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Tax and Legal News

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On Monday 23 March 2020, the President of South Africa announced unprecedented measures in assisting South Africa in its fight against COVID-19. Most notably, a nationwide lockdown effective for 21 days from midnight on Thursday 26th March 2020. The lockdown will be lifted at midnight on Thursday 16th April 2020.

COVID-19 – Mining companies to bear the cost of business disruption

Whilst, the global spread of the virus was already adversely impacting some sectors of the South African economy, the arrival of the Covid-19 virus to our shores and the steps necessary to curtail its spread have heralded a new era of disruption to the economy. As part of the lockdown, mining companies will heed the directive by President Cyril Ramaphosa to shut down their underground operations as part of lockdown.

In his address, the President instructed that "companies whose operations require continuous processes such as furnaces or underground mine operations will be required to make arrangements for care and maintenance to avoid damage to their continuous operations."

The resultant halt in operations is expected to severely impact the mining sector which has already been suffering as a result of commodity price volatility and other operational challenges.

This could result in additional costs to mines. We look at the tax treatment of costs incurred during 'care and maintenance' below.

Costs incurred during care and maintenance

Generally ongoing costs, including maintenance, incurred by operating mines would be deductible in terms of the general deduction formula provided these costs meet the requirements of *inter alia* actually incurred, in the production of income and for purposes of trade, whilst not of a capital nature.

However section 36(11)(b) of the Income Tax Act specifically provides that any expenditure incurred during any period of non-production, on development, general

administration and management (including interest incurred on loans utilised for mining purposes), would constitute capital expenditure for tax purposes. Accordingly the section 36(11)(b) costs will be capitalised to mining capital expenditure and can only be claimed against mining income.

In in the context of the lockdown the section 36(11)(b) costs, will in all likelihood be incurred during a time of non-production for mining companies. Accordingly any section 36(11)(b) costs incurred would not be deductible in terms of the general deduction formula and should instead be regarded as mining capital expenditure.

This would be pertinent to mining companies as follows:

- The section 36(11)(b) costs are not deductible immediately and may be deferred should the mine not generated sufficient taxable mining income to utilise capital expenditure.

- The capitalisation of the section 36(11)(b) costs may increase the tax liability to the extent that the mine has non-mining income ie the section 36(11)(b) costs cannot be claimed against income other than mining income.

- Mines in an assessed loss position or mines with non-mining income claiming the costs in terms of the incorrect section (section 11(a) as opposed to capitalising such expenditure) could overstate the company's assessed loss or understate its taxable income. In this instance, SARS could levy understatement penalties.

Mining companies should consider the following:

- Understand the cost base and analyse all costs to determine which costs will fall within the ambit of section 36(11)(b).

- Perform an apportionment exercise to ensure that costs incurred during the period of non-production are treated correctly for tax purposes.

- Critically determine the period of non-production (when does non-production start and when does non-production end).

Indeed the lockdown may have unintended tax consequences and additional costs for mining companies. We would appreciate the opportunity to work with you to understand and quantify the impact of the lockdown on your company.

If you have any queries, require assistance or need more information, please contact us:

Contact us

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