Mining rehabilitation funds – what if they are no longer needed? Thoughts on Section 37A of the Income Tax Act

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Mining companies are obliged to perform environmental rehabilitation of mining sites upon the termination or premature closure, decommissioning and final closure, of mining activities.

Section 37A of the Income Tax Act, 62 of 1968 ("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 37A of the ITA grants a tax deduction for payments made to a dedicated mining rehabilitation funds ("the rehabilitation fund") and requires the funds to be strictly utilised in accordance with their objects. These rehabilitation funds are typically created as companies or trusts.

What happens though, when the rehabilitation fund is no longer needed, or has fulfilled its purpose and has surplus assets? What are the tax implications of amending or terminating such a rehabilitation fund?

Section 37A of the ITA was introduced in 2006. The primary object of the "new" section 37A was to grant a deduction from income tax to mining companies that pay cash into a rehabilitation fund which complies with section 37A.

Section 37A imposes strict rules in respect of rehabilitation funds, for example:

- the rehabilitation fund may only apply its assets for prescribed rehabilitation purposes (section 37A (1)(a));

- once the rehabilitation has been completed to the satisfaction of the Minister of Minerals and Energy ("the Minister"), 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 the Commissioner for the South African Revenue Service ("the Commissioner") (section 37A (3)); and

- should the rehabilitation fund meet all its liabilities and have sufficient assets to perform the required rehabilitation, the rehabilitation fund may transfer any surplus assets to another company or trust approved by the Commissioner (section 37A (4)).

Section 37A does not appear to cater for a situation where the rehabilitation fund has completed rehabilitation and has surplus assets, and the mining company does not have similar funds to which the assets can be transferred, or for the situation where the mining company wants to transfer the assets of the rehabilitation fund to a similar fund, for value.

Section 37A (6), (7) and (8) impose income tax for contraventions of, or non-compliance with, section 37A. In some cases, the South African Revenue Service ("SARS") possesses a discretion to reduce the income tax so imposed.

If the rehabilitation fund distributes its property for purposes other than the prescribed rehabilitation, in terms of Section 37A (7), the rehabilitation fund will have an inclusion in its taxable income for that year of assessment, of an amount equal to the market value of the property that was so *distributed.* The inclusion of the market value of the property so distributed, in the taxable income of the rehabilitation fund, is obligatory and SARS has no discretion.

Section 37A(8) is a catch all provision that applies to any contravention of section 37A. Where section 37A has been contravened, the Commissioner *may* –

- include an amount equal to twice the market value of all property held in the rehabilitation fund, on the date of contravention, in the *rehabilitation fund's* taxable income, and

- include the amount that the mining company contributed to the rehabilitation fund (and claimed a tax deduction for), in *the mining company's* income, to the extent that the property in the rehabilitation fund was directly or indirectly derived from cash paid to the rehabilitation fund.

Both the rehabilitation fund and the mining company pay tax where section 37A(8) is triggered.

The inclusion of twice the market value of all property held in the rehabilitation fund on the date of contravention, in taxable income, is discretionary, and the Commissioner has a discretion to reduce the amount of taxable income as he deems fit. Also, the inclusion in terms of section 37A(7) is of an amount equal to the market value of the property that was *distributed,* whereas the inclusion in terms of section 37A (8) is of twice the market value of the assets *held in the trust* on date of contravention. An inclusion in terms of section 37A (7) is not discretionary, whereas the imposition of tax in terms of section 37A (8), is.

Termination or amendment of the Fund

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.

The directors or trustees of a rehabilitation fund shall be bound to act in accordance with the constitutional documents in order to legally effect an amendment or termination. If the rehabilitation fund is a trust, for example, the trustees will have to take care to act in terms of the trust deed. This principle was entrenched in the authoritative South African case on the law of trusts, *Land and Agricultural Development Bank of SA v Parker and others* [2004] 4 All SA 261 (SCA), which provides commentary on the invalidity of trustees' actions which are not in line with the provisions of the trust instrument:

> *"It [the trust] vests in the trustees, and must be administered by them – and it is only through the trustees, specified as in the trust instrument, that the trust can act. Who the trustees are, their number, how they are appointed, and under what circumstances they have power to bind the trust estate are matters defined in the trust deed, which is the trust's constitutive charter. Outside its provisions the trust estate cannot be bound."*

However, an amendment of the constitutional documents which places the object and transfer of assets outside of the ambit of section 37A of the ITA will result in a contravention of section 37A (3) and (4) (which specify to whom assets can be transferred to upon termination or closure) and the trustees or directors will have to take the tax and/or penalties imposed by section 37A, into account.

Since the constitutional documents of the rehabilitation fund will initially be drafted to comply with section 37A, it can be assumed that any amendment or termination of the rehabilitation fund will need to be made with the approval of the Commissioner. Questions arise about whether the Commissioner will consent to an amendment of the constitutional documents of rehabilitation funds. The Commissioner should not be legally precluded from approving such an amendment to the constitutional documents, but this will depend on the facts of every case. The Commissioner cannot be be requested to approve a breach of section 37A, but

should be requested to approve the amendments of the constitutional documents which have the effect that, after the amendments, the rehabilitation fund becomes an fund which no longer qualifies for tax benefits in terms of section 37A.

It is likely that amendments to section 37A rehabilitation funds, could be dealt with in the following manner:

- submissions will have to be made and reasons given to convince SARS why the "penalty" catered for in section 37A (8) should not be imposed. SARS is obliged to apply its mind and consider any submissions made, fairly. It is highly unlikely that SARS will waive the full amount as SARS may be of the view that the company has enjoyed the benefit of a tax deduction in terms of section 37A.

- furthermore, it is likely that SARS may request that the assets in the rehabilitation fund be transferred to a similar account specified by the Minister (as contemplated in section 37A(3)(b) of the ITA). It is not clear, and it seems unlikely, that SARS can insist on such a transfer.

- any submissions made, should deal with the equity of the resultant position and show that the tax benefit enjoyed as a result of the tax deduction, will be offset by the inclusion in taxable income that will occur in terms of section 37A (7).

A transfer to a party other than a section 37A rehabilitation fund could be accomplished by amending the constitutional documents to allow for such a transfer. However, the risks of contravening the provisions of section 37A are such that it would be prudent to approach the Commissioner for prior approval to amend the constitutional documents of the rehabilitation fund and to request a decision on how SARS will exercise its discretion in terms of section 37A(8).

An amendment of the constitutional documents will most likely trigger the penalties imposed by section 37A (7) and/or (8). The ITA does not expressly prohibit the Commissioner to consent to such amendments. The position appears to be that it is possible for a mining company to terminate or amend the terms upon which the Rehabilitation Fund is founded, but there will probably be a tax cost. The extent of the tax cost depends on how SARS exercises its discretion.