as a QET, the trust may invest only in qualified investments (KPMG, 2011:20-21).

Every QET resident in Alberta at the end of a taxation year must pay tax equal to their investment income for the year, as calculated under the federal Act, multiplied by the Alberta corporate tax rate of 10 percent. A corporation that is a beneficiary of the QET is also required to report and pay tax on its share of the QET’s investment income for the year (Alberta Treasury Board and Finance, Tax and Revenue Administration, 2015). To offset the second level of tax on the QET’s income, the corporation may claim a refundable Alberta QET tax credit equal to the corporation’s share of the amount of Alberta tax paid by the QET (KPMG, 2011:20-21).

A taxpayer may deduct reclamation expenses in respect of a mining property only at the time the expense is actually incurred. Historically, this has been after the mine has ceased production and is no longer generating income (KPMG, 2011:20). The requirement to pre-fund reclamation obligations creates an income tax issue, as expenses are generally deductible for tax purposes only when they have been incurred, and a future deduction for tax purposes may be allowed at a time when no taxable income is available to benefit from such deduction (EY, 2014:2). All withdrawals from the trust will be included in computing the recipient’s income.

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for tax purposes (Natural Resources Canada, 2015). However, there should be an offsetting deduction for reclamation costs actually incurred (KPMG, 2011:20-21).

4.5.2 Comparison: Rehabilitation trusts and Qualifying Environmental Trusts

Section 37A of the South African ITA provides for the deduction for income tax purposes of contributions made to a qualifying rehabilitation trust (Van Zyl, 2014). In Canada, under the Tax Act the company is allowed to deduct the amount placed into a QET from their income in the current year (Dixon et al., 2012). A QET is the only vehicle that enables a corporation to claim a tax deduction in the year for amounts set aside for future reclamation (Alberta Treasury Board and Finance, Tax and Revenue Administration, 2013). The tax treatment for contribution of funds into the trust in South Africa and Canada is therefore the same.

In South Africa, as a general principle, any income earned by the fund on investment of contributions should be treated as exempt income. This is on the basis that the purpose of the fund is to provide for decommissioning, and any increase in its overall balance should be intended for the same purpose (Choudhury et al., 2015). Section 64E(d) of the ITA exempts dividends earned by the trust. In Canada every QET resident in Alberta at the end of a taxation year must pay tax equal to its income for the year, as calculated under the federal Act, multiplied by the Alberta corporate tax rate of 10 percent. A corporation that is a beneficiary of the QET also is required to report and pay tax on its share of the QET’s income for the year (Alberta Treasury Board and Finance, Tax and Revenue Administration, 2015). To offset the second level of tax on the QET’s income, the corporation may claim a refundable Alberta QET tax credit equal to the corporation’s share of the amount of Alberta tax paid by the QET (KPMG, 2011:20-21). The treatment in South Africa provides an advantage to the mining company as the income is not taxable in the hands of the trust. In Canada the income is taxable in the hands of the trust. Even though the mining company includes the income in its taxable income and obtains a rebate of the tax paid by the QET, the income is still taxable in the hands of the trust and additional administrative expenses will be incurred to finalise the process to claim it back.

In South Africa, rehabilitation costs are deductible when incurred by the mining company in ITA as per other funding options per section 37B(6). In Canada, a taxpayer may deduct reclamation expenses in respect of a mining property only at the time the expense is actually incurred. Historically, this has been after the mine has ceased production and is no longer generating income (KPMG, 2011:20). The tax treatment for rehabilitation costs is therefore the same in South Africa and in Canada.
Section 37A(3) of the South African ITA places a restriction on distribution of the trust assets once the mine has been wound up and liquidated. First option is that the trust assets can be transferred to another company or trust as approved by the Commissioner. If there is no other company or trust established by the existing mining company, then the funds must be transferred to a company or trust as approved by a cabinet member. In Canada all withdrawals from the trust will be included in computing the recipient’s income for tax purposes (Natural Resources Canada, 2015). The requirements in the two countries are therefore different as South African tax legislation places a restriction on balance of trust assets whereas in Canada, if the funds are distribution, they will be taxable in the hands of the recipient mining company. SARS could consider providing an option where a mining company can include the balance of funds in the mining company’s gross income as it is a significant disadvantage to use a trust if the mining company only has one mine or if there has been overfunding. This could encourage even smaller mines to use rehabilitation trusts as funding vehicles.

4.7 Conclusion

The objective of the chapter was to identify comparable rehabilitation funding options available in Canada and Australia and to compare the income tax implications of the funding options with those identified in South Africa. The first option analysed was the bank deposit option, which is used by both Australia and Canada. The first difference identified with this option is that South African and Australian authorities keep the funds in a pool of funds and do not distinguish between the funds of each mine by utilising a separate bank account for each mine. Interest income is not provided to the mining companies by the mining authorities. In Canada each mine’s funds are held in a separate account in the name of the mining company and provide for interest for each mining company, which is then taxed on the interest income. As this option provides the best security for the DMR, South African authorities could consider providing for interest on this option, which could encourage mines to use this option. The deduction of rehabilitation expenditure against taxable income is consistent across all three countries, which is once the expenditure is incurred by the mining company. Once rehabilitation is complete and the security is released, section 20-A of the Australian ITAA includes in assessable income an amount that an entity receives as recoupment by way of insurance, indemnity or other recoupment. If it is for an expense that is deductible and is not otherwise assessable income, the refund of the security would be included in the company’s assessable income. In South Africa and Canada, the amount of the refund is not included in gross income. The tax treatment is therefore the same in South Africa and Canada but different in Australia, as the funds are taxable in Australia. As the payment of the deposit was
not initially deductible, the treatment in South Africa and Canada when the refund is obtained is appropriate for this transaction.

In addition to providing security, Australia’s Northern Territory has a 1 percent levy on the security provided. The 1 percent levy introduced by the Northern Territory is an environmental tax (Swanepoel, 2013). In return for the levy, operators will receive a 10 percent reduction in the level of security they need to lodge with the Department of Mines and Energy (Harris, 2013). South Africa and Canada do not have a similar additional tax. The DMR could consider introducing a similar environmental tax, which would assist the government in rehabilitating abandoned mines and would provide mining companies with a discount on the rehabilitation funding, which could provide the company with more funds for capital investment instead of providing 100 percent security for the life of the mine, as rehabilitation security does affect mines’ cash flow negatively.

The second comparison was the income tax implication of the bank guarantee option in South Africa to that of Australia. The payment of the bank guarantee is not deductible in South Africa or Australia as it does not meet the requirements of the general deduction formula of each country. A difference exists with the income tax treatment of the expenses incurred on the bank guarantee charged by the financial institution that has issued the guarantee. In South Africa the costs are deductible, but in Australia the deduction is specifically prohibited by section 40.745 of the ITAA. The treatment in South Africa is appropriate as the bank charges meet the requirements of section 11(a) of the ITA. The mines in Australia are at a disadvantage in comparison with the two tax treatments as the expenditure is closely related to mining operations.

Once the rehabilitation has been completed, the guarantee would be released and the amount would not be included in gross income in South African ITA as it is merely a refund of funds previously provided to the DMR. In Australia, per section 20-A of the ITAA, if an amount of expenditure previously deducted from income is recouped by way of insurance, indemnity or other means, the amount may be included in assessable income if that amount is for deductible expenditure and it is not otherwise assessable income. There is therefore a difference in the income tax treatment of the two countries. The tax treatment in South Africa is appropriate as the payment of the guarantee was not allowed as a deduction and it would not be appropriate to include the refund of the funds in gross income.

The third income tax comparison was between the income tax implications of environmental trusts in South Africa to those in Canada. The income tax provisions in both countries allow
for the deduction of contributions made into the rehabilitation trust. Section 37A of the ITA of South Africa exempts any income earned by the trust but in Canada every QET must at the end of a taxation year pay tax equal to its income for the year, as calculated under the federal Act, multiplied by the Alberta corporate tax rate of 10 percent. A corporation that is a beneficiary of the QET also is required to report and pay tax on its share of the QET’s income for the year (Alberta Treasury Board and Finance, Tax and Revenue Administration, 2015). In order to offset the second level of tax on the QET’s income, the corporation may claim a refundable QET tax credit equal to the corporation’s share of the amount of tax paid by the QET (KPMG, 2011:20-21). The treatment in South Africa provides a better tax advantage to the mining company as the income is not taxable in the hands of the trust. In Canada the income is taxable in the hands of the trust. Even though the mining company includes the income in its taxable income and obtains a rebate of the tax paid by the QET, the income is still taxable in the hands of the trust.

Section 37A(3) of the South African ITA places a restriction on distribution of the trust assets once the mine has been wound up and liquidated. First option is that the trust assets can be transferred to another company or trust as approved by the Commissioner. If there is no other company or trust established by the existing mining company then the funds must be transferred to a company or trust as approved by a cabinet member. In Canada all withdrawals from the trust will be included in computing the recipient’s income for tax purposes. SARS could consider providing an option where a mining company can include the balance of funds in the mining company’s gross income as it is a significant disadvantage to use a trust if the mining company only has one mine or if there has been overfunding. This could encourage even smaller mines to use rehabilitation trusts as funding vehicles.

As mentioned in Chapter 2, the use of insurance products certainly has conceptual appeal but they are relatively untested, although used in South Africa and by some states in the USA. Concerns range from so-called “unscrupulous fly-by-night operators” to the fact that the products are not actually insurance products but performance guarantees disguised as insurance products. The scepticism surrounding the use of insurance products for mining rehabilitation is also evident in Western Australia (Bond-Smith et al., 2012). Yukon, which is a province in Canada, makes use of insurance as a funding option mechanism but very limited information is available on this option and what is, is merely background information.

It was found that the income tax implications in the three countries are very similar and all allow for the deduction of rehabilitation expenditure when incurred. The main differences in
the income tax implications resulted from the interest earned with the deposit option and the investment income earned when using the trust option.
CHAPTER 5: CONCLUSION

5.1 Overview of analysis performed

This study aimed to conduct an analysis of how the South African income tax implications of mine rehabilitation funding vehicles compare to tax implications of vehicles allowed by the relevant regulations governing rehabilitation. In order to answer the question certain objectives were identified in Chapter 1.

The first objective, dealt with in Chapter 2, was to identify the rehabilitation funding vehicles that are available for mining companies per the MPRDA, which is the current body that regulates provision of funds for mine rehabilitation. Chapter 2 also addressed the second objective of the research, which was to explore the commercial terms of the funding vehicles that are available in South Africa. The vehicles available to provide funding to DMR for the purpose of mine rehabilitation available in South Africa are a cash deposit, a guarantee issued by a bank, and a guarantee issued by an insurance company or by setting up a rehabilitation trust. The income tax implications of each are different in some aspects and in some aspects similar. Each also has advantages and disadvantages in terms of cash flow impact, cost, tax implications, flexibility and investment opportunity.

While the cash deposit option presents the lowest risk to the DMR, it is the least used due to the constraints it places on the working capital requirements of the mining entity (Bond-Smith et al., 2012:32). An advantage of a cash-backed guarantee compared to the cash deposit option is that a company can earn interest on money that would have otherwise been paid as the company can choose from a number of investment accounts, including term deposits, to earn interest on its secured cash (Commonwealth Bank, n.d.). This option does, however, tie up the bank credit lines to the client or may limit access to additional credit lines (Marsh, 2015). Normally these capital outlays are enormous and can often be enough to put off junior miners. The insurance mining rehabilitation guarantee is a viable alternative and is approved by the DMR (Udemans, 2011:9). The trust option is used mainly by larger organisations as the option is restrictive and regulated. Gaining access to the funds may be complicated and the remainder of the funds may be used to rehabilitate mines that are not even part of the company. Section 37A(1) of the ITA prescribes certain characteristics that a rehabilitation trust should have.

The third objective of the research, which was addressed in Chapter 3, was to analyse the income tax implications of each of the funding vehicles identified in Chapter 2 as a bank
transfer, bank guarantee, insurance guarantee and rehabilitation trust. As discussed in Chapter 3, when payment for the rehabilitation funds is made to the DMR on the bank transfer option, the payment does not result from an expense that was incurred and would thus not be deductible for tax purposes. In South Africa, the mining company would incur bank charges like any other payment and these would be deductible for tax purposes as the expense meets the requirements of section 11(a) of the ITA. Interest earned on the funds accrues to the DMR, so the mining company would not be taxed on any income. For all the options the rehabilitation costs are deductible per section 37B(6) as environmental expenditure of the ITA. Once rehabilitation funds are returned to the mining company when mine rehabilitation is complete, the income is of a capital nature as it does not meet the requirements of the gross income definition in section 1 of the ITA.

If there are costs incurred on the creation of a bank guarantee they would have the same tax implications as the cash transfer option. Subsequent costs incurred by the mining company on maintaining the guarantee would be deductible for tax purposes as they meet requirements of section 11(a) and are not prohibited by section 23(g). Interest income would be earned on the bank guarantee and would accrue to the company per section 24J of the ITA as the mining company would hold the income instrument. The specific amount of interest included in the income of a taxpayer is calculated in terms of the various formulas contained in section 24J of the ITA (Reifarth, 2015). Once the mine rehabilitation is complete, the guaranteed funds would be released to the mining company (Chamber of Mines, 2015). Refund of the funds to secure the guarantee provided by the financial institution once the guarantee document has been returned to the financial institution would not be included in gross income as it is merely a transfer of funds from one bank account to another.

With the insurance option, when payments to an insurance policy are made, they would meet the deductibility requirements of section 11(a). However, the deductions could be restricted if SARS sees the insurance policy as an investment disguised as an insurance policy. Should the insurance company provide a discretionary bonus on cancellation of the policy the bonus would be taxable as it is closely related to recoupment of a previous amount, the insurance premium previously deducted per section 11(a). Also, section 23L(3) provides that where policy benefits are received by or accrued to a person in terms of an investment policy, such amounts must be included in the person’s gross income. At the time the premiums on that policy which were not deductible under section 23L(2) of the ITA must be allowed as a deduction against the benefits received (Croome et al., 2013:224).
Section 37A provides for the deduction of contributions into the rehabilitation trust. In South Africa any income earned by the fund on investment of contributions should be treated as exempt income. Section 64E(d) of the ITA exempts dividends earned by the trust. Section 37A(3) of the South African ITA places a restriction on distribution of the trust assets once the mine has been wound up and liquidated. The first option is that the trust assets can be transferred to another company or trust as approved by the Commissioner. If there is no other company or trust established by the existing mining company, the funds must be transferred to a company or trust as approved by a cabinet member.

Chapter 4 analysed the income tax implications of similar funding vehicles that are available in Canada and Australia in comparison to those identified in South Africa in Chapter 2. A summary of the findings of the analyses is documented in 5.2 below.

5.2 Summary of findings

In paragraph 4.3.3 (Chapter 4) of this research, it was found that the income tax implications for the cash deposit option are the same in South Africa and in Australia, but it was also found that the main difference with Canada is that Canada provides for interest income on the cash deposit option. The South African government can consider this structure in order to encourage mines to use this option as it provides maximum security because the DMR has the funds held in their own bank account. Another difference that was identified with this option is that Australia’s Northern Territory also has an environmental tax which is calculated at 1 percent of the rehabilitation provision and is not refundable to the mining company and the mine is able to assist government to rehabilitate abandoned mines. This tax is payable in addition to the cash transfer. In return for this tax mines get a 10 percent reduction on the rehabilitation security. A recommendation is that South Africa could also provide for this as it would free a portion of tied up capital to provide mines with more cash flow for capital investment.

In paragraph 4.4.2 (Chapter 4) of this research, a comparison of the tax implications of the bank guarantee option in South Africa and Australia was conducted. With the bank guarantee option, the tax treatment on payment of the guarantee to a financial institution is consistent in South Africa and Australia, as the payment is not deductible for tax purposes; it is merely a transfer of funds from one bank account to another. In South Africa it was concluded that expenses incurred in relation to the guarantee are deductible per section 11(a). In Australia, section 40.745 of the ITAA prohibits deduction of bond or security expenditure for performing mining site rehabilitation. The treatment in South Africa is appropriate as the costs incurred
are closely related to mining activities that generate income. Once the rehabilitation has been completed, the guarantee would be released and the amount is not included in gross income in South African ITA as it is a refund of funds previously provided to the DMR. In Australia, per section 20-A of the ITAA, if an expenditure previously deducted from income is recouped by way of insurance, indemnity or other means, the amount may be included in assessable income if that amount is for deductible expenditure and is not otherwise assessable income. There is therefore a difference in the income tax treatment of the two countries. The tax treatment in South Africa is appropriate as the payment of the guarantee was not allowed as a deduction and it would not be appropriate to include the refund of the funds in gross income.

In both South Africa and Canada, beneficiary companies can deduct the value of the contributions made into a rehabilitation trust for the purpose of mine rehabilitation. The comparison of the income tax implications of the trust option was conducted in section 4.5.2 in Chapter 4. The tax treatment for contribution of funds into the trust in South Africa and Canada is therefore the same in both countries. In South Africa, any income earned by the fund on investment of contributions should be treated as exempt income. In Canada every QET at the end of a taxation year must pay tax equal to its income for the year, as calculated under the Federal Act, multiplied by the Alberta corporate tax rate of 10 percent. A corporation that is a beneficiary of the QET also is required to report and pay tax on its share of the QET’s income for the year. In order to offset the second level of tax on the QET’s income, the corporation may claim a refundable Alberta QET tax credit equal to the corporation’s share of the amount of Alberta tax paid by the QET (KPMG, 2011:20-21).

Section 37A(3) of the South African ITA places a restriction on distribution of the trust assets once the mine has been wound up and liquidated. The first option is that the trust assets can be transferred to another company or trust as approved by the Commissioner. If there is no other company or trust established by the existing mining company, the funds must be transferred to a company or trust as approved by a cabinet member. In Canada all withdrawals from the trust will be included in computing the recipient’s income for tax purposes (Natural Resources Canada, 2015). SARS could consider providing an option where a mining company can include the balance of funds in the mining company’s gross income as it is a significant disadvantage to use a trust if the mining company only has one mine or if there has been overfunding and the funds cannot be returned to the contributing entity. This could encourage even smaller mines to use rehabilitation trusts as funding vehicles.
5.3 Possible topics for further study

The Davis Committee recommended in June 2015 that an investigation be conducted with a view to providing appropriate tax relief in respect of all the funding mechanisms available in terms of NEMA, subject, of course, to application of due care in not opening any doors to tax avoidance (DTC, 2015). When this investigation is complete and should it result in changes to the ITA that make provision for tax relief on all the funding vehicles identified in Chapter 2 of this research, a study on the changes and comparison of the tax incentives analysed in Chapter 3 of this research can be conducted.

5.4 Conclusion

The only funding option that has a specific tax incentive and has directly mentioned tax implications in South African tax legislation is the rehabilitation trust. The recommendation made by the Davis Committee for the attention of the Minister of Finance of South Africa as mentioned in 5.3 should be considered in order to eliminate continuous challenge with unrehabilitated mines in South Africa. Deductions may also be obtained on the risk-based insurance option if the deductions are not prohibited by section 23L of the ITA. These two options are the only options that provide for the deduction of contribution for future rehabilitation. The bank transfer and the bank guarantee do not provide for deduction of the funds for purposes of mine rehabilitation funding. This treatment is consistent in Australia and Canada.

With the bank transfer option, differences in income tax treatment exist with regard to interest earned on the funds. South African authorities should consider keeping the funds of each mining company in a separate account and providing for the interest on each mining company’s funds. This could encourage companies to use this option. Even though they would be taxed on the interest income, the fact that they would earn interest is an advantage in comparison to how the funding option is currently set up. Another difference identified with this option is that the refund of the funds is taxable in Australia but is not taxable in South Africa and Canada. It is concluded that the treatment in South Africa is appropriate.

The main difference in the income tax implications of the bank guarantee option is that the refund is included as income in Australia where it is not included as income in South Africa and Canada. The treatment in South Africa is appropriate as the refund is a mere transfer of funds from one bank account to another. The main difference in the income tax implications relating to trusts is that in Canada, the trust is taxed on income earned at a rate of 10 percent.
The beneficiary company would also be required to include the income earned by the trust in its income but is able to utilise a tax rebate equal to the tax paid by the trust. In South Africa, the trust income is exempt for income tax purposes. The treatment in South Africa is deemed appropriate as even though the beneficiary company obtains a rebate for the tax paid by the trust, the income is still taxable in the trust. On termination of the rehabilitation trust, any balance of the funds in Canada can be distributed to the beneficiary company but the funds would be included as income as the payments into the trust were previously deductible. South African authorities prohibit such distribution but should consider this option, especially for mining companies that only have one mine.

Overall, the study confirms that the income tax implications of the bank transfer, bank guarantee and the rehabilitation trust are comparable to similar funding options available in Canada and Australia. The only option that is not comparable is the insurance guarantee option, as there are concerns with the option ranging from so-called “unscrupulous fly-by-night operators” to the fact that the products are not actually insurance products but performance guarantees disguised as insurance products. The scepticism surrounding the use of insurance products for mining rehabilitation certainly exists internationally.

This study further concludes that there are some gaps in the income tax implications of some of the rehabilitation funding vehicles, which has resulted in the recommendations mentioned above. The recommendations should be considered in order to ensure that a tax advantage is provided to companies to ensure that they continue to take responsibility for their environmental requirements, which will assist the government in maintaining its commitment to ensure that every citizen of the Republic has access to an environment that is protected, pollution free, and sustainable, by enacting certain regulations.
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