

Analysis – Armgold/Harmony Freegold Joint Venture (Pty) Ltd v CSARS (703/2011) [2012] ZASCA 152

The case of Armgold/Harmony Freegold Joint Venture (Pty) Ltd v CSARS (703/2011) [2012] ZASCA 152 dealt with the deduction of certain mining capital expenditure under subsections 36(7F) and 36(7E) of the Income Tax Act 58 of 1962 (“the Act”) as well as the basis of calculation to be adopted where a mine of a taxpayer operates at a loss. **facts of the case**

A company with limited liability called Armgold/Harmony Freegold Joint Venture (“AHF JV”) was formed as a joint venture between companies within the Harmony group. Its income is derived from three gold mines, Freegold, Joel and St Helena.

In September 2008, SARS issued revised tax assessments for AHF JV, adjusting its income tax liability for the 2002 to 2005 tax years. Nevertheless, the only relevant years for the purpose of the appeal are 2003 and 2004.

SARS set off the losses of the St Helena mine against the taxable income of the Freegold and Joel mines before taking into account the mining capital expenditure incurred in respect of those mines. The effect of this was to reduce the amount of capital expenditure that could be redeemed in respect of the Freegold and Joel mines.

tax law

Section 36(7E) of the Act limits the deduction of the aggregate of capital expenditure determined under section 36(7C) of the Act in a particular year of assessment in relation to any mine or mines to what is referred to as the

“gross mining taxable income” derived by the taxpayer from mining.

In terms of section 36(7F) of the Act, the capital expenditure of a mine is ring fenced to that mine which means capital expenditure incurred in a mine cannot be used to reduce the taxable income of another mine.

court’s ruling

The table below summarises the manner in which the taxpayer calculated its tax liability for the 2003 tax year:

	St Helena	Freegold	Joel	Non-mining
Balance of assessed loss	0	0	0	0
Taxable income (before capex) – A	(R 51m)	R 1,177m	R 20m	R 156m
Capex deductible in 2003 – B	N/A	R 1,177m	R 20m	N/A
Taxable income (A less B)	(R 51m)	0	0	R 156m
Assessed loss (current year)	(R 51m)	N/A	N/A	N/A

The Supreme Court of Appeal disagreed with the taxpayer’s method in calculating its tax liability. The court held that a total of R 1 197m cannot be allowed as a capex deduction from Freegold’s taxable income of R1 177m and Joel’s taxable income of R 20m. The taxpayer’s aggregate capex deductions for the year was limited to R 1 146m under section 36(7E), being its taxable income from mining before any capex deduction. The cap of R 1 146m is calculated by aggregating the taxable income of the Freegold and Joel mines of R 1 197m less the loss of R 51m incurred by the St Helena mine.

The table below summarises the manner in which SARS assessed the taxpayer for the 2003 tax year:

	St Helena	Freegold	Joel	Non-mining
Balance of assessed loss	0	0	0	0
Gross taxable income before capex	(R 51m)	R 1,177m	R 20m	R 156m
Set off St Helena Loss		(R 50m)	(R 1m)	
Net taxable income before Capex	0	R 1,127m	R 19m	N/A
Redemption of Capex	0	R 1,127m	R 19m	N/A
Taxable income	0	0	0	R 156m

SARS had calculated the taxpayer's tax liability by setting off St Helena's loss from the taxable incomes of the Freegold and Joel mines. The court held that, this method is impermissible in principle in terms of section 36(7C) and section 36(7F) of the Act, as the taxable incomes of mines are required to be assessed separately and without the operating expenses of one mine being used to reduce the taxable income of another.

The table below summarises the treatment adopted by the court for the taxpayer's tax liability for the 2003 year:

	St Helena	Freegold	Joel	Non-mining
Balance of assessed loss	0	0	0	0
Taxable income before Capex	(R 51m)	R 1,177m	R 20m	R 156m
Capex deductible	0	R 1,127m	R 19m	N/A
Taxable income after Capex	(R 51m)	R 50m	R 1m	R 156m

The court held that 'although section 36(7F) provides for a maximum (or particular cap) that may be deducted for capital expenditure in respect of each of the Freegold and Joel mines, it does not necessarily entitle SARS to deduct the full amount of each such cap'.

The court also indicated that 'the individual capex caps of the Freegold and Joel mines was to be reduced so that their total does not exceed the general cap imposed by section 36(7E). In this way the two sub-sections will work in tandem, setting a maximum total deduction and reducing the Freegold and Joel mines maximum caps proportionally.'

conclusion

Although the court reached the same conclusion determined by SARS, the underlying principle giving rise to the result was different.