Davis commission calls for mining sector's upfront capex tax to be scrapped

By Linda Ensor

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The Davis Tax Committee has recommended that the special tax regime for the mining sector be abolished so that its income tax regime is aligned more closely with that of other economic sectors.

Judge Dennis Davis

Implementing the recommendation would entail far-reaching changes to the way the mining industry has traditionally been taxed.

The committee argued in its final report on hard rock mining taxes - released on Monday - that the royalty system could be relied on to deal with the non-renewable nature of mineral resources.

A previous interim report was published in 2015 for public comment.

The committee said it had not been persuaded that the current mining tax system did much to encourage investment as originally intended.

It has recommended that the upfront capital expenditure (capex) write-off regime should be discontinued and replaced with an accelerated capex depreciation regime, which is in parity with the write-off periods provided for in respect of the manufacturing (40-20-20-20) basis. This capex should be written off from the date at which it is incurred.

"The removal of the upfront capex tax allowance regime (and hence the promotion of intersectoral neutrality) paves the way for the removal of ring-fences aimed at preventing the set-off of future capex expenditure against the tax base of other mines and against non-mining income. The removal of these ring-fences should adequately compensate taxpayers for the removal of the upfront capex allowance and the lost tax benefits associated with falling within the tax tunnel applicable to the gold mining tax formula.

"Removal of ring-fences is likely to promote added investment, as losses related to failed mining ventures will not be sterilised for purposes of [setting] off against other mining income or ventures. A further consequence of the removal of ring-fences may be to encourage the mining of marginal ores. This could occur in circumstances where a low-profit mining venture is effectively cross-subsidised through absorbing tax losses from previously (but no longer) ring-fenced sources."

The report referred to a study by the South African Revenue Service (Sars) that was conducted to assess the cost of removing existing ring-fences. It estimated that a cumulative amount of R140bn in unredeemed capex (old capex) was currently being carried forward by taxpayers.

"Allowing this amount to be converted to an assessed loss for offset without ring-fences in the future would constitute a prohibitive and unjustified cost for the fiscus to absorb. For this reason, it is recommended that the removal of ring-fences should be done prospectively so as to confine offsets of capex (without application of ring-fences) to capex incurred or accumulated in a future standardised tax regime (new capex)."

The committee recommended that going forward past unredeemed capex expenditure should remain ring-fenced as per existing ring-fencing rules. However, new capex would be allowed on a 40-20-20-20 basis but would not be subject to any of the current ring-fence rules. This would mean that new capex expenditure, which is not set-off against income in a current year of assessment, will be carried forward in future as part of a regular assessed loss.

In order not to precipitate a further decline in employment, particularly in marginal mines, the committee has recommended that the gold mining formula (and ring fences) be retained for existing gold mines unless the relevant mine elected to move to the proposed regime. It would not apply to new mines.

The committee has also recommended that the additional capital allowances available to gold mines be discontinued for all gold mining taxpayers.

In doing this, restrictions on the deduction of interest expenditure (where applicable) should be lifted.

Recommendations have also been made to improve the mineral royalty regime, for example, by increasing the small business exemption.

Source: *BDpro*