SOME IMPLICATIONS OF THE NEW ASSISTANCE FORMULA FOR SOUTH AFRICAN GOLD MINES

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Written contribution

E. Wroth* (Visitor): The technical aspects of the assistance scheme which is provided for in the Gold Mines Assistance Act, 1968, and certain consequential amendments to the Income Tax Act, 1962, are explained by Dr Krige. The object of this contribution is to explain the working of the Gold Mines Assistance Act (hereafter referred to as the 'Assistance Act') for the benefit of those concerned with the tax and assistance assessments of gold mining companies.

The views expressed do not necessarily reflect the Revenue Department's interpretation of the legal provisions involved.

1. MINES WHICH QUALIFY FOR ASSISTANCE

1.1 The assistance scheme is applied on a selective basis. Mines which qualify for assistance are defined in the Assistance Act as 'assisted gold mines'. The requirements for classification as an assisted gold mine are that:
  (i) the mine be a producing gold mine;
  (ii) it would be likely to close down within eight years if not assisted; and
  (iii) with State assistance its life would be appreciably prolonged and there would be a significant increase in production of gold or uranium, or of both gold and uranium.

1.2 A mine is only considered for classification as an assisted gold mine on application. Such applications must be made to the Mining Leases Board through the Government Mining Engineer. Classification of a mine as an assisted gold mine is at the discretion of the Minister of Mines who acts in consultation with the Minister of Finance and has regard to the recommendations of the Mining Leases Board.

1.3 The Minister of Mines will impose conditions subject to which a mine is to be classified as an assisted gold mine. The most important will be that the mine must immediately lower its operating pay limit, as normally calculated, by a percentage fixed by the Mining Leases Board and conduct its future mining operations in accordance with the average grade of its ore reserves determined on the basis of such lower pay limit.

1.4 The Minister will fix the date as from which classification as an assisted gold mine is to be effective. So long as the mine has operated on the basis of the lowered pay limit for at least three months during the particular year of assessment, he would normally fix the effective date as the first day of the year of assessment.

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1.5 The Minister, in consultation with the Minister of Finance and having regard to the recommendations of the Mining Leases Board, may terminate a mine's classification as an assisted gold mine if the Government Mining Engineer reports that, in his opinion, the mine's production of gold or uranium is insufficient to warrant further State assistance. In such an event, the operating company must be given at least six months notice of the decision to change the mine's status. The change will always take effect from the first day of a year of assessment which will obviate the necessity for two separate returns for one year.

1.6 A mine automatically ceases to be classified as an assisted gold mine when it ceases underground mining operations. Separate returns will have to be rendered in respect of the two periods up to and after the day on which these operations ceased and each of these periods must be separately assessed as if they were separate years of assessment. This is provided for in the new sub-section (5) which has been added to section 67 of the Income Tax Act, 1962, by section 16 of the Income Tax Act, 1968.

2. THE NATURE OF THE ASSISTANCE

2.1 The assistance provided for in the Assistance Act and the amendments to the Income Tax Act, 1962, takes the form of either—

(*a*) *tax relief* in the case of a mine which pays tax, or

(*b*) *direct financial assistance* in the case of a mine which does not pay tax either because it has been worked at a loss or because the margin of profit is not sufficiently high to attract liability under the prescribed formula.

2.2 Assisted gold mines which are liable for income tax will be taxed at a rate determined by either the standard $Y = 60 - \frac{360}{x}$ formula (or the 'small mines formula' $Y = 20\left(1 - \frac{6}{x}\right)$, properly adjusted, if the taxable income is less than R140,000) or the newly prescribed formula $Y = 68 - \frac{601}{x}$, whichever is the more advantageous to the mine.

To the tax calculated under the 68 formula there must be added the 5 per cent loan portion of tax (if any) but *not* the 5 per cent surcharge which is payable by companies paying tax under the standard 60 formula or the 'small mines formula'. There is no tax payable under the 68 formula when the ratio of *taxable income* from mining to *gross revenue* from mining, expressed as a percentage, $\left(\frac{P}{R}\right)$, is $8\frac{57}{68}$ per cent or lower.

2.3 Usually, an assisted gold mine, which is not liable for normal income tax under the 68 formula, becomes entitled to direct financial assistance under the Assistance Act.

The amount of the assistance payable is calculated as follows:

Assistance = 6·01 per cent of gross mining income less
68 per cent of *mining profit*,
Or
6·01 per cent of gross mining income plus
68 per cent of *mining loss*.

(The calculation of the mining profit or mining loss is dealt with in paragraph 3). The amount of assistance so calculated for any one year is *limited to* 25 *per cent of the gross income* from sales of gold, uranium and other metals won in conjunction with the mining for gold and uranium. It should be noted that the gross income for purposes of determining the maximum assistance is not the same as the gross income taken into account in determining the mining profit or the mining loss. (See paragraph 3.1).

2.4 The distinction between the terms 'taxable income' and 'assessed loss' under the Income Tax Act, 1962, and 'mining profit' or 'mining loss' under the Assistance Act must be clarified. An assisted gold mine which is liable for income tax is assessed on the 68 formula on its *taxable income*, whereas the direct assistance payable under the Assistance Act is calculated on the *mining profit* or the *mining loss*. It must be emphasized that the mining profit or the mining loss is not necessarily the same as the taxable income or the assessed loss for income tax purposes. It is thus not impossible for an assisted gold mine to be exempt from normal tax under the 68 formula and yet not receive assistance under the Assistance Act. (See Example C in paragraph 3.)

2.5 The granting of assistance, whether directly or by way of tax relief, is subject to the condition that in respect of the year of assessment in question the terms on which the mine was classified as an assisted gold mine were complied with. The onus is on the operating company to satisfy the Government Mining Engineer in this respect.

3. MINING PROFIT AND MINING LOSS.

3.1 The mining profit or mining loss is determined by deducting from the mining income the sum of:

(a) the deductions which have been allowed against that income for income tax purposes in terms of section 11 of the Income Tax Act 1962, excluding paragraph (*q*) of that section (i.e. capital expenditure incurred on scientific research), and

(b) an allowance for redemption of capital expenditure.

The mining income is the same as the gross income for income tax purposes. It includes, in addition to the income from gold, income from uranium, silver, osmiridium, pyrites and other metals won in the course of mining for gold as well as sundry income which results directly from mining for gold, such as sales of waste rock and scrap material, rents from mine houses, pneumoconiosis refunds, etc. Excess recoupments of capital expenditure are not included.

The expenses allowed are the mine's normal working costs. The test is whether they are deductible from the mining income for income tax purposes in terms of section 11 of the Income Tax Act, 1962. Thus, expenditure which produces non-mining income is not included. Nor is certain other expenditure, for instance, prospecting expenditure incurred outside the lease area which is allowed for income tax purposes in terms of section 15 and not section 11 of the Income Tax Act,1962.

The allowance for the redemption of capital expenditure is dealt with in paragraph 4. It is mentioned here that this allowance is not necessarily the same as the capital redemption allowance made for income tax purposes.

EXAMPLE A

Assume:

		R
Gross revenue from mining		100
Farm rentals		3
Working costs all deductible in terms of section 11 of the Income Tax Act		85
Prospecting expenditure outside the lease area		1
Redemption allowance for purposes both of tax and of assistance		10
Expenses on farm property		1

Solution: *Normal Tax Assessment*

Gross revenue from mining (R)		100
Working costs	85	
Prospecting expenditure	1	
Redemption allowance	10	96
Taxable income from mining (P)		4

P/R is less than $8\frac{57}{68}$ per cent no formula tax is payable.

Farm rentals	3
Expenses	1
Taxable income (non-mining) subject to normal tax at ordinary company rates	2

Assessment of Assistance

Taxable income from mining assessed for normal tax		1
Add back prospecting expenditure (not deductible in terms of section 11)		4
Mining profit ($M.P.$)		5
Assistance payable = 6·01 per cent R (100)	=	6·01
− 68 per cent $M.P.$ (5)	=	3·40
		2·61

EXAMPLE B

Assume: The same particulars as in Example A except that the company had an assessed loss of 20 at the end of the preceding year of assessment.

Solution: *Normal Tax Assessment*

		R
Gross revenue from mining (R)		100
Working costs	85	
Prospecting expenses	1	
Redemption allowance	10	96
		4
Non-mining income	3	
Expenses	1	2
		6
Assessed loss brought forward		20
Assessed loss carried forward to next year		14

Assessment of Assistance

Assessed loss determined for tax purposes		14
Add back deductions not made in terms of section 11—		
Prospecting expenses	1	
Assessed loss brought forward	20	21
		7
Exclude non-mining income		2
Mining profit (*M.P.*)		5
Assistance payable = 6·01 per cent *R* (100)	=	6·01
− 68 per cent *M.P.* (5)	=	3·40
	=	2·61

EXAMPLE C

		R
Assume:	Gross revenue from mining	100
	Working costs	78
	Exporter's allowance	1
	Redemption allowance for purposes both of tax and assistance ..	10
	Assessed loss brought forward	3

Solution: *Normal tax assessment*

Gross mining revenue (*R*)		100
Working costs	78	
Exporter's allowance	1	
Redemption allowance	10	
Loss brought forward	3	92
Taxable income (*P*)		8

P/R is lower than $8\frac{57}{68}$ per cent and there is no tax payable.

Assessment of assistance

Taxable Income		8
Add deductions not made in terms of section 11—		
Exporter's Allowance	1	
Loss brought forward	3	4
Mining Profit (*M.P.*)		12

$M.P./R$ is higher than $8\frac{57}{68}$ and there is no assistance payable.

In examples A, B and C the companies have taxable incomes. If an assessed loss is incurred such loss is reduced by the 'mining loss' as calculated for assistance purposes. Example D below covers the operation of this principle.

4. REDEMPTION OF CAPITAL EXPENDITURE.

4.1 Section 14 of the Income Tax Act, 1968, adds a new sub-section (3) *ter* to section 36 of the Income Tax Act, 1962, which provides that the capital expenditure incurred by an assisted gold mine is to be allowed as a deduction in the year of assessment in which it is incurred, as is the case with 'new gold mines'. In addition the unredeemed balances of capital expenditure of the pre-1946 mines which are classified as assisted gold mines will be allowed as deductions for tax purposes in the year in which they are so classified.

4.2 The above-mentioned provisions apply, of course, only to the assessment of the *taxable income or assessed loss* of an assisted gold mine. The allowance for redemption of capital expenditure for purposes of determining the mining profit or the mining loss on which *assistance* is paid, is provided for in section 6 of the Assistance Act. This allowance differs from the allowance made under the Income Tax Act in the following respects:

(a) It is limited to expenditure incurred in the year of assessment in question and to expenditure of the nature described in paragraph (*a*) of the definition of 'capital expenditure' in section 36(11) of the Income Tax Act, 1962, i.e. expenditure on shaft-sinking and mine equipment including any single renewal or replacement which together with the accessories thereto exceeds in cost R40,000. Thus, no allowance would be made, for instance, in respect of the effective value of redeemable assets acquired by the mine on change of ownership of a mining property, which would constitute capital expenditure ranking for redemption for income tax purposes in terms of section 37 of the Income Tax Act 1962.

(b) The Government Mining Engineer has a discretion to prohibit any allowance being made in respect of expenditure on a project which, in his opinion, will not benefit the production of gold and uranium, for instance, the cost of erection of a new office block.

(c) The allowance for any one year is limited to an amount which will result in the amount of assistance, calculated in accordance with the 68 formula, not exceeding the maximum assistance permitted—namely, 25 per cent of the revenue from sales of gold, uranium and other minerals won in conjunction therewith. Expenditure which is not allowed on account of this limitation is carried forward to the next succeeding year of assessment. The purpose of this provision is to ensure that a mine which has heavy capital expenditure in a particular year will get full assistance in respect of that expenditure and will not suffer by the limit which has been placed on the amount of assistance for any one year.

The amount of the redemption allowance when the limitation applies can be calculated in accordance with the following formula:

Assistance $= 25$ per cent $S = 6{\cdot}01$ per cent $R - 68$ per cent MP.

$= 25$ per cent $S = 6{\cdot}01$ per cent $R - 68$ per cent $(W.P. - x)$, where:

x = Redemption allowance to be made.

S = Sales of gold, uranium and other minerals.

R = Gross revenue from mining as determined for income tax purposes.

$W.P.$ = Working profit before the deduction of the redemption allowance.

$M.P.$ = Mining profit determined in terms of the Assistance Act, i.e. after the deduction of the redemption allowance.

The same formula, suitably adjusted, can be used in cases where a mining loss is made.

EXAMPLE D

A pre-1946 mine is classified as an assisted gold mine with effect from its 1968 year of assesment. For that year it had the following revenue and expenditure:

	R
Sales of gold and other minerals	80,000
Other mining revenue	5,000
Non-mining revenue	3,000
Working costs all deductible in terms of section 11 of the Income Tax Act	70,000
Exporters' allowance for the year	100
Capital expenditure incurred during the year, including R5,000 on a new office	55,000
Capital expenditure unredeemed at the end of the 1967 year of assessment	20,000

Normal Tax Assessment

Sales of gold and other minerals		80,000
Other mining revenue		5,000
		85,000
Deduct: Working costs	70,000	
Exporter's allowance	100	
Capital expenditure incurred during year	55,000	
Capital expenditure unredeemed at the beginning of the year	20,000	145,100
Loss on gold mining		60,100
Reduced by mining loss, as calculated below, in respect of which assistance is payable. (See paragraph 6.2)		21,900
		38,200
Non-mining income		3,000
Assessed loss forward to 1969		35,200

Assessment of mining loss

Sales of minerals (S)	80,000
Other mining revenue	5,000
Mining income (R)	85,000
Working costs	70,000
Working profit before deduction of capital redemption allowance (W.P.)	15,000
Capital redemption allowance as calculated below	36,900
Mining Loss (*M.L.*)	21,900

Capital redemption allowance

Capital expenditure for year	55,000
Exclude expenditure on office not approved by G.M.E.	5,000
	50,000
Redemption allowance for year calculated as below	36,900
Capital expenditure deemed to have been incurred in 1969 (next year)	13,100

Redemption allowance for year (see formula in paragraph 4.2):

25 per cent $S = 6\cdot 01$ per cent $R - 68$ per cent $(W.P. - x)$

25 per cent of $80{,}000 = 6\cdot 01$ per cent of $85{,}000 - 68$ per cent of $15{,}000 + 68$ per cent x

$$20{,}000 = 5{,}108\cdot 5 - 10{,}200 + \cdot 68x$$

$$\cdot 68x = 25{,}091\cdot 5$$

$$x = 36{,}900$$

Assessment of assistance payable

Assistance payable $= 6{\cdot}01$ per cent $R + 68$ per cent $M.L.$
$= 6{\cdot}01$ per cent $85{,}000 + 68$ per cent $21{,}900$
$= 5{,}018 + 14{,}892$
$= \underline{\underline{20{,}000}}$

which is 25 per cent of revenue from sales of minerals, as is to be expected because only the appropriate amount of capital has been redeemed.

5. RECOUPMENTS OF CAPITAL EXPENDITURE

5.1 For income tax purposes there is no change in the method of dealing with recoupments of capital expenditure. Since assisted gold mines will have been allowed to redeem their capital expenditure in full, the total amount of any recoupment of capital expenditure which exceeds the current year's capital expenditure will constitute gross income in terms of paragraph (j) of the definition of that term in section 1 of the Income Tax Act, 1962. As is the case with unassisted gold mines, these recoupments will not be subjected to tax at the rate determined by the formula, but at the average rate of the formula tax paid by the company over the years as laid down in the Income Tax Act. Thus a mine which receives assistance can in fact pay what is conveniently called the excess recoupments tax.

5.2 For purposes of determining the amount of the assistance payable, whether in respect of a mining profit or a mining loss, recoupments of capital expenditure, irrespective of whether that expenditure was incurred before or after the mine was classified an assisted gold mine but excluding any amounts which have to be repaid to the State in respect of loans for capital expenditure made under the old State assistance scheme, will be set off against the current capital expenditure incurred by the mine. Any amount by which recoupments may exceed the current capital expenditure does not enter into the assessment of the assitance to be paid.

EXAMPLE E

	R
Gross revenue from mining	100
Working costs—all deductible in terms of section 11 of the Income Tax Act	97
Capital expenditure incurred during the year	10
Recoupment of capital expenditure	15

Income tax assessment:

Gross mining revenue		100
Working costs		97
		3
Capital expenditure unredeemed	Nil	
Recoupment of capital expenditure	15	
	−15	
Current capital expenditure	10	
Excess recoupment		5
Taxable income for year		8

Taxable income to be subjected to tax as follows:

(1) Subject to formula $Y = 68 - \dfrac{601}{x}$ 3

(P/R is less than $8\frac{57}{68}$ per cent and there is no tax payable.)

(2) Subject to the excess recoupments tax at the average rate of the normal tax paid by the company over the years 5

Assessment of assistance:

Gross mining revenue		100
Working costs		97
		3
Current capital expenditure	10	
Recoupment of capital expenditure	15	
Allowance		Nil
Mining profit in respect of which assistance is payable		3

In this case the mine will receive assistance on its mining profit of 3 and will pay the excess recoupments tax on 5.

6. ASSESSED LOSSES.

6.1 Allowable deductions for purposes of determining the assistance payable in terms of the Assistance Act are restricted to items which have been deducted from income in terms of section 11 of the Income Tax Act, 1962, in the determination of the company's taxable income. In the computation of taxable income, any balance of assessed loss incurred in a preceding year of assessment is permitted to be set off. Since the set-off is not allowed under Section 11 but in terms of section 20 of the Income Tax Act, 1962, it follows that it does not operate for purposes of the Assistance Act.

6.2 For income tax purposes, an assisted gold mine will continue to be permitted to set off an assessed loss incurred on gold mining against income from other sources and any balance of assessed loss resulting therefrom will be carried forward for set-off in the succeeding year of assessment. However, if the company has received assistance in terms of the Assistance Act in respect of the particular year, the assessed loss for that year must be reduced *by the amount of the mining loss* on which the assistance was paid. See new sub-section (3) which has been added to section 20 of the Income Tax Act, 1962, by section 13 of the Income Tax Act, 1968.

6.3 The provision referred to above will apply also to the assessment of profits of which a share is payable to the State in terms of any mining lease granted subsequent to the 1st July, 1934, since these profits are determined in like manner as the taxable income derived from gold mining is determined for income tax purposes.

6.4 For the purpose of the State's share of profits payable under any mining lease granted prior to the 1st July, 1934, and the assessments in respect of which are made under the Second Schedule to the Transvaal Mining Leases and Mineral Law Amendment Act, 1918, no portion of any loss so assessed for a year or period in respect of which assistance is payable under the Assistance Act is carried forward to the succeeding year or period, notwithstanding the provisions of paragraph 4(3) of the said schedule. This provision is contained in section 7 of the Gold Mines Assistance Act.

7. THE CAPITAL ALLOWANCE.

Section 14(1)(*d*) of the Income Tax Act, 1968, amends the definition of 'capital expenditure' in section 36 (11) of the Income Tax Act, 1962, to the effect that the special additional allowance on capital expenditure (known as the 'capital allowance'), to which certain mines are entitled, does not accrue in respect of any year of assessment during which the mine concerned is classified as an assisted gold mine. This capital allowance will also not be taken into account in the determination of the assistance payable in terms of the Assistance Act.

8. ASSISTANCE RECEIVED IN TERMS OF THE GOLD MINES ASSISTANCE ACT, 1968, EXEMPT FROM INCOME TAX.

A new paragraph (*y*) has been added to section 10 of the Income Tax Act, 1962, by section 8(1)(*e*) of the Income Tax Act, 1968, in terms of which the amount paid to an assisted gold mine under the Assistance Act, is exempt from income tax.

9. PAYMENT OF ASSISTANCE IN TERMS OF THE GOLD MINES ASSISTANCE ACT.

9.1 The assessment of the amount of the assistance payable in terms of the Assistance Act will be made by the Secretary for Inland Revenue and any company claiming to be entitled to such assistance must submit an application with its income tax return for the year in question. For purposes of making the assessment the Secretary for Inland Revenue will be entitled to use the company's income tax returns and any other information available to him under the Income Tax Act.

9.2 The Secretary for Inland Revenue will inform the Secretary for Mines of his determination of the amount of the assistance payable in each case and payment of the amount due will then be effected by the latter.

An assisted gold mine may apply to the Secretary for Mines for advance payments to be made during the course of a year on account of any assistance which is likely to be due in respect of that year. These advance payments will be set off against the assistance payable as finally determined by the Secretary for Inland Revenue. In the event of an overpayment, the amount overpaid must be refunded by the company to the Mines Department.

Any payment of assistance is, of course, subject to the Government Mining Engineer certifying that he is satisfied that, in respect of the period or year of assessment in question, the terms upon which the mine was classified as an assisted gold mine have been complied with.

Author's reply to discussion

D. G. Krige: The stimulating contributions from Messrs Cooke, Curtis, Martus, Johnston, Van Wyk, Van Rensburg and Wroth are appreciated by the author and provide clear evidence of the importance not only of the principle of assistance to gold mines, but also of its *scope* and *form*.

In general all the arguments, raised by Messrs Cooke, Martus and Johnston in favour of extending the *scope* of the new assistance scheme can be accepted as sound.