REPORTABLE

CASE NO. SA 4/2006

IN THE SUPREME COURT OF NAMIBIA

In the matter between:

THE MINISTER OF FINANCE **APPELLANT**

And

DE BEERS MARINE (PTY) LTD **RESPONDENT**

CORAM: Maritz, J.A., Strydom, A.J.A. et Chomba, A.J.A.

HEARD ON: 9/10/2006

DELIVERED ON: 8/12/2006

APPEAL JUDGMENT

STRYDOM. A.J.A.: [1] This is an appeal from the Special Tax Court of Appeal. The

respondent (i.e. the appellant in the Court *a quo*), objected to a tax assessment by the Receiver of Revenue in terms whereof it was assessed at a rate of 55% of the money recouped in respect of the sale of five of its vessels after they had ceased rendering services in connection with the mining for diamonds to Namdeb Diamond Mining Corporation (Pty) Ltd ("Namdeb"). The respondent maintained that the taxable income, derived from the sale of the vessels, was subject to tax at a rate of 35%.

[2] The respondent's objection was disallowed by the Commissioner for Inland Revenue. The respondent then launched an appeal to the Special Tax Court where it was successful and where that Court ordered that the assessment of that income be reduced in accordance with the rate of normal tax of 35%.

[3] The appellant (i.e. the respondent, in the Court *a quo*) was not satisfied with the outcome of the matter in the Special Tax Court and thereupon appealed to this Court. According to sec. 76(9) of the Income Tax Act, Act 24 of 1981 (as amended), an appeal lies directly to this Court.

[4] The grounds of appeal centre on the findings by the Court *a quo* that the recoupments made by the respondent when it sold its vessels did not constitute income derived from mining of diamonds and/or from services rendered by the Respondent in connection with mining for diamonds on behalf of any person licensed to conduct such mining operations. The appellant was represented in this appeal by

Mr. G. Narib and the respondent by Mr. T.S. Emslie, SC. The Court is indebted to Counsel for their full and helpful arguments.

[5] The facts relevant to the appeal were set out in a Statement of Agreed Facts and were part of the record before the Special Tax Court of Appeal. These are as follows:

"STATEMENT OF AGREED FACTS

1. In tax year ending 31 December 2000, Appellant ("DBM") declared a taxable income of N$636,877,240, 00.

2. Appellant as at 31st of December 2000 sold 5 of its diamond mining vessels, 4 to a newly formed company De Beers Marine Namibia (Pty) Ltd.

3. The 5 vessels, and the values at which they were sold, were:

Louis G Murray	N$211,157.00
Grand Banks	N$7,920,533.00
Debmar Atlantic	N$6,851,743.00
Debmar Pacific	N$75,479,188.00
!Garieb	N$195,277,453.00

4. Capital allowances were claimed in respect of vessels in previous years.

5. Appellant conducted business as a marine, prospecting and mining contractor to Namdeb Diamond Mining Corporation (a company in which De Beers and the GRN are shareholders). As such it was engaged in rendering services in connection with the mining for diamonds on behalf of Namdeb. The vessels in issue were utilised for this purpose.

6. The following facts are relevant in regard to the sale of the vessels by

the appellant to De Beers Marine Namibia (Pty) Ltd:

- The 5 vessels were sold for a total amount of N$285,740,074.00.
- The taxable recoupment is N$250,639,697.00.
- The 5 vessels were sold with effect from 1st day of the new 2001 financial year.
- De Beers Marine Namibia (Pty) Ltd received a loan from appellant to purchase the 4 vessels from appellant.
- De Beers Marine Namibia (Pty) Ltd stepped into the shoes of appellant and replaced appellant as the marine prospecting and mining contractor to Namdeb as its exclusive contractor until 2020.
- Appellant carries out prospecting services and production services for De Beers Marine Namibia (Pty) Ltd. from 1 January 2001.
- Appellant and De Beers Marine Namibia (Pty) Ltd are part of the same group of companies.

7. The allowances in question were claimed by the appellant in terms of section 17(1)(e) of the Act.

8. The respondent has now informed the appellant that he granted the allowances claimed in terms of section 18(1)(a) of the Act, but never communicated this fact to the appellant, which was under the impression that the allowances had been granted in terms section 17(1)(e).

9. It is agreed that the business of the appellant was at all material times the rendering of services, whether to Namdeb in connection with mining and prospecting for diamonds or to other companies in connection with mining and prospecting elsewhere. The appellant did not conduct mining and prospecting operations on its own behalf, and did not itself have a licence to mine.

10. In respect of the aforesaid mining activities appellant was taxed at a rate of 55% on income."

[6] Although the matter is not free from complexity, the ambit within which the

Court must decide the issue is a fairly narrow one, namely whether the money recouped by the sale of the 5 vessels could be brought under mining of diamonds or services rendered in connection with the mining for diamonds, as contended for by Counsel for the appellant, or whether such money was not directly linked to either of the two activities, as was submitted by Counsel for the Respondent. In the first instance the rate of taxation would be 55% whereas in the latter instance the rate would be 35%. The relevant rates of taxation are set out in para. 3(1) of Schedule 4 to the Act which are as follows:

> "3(1) Subject to subparagraph (2), the rates of normal tax to be levied in respect of the taxable income derived by a company shall be as follows:
>
> (a) On each N$ of taxable income derived from a source other than mining, 35 cents;
>
> (b) On each N$ of taxable income derived from mining of a mineral or substance other than diamonds, 37,5 cents;
>
> (c) On each N$ of the taxable income derived from the mining of diamonds, or from services rendered by such company in connection with the mining for diamonds on behalf of any person licensed to conduct such mining operations, 50 cents: Provided that there shall be added to the amount of tax determined in accordance with this paragraph a surcharge equal to 10% of that amount."
>
> (Subparagraph 2 has no relevance to the issue.)

[7] It is significant that para. 3(1)(c) previously only related to income derived from the mining of diamonds. (See sec. 21 of Act 25 of 1992), By sec. 13(c) of Act 22 of 1995 the words "or from services rendered by such company in connection with the mining for diamonds on behalf of any person licensed to conduct such mining

operations," were inserted in the section. As a result of this amendment services rendered to a company licensed to mine diamonds were also taxed at 55%.

[8] In regard to the above amendment Mr. Narib submitted that it was only brought about to clarify that services rendered in connection with the mining for diamonds were taxable in terms of sec. 3(1)(c), because such services fall squarely within the definition of mining, set out in sec. 1 of the Act. If I understood Counsel correctly such amendment was not really necessary as the activity was already covered by the definition of mining. This point was further illustrated by Counsel by reference to secs 18(1)(a) and 36 of the Act. More particularly it was submitted that the activities undertaken by the respondent such as exploration and prospecting necessitated the respondent to acquire vessels capable of doing this work in order to claim the deductions in terms of sec 18(1)(a).

[9] With reference to secs. 5 and 6 of the Act read with sec 1(h) Mr. Narib submitted that the recoupment made on the sale of the vessels was income and once the deductions allowed for by the Act, in terms of sec. 18(1)(a) read with sec 36, were made, what remained would be taxable income. The source of this income was mining of diamonds or from services so rendered. That is the scheme of the Act and there is no need to differentiate because the scheme determined what is taxable, and in this case, applying schedule 4 of the Act, the tax payable is 55%.

[10] Mr. Emslie's answer to the submissions of the appellant was that the

recoupment of the vessels did not amount to income derived from mining of diamonds or rendering services in connection therewith. Counsel submitted that whether the respondent might have been either mining or rendering services was not decisive of the answer to the question whether the recoupment constituted taxable income derived from either of those sources. Counsel therefore submitted that the recoupment by the sale of the vessels could not be brought under “mining” or “mining operations” nor could it be brought under ‘services rendered in connection with the mining for diamonds”.

[11] The argument by Counsel for the appellant necessitates a consideration of some of the definitions of the Act as well as some of its provisions.

[12] According to sec. 1 of the Act **“mining operations”** and **“mining”** include every method or process by which any mineral (excluding petroleum) is won from the soil or from any substance or constituent. Other definitions relevant were the following:

> (i) **“ 'gross income'**, in relation to any year or period of assessment, means, in the case of any person, the total amount, in cash or otherwise, received by or accrued to or in favour of such person during such year or period of assessment from a source within or deemed to be within Namibia, excluding receipts or accruals of a capital nature, but including without in any way limiting the scope of this definition, such amounts whether of a capital nature or not so received or accrued as are described hereunder, namely – …"

This provision then, by sub. para. (h), includes into the definition of **“gross income”** recoupments of a capital nature to which the provisions of sec 18(1)(a) applied. In regard to deductions made in terms of sec. 17 of the Act, sec 14(4) included "in the taxpayer’s income all amounts allowed to be deducted or set off under the provisions of sub.sec. (1) of this section and of sections 17 to 21, inclusive…”

(ii) **“ 'income'** means the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part 1 of Chapter II;” and

(iii) “ **'taxable income'** means the amount remaining after deducting from the income of a person all the amounts allowed under Part 1 of Chapter II to be deducted from or set off against such income.”

[13] Various other sections of the Act were also referred to by Counsel to support his submission. These provisions are no doubt important and they provide for a number of issues. Section 5 provides for the payment of tax by persons and by companies and sec. 6 states that the tax payable in terms of sec. 5(1) shall be as set out in Schedule 4. Sec. 15 is a deeming provision which sets out certain instances whereby it shall be deemed that money received was so received or has accrued from a source within Namibia.

[14] Section 16 deals with exemptions and the section determines what revenue shall not be subject to taxation. Section 17 contains allowable deductions. Respondent maintains that the deductions made by it were in terms of sec. 17(e)

which provides for deductions in regard to expenditure incurred for "sea-going craft, machinery and implements" used by the tax-payer to do its trade. Section 18(1) allows for deductions from the income derived from mining operations and is the section under which the appellant said it allowed deductions by the respondent.

[15] Strong reliance was placed by Mr. Narib on sec. 36. Section 36 provides that the capital expenditure to be deducted under sec. 18(1)(a) may consist of either exploration expenditure or development expenditure or both. Sub-section (2) and (3) provides how such expenditure should be deducted. Sub-sections (4), (5) and (6) determine what is included in the various types of expenditure. Mr. Narib said that what was done by the respondent falls squarely within what is described as exploration and development operations.

[16] It seems to me that the fallacy in Mr. Narib's argument lies in his acceptance that the various sections of the Act, referred to by him, create a scheme which determines what the taxable rate must be. These sections do no more than define income, to state what allowable deductions there are and determine how taxable income should be calculated. None of the sections, referred to, deal with or determine what the rate of tax must be. In terms of the Act the rate of tax payable by companies is determined with reference to the income derived from a particular source and this is set out in para. 3(1) of Schedule 4 of the Act. Once the taxable income is determined the rate of tax payable is established by application of para. 3(1) and can be either from a source other than mining (a), or from a source derived

from mining, other than the mining of diamonds (b), or it can be derived from the mining of diamonds or services rendered in connection therewith (c). Para. 4 also makes it clear that the rate of tax payable may differ depending on whether the taxable income is derived from different sources as set out in para. 3(1). It follows therefore that in terms of the same assessment different rates of tax may be payable.

[17] There can be no quarrel with the submission by Mr. Narib that what is taxable in a specific instance is the taxable income as defined above after the deductions provided for in Part I of Chapter II have been made. However, as I understood Counsel he argued that once the deductions were made in terms of Chapter II what remained constitute, in terms of the scheme of the Act, the taxable income. That is correct. I, however, do not agree with Counsel that there is then only one rate of tax applicable, namely that determined by para. 3(1)(c). The sections of the Act relied upon by Mr. Narib do not support his submission. The rate of tax payable by a company is determined by Schedule 4 of the Act and not the other provisions. That is also made clear by sec. 6 of the Act.

[18] I therefore do not agree with Mr. Narib that the scheme of the Act inevitably leads to a finding that the activities of the respondent were covered by the definition of “mining” or “mining operations” which would be taxable in terms of para 3(1)(c) of Schedule 4. Mr. Narib referred to the cases of *Grootvlei Proprietary Mines Ltd v C.I.R.,* 1952 (4) SA 440 (AD) *and Commissioner for Inland Revenue v Wolf,* 1928 AD 177. In the *Grootvlei*-case the Court had to decide whether the whole amount

received for the sale of a winder, which was 4 times more than what was paid for it, must be regarded as the recoupment for purposes of the Act. The Court concluded that the whole amount was a recoupment. The question in the *Wolf*- case was whether recoupments made by a mine when it ceased operations were part of “gross income” and therefore taxable in terms of that Act. The Court found that such recoupments were “gross income”.

[19] In the present case the question is different, namely whether vessels sold by a company which rendered services in connection with the mining for diamonds constituted a recoupment which would render the respondent liable to pay tax in terms of para. 3(1)(c) of Schedule 4, therefore as mining of diamonds or services rendered in connection therewith, or para. 3(1)(a), as being income derived from a source other than mining. The two cases referred to by Mr. Narib do not assist in finding an answer to the question. They, in effect, constitute authority for propositions which are common cause in this case.

[20] It is common cause, as pointed out before, that the recoupment of the sale of the 5 vessels constitute, according to the provisions of the Act, income in the hands of the respondent which is taxable.

[21] Because of the submission of Mr. Narib that the rendering of services by the respondent is covered by the definition of **“mining”** and **“mining operations”** it is necessary to determine what the respondent’s source of income was and to establish

under which of the categories, set out in para. 3(1) to the Schedule, tax must be payable for the recoupment of the vessels.

[22] In the Income Tax Act of the Republic of South Africa, Act 58 of 1962, the definition of **“mining”** and **“mining operations”**, as far as minerals are concerned, is identical to our Act 24 of 1981. Various cases in that jurisdiction considered the meaning of the definition and concluded that the definition does not only mean the physical extraction of minerals from the soil.

[23] In Income Tax Case No 1572, Zulman, J, who was the President of the Special Income Tax Court, remarked as follows at p. 184:

> “I am in agreement with Mr. Du Plooy’s proposition to the effect that the mere physical act of extracting minerals considered apart from the other steps necessary to bring income into existence, is, to use his phrase ‘a barren act that is not in itself capable of being an income source’. That physical act cannot, so it was argued, be what is contemplated by the legislature when it uses the words ‘mining’ or ‘mining operations’. I accordingly agree with the submission that when the Act refers to ‘income derived from mining/mining operations’, this is a reference to income derived from a business of mining and not merely a physical act.”

[24] A similar conclusion was reached by Friedman, JP, in the case of *Commissioner for Inland Revenue v BP Southern Africa (Pty) Ltd,* 1997 (1) SA 375 at B –D.

[25] In the decision of the Supreme Court of Appeal of South Africa, namely *Western Platinum Ltd. v The Commissioner for South African Revenue Service,* unreported judgment of the Supreme Court of Appeal of South Africa dated 27 December 2004, Case No. 294/03, Conradie, JA, who delivered the unanimous decision of the Court, said the following on p. 4 of the unreported judgment:

> "Mining operations by themselves cannot produce income. However, the definition of 'mining' and 'mining operations', being context-dependent, is capable of accommodating commercial transactions. Since there can be no derivation of income without commercial activity we are entitled to read that into the definition. In the case of minerals or metals from a mine such an income-producing transaction would commonly be a sale. One would therefore, at least, have to interpose a sale (and the associated delivery and payment) between the extraction of the minerals and the income, thus postulating a business."

[26] The Court, p 5, cited with approval the finding by Friedman, JP, in the *BP Southern Africa*-case, *supra*, as to the meaning of the words "income derived from mining operations".

[27] According to the Agreement of Facts it is common cause that the business conducted by the respondent was at all material times the rendering of services, whether to Namdeb in connection with mining and prospecting for diamonds or to other companies in connection with mining and prospecting elsewhere. The appellant did not conduct mining and prospecting operations on its own behalf, and did not itself have a license to mine.

[28] As such the source of the respondent's income was not derived from the business of mining or mining operations but from services rendered in connection therewith. From the agreed facts, and this was also conceded by Mr. Narib, the respondent was not involved in the sale of diamonds extracted from the soil. As it was put by Mr. Narib, on a question by the Court, "that would not be their business, (i.e. the sale of diamonds) their business would be to render the particular service of extracting and giving it to the owner to deal with it in the manner it sees fit". I agree with Counsel that that is the distinction to be drawn and, bearing in mind the meaning ascribed to the words **"mining"** and **"mining operations",** set out above, it follows in my opinion that it cannot be said that the activity of rendering services in connection with mining is covered by those definitions. That, so it seems to me, is so even if the respondent was involved in the physical act of extracting diamonds from the soil. Its source of income remained the rendering of services. In my opinion when para. 3(1)(c) refers to "taxable income derived from the mining of diamonds" it means "income derived from the business of extracting minerals from the soil". (The *BP Southern Africa*-case, *supra*, p 379 C-D.)

[29] What also militates against the submission that mining and services rendered in connection therewith is one and the same thing is in my opinion the fact that the Legislature thought it necessary to amend sec 3(1)(c) to include the latter activity. This, so it seems to me, was necessary because services rendered in connection with mining is something different from mining or mining operations. As set out before the

source of income from mining is the business of dealing with any mineral won from the soil. The source of income in the second instance was the services rendered in connection with mining, in this case, of diamonds. The interpretation submitted by Counsel for the appellant would render the entire amendment redundant, something which is not easily accepted in the interpretation of statutes. (See in this regard *Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd*., 1993(4) SA 110 (A) at 116F - 177A.)

[30] The question remains whether the recoupment by the sale of the vessels is connected to the rendering of services in connection with the mining for diamonds and the tax payable therefore in terms of paragraph 3(1)(c) of Schedule 4 of the Act. In this regard it was stated that such connection must be direct. An indirect connection or a remote one will not suffice. (See *Commissioner for Inland Revenue v D & N Promotions (Pty) Ltd,* 1995 (2) SA 296 at 306C-D and the *Western Platinum*-case, *supra,* at p 5).

[31] In order to determine whether there is such a connection the Court must, on the one hand, not apply too narrow a construction on the business of rendering services in connection with diamond mining. On the other hand it must also guard against a construction which is too generous. (See the *Western Platinum*-case, *supra,* p8).

[32] A direct connection was found to exist in cases where loss of money was of a

'revenue nature'. (*Western Platinum*-case). Thus, insurance paid to compensate loss of revenue when mining equipment became defective was found to be income derived from mining of gold. (See *Income Tax Case 1572).* Money earned by delivery of sugar cane but which was retained for a period and interest on that amount was found to be derived from farming operations. (See *D & N Promotions*-case). Interest earned from foreign banks for receipts held by them as part of the security for loans to enable the mine to operate was found to be directly linked to mining operations. (*Western Platinum*-case). See also *Burmah Steam Ship Company Ltd v Commissioner for Inland Revenue,* 16 TC 68 where an amount of money was paid to owners of a ship for loss caused by delay.

[33] In the insurance cases the insurance money paid and money paid for loss of income were regarded as "filling the hole" left by the loss of income. See the *Burmah Steam Ship Company*-case, *supra,* p. 73. For this reason money received was regarded as income and was taxed as such.

[34] In the following instances the connection between money received and taxable income derived from mining operations or farming was found to be not sufficiently direct. The recoupment by a sale of its interest in a coal mine was found not to be income derived from mining (*BP Southern Africa*-case). Because of the rationalization of the sugar industry farmers lost certain rights. To compensate them for the loss of these rights, and other burdens imposed upon them, they were paid a monetary compensation by the Sugar Association. It was found that the receipts

were of a capital nature which fell outside the ambit of the farmer's income-earning operations from sugar farming. (*The D & N Promotions*-case). Interest earned as a result of an investment decision by a mine altered the character of such interest from mining to investment income and took the interest out of the mining income stream. (*Western Platinum*-case).

[35] In the present instance the respondent sold its vessels to De Beers Marine Namibia (Pty) Ltd which company then stepped into the shoes of the respondent and replaced it as the marine prospecting and mining contractor to Namdeb. The sale of the vessels can in my opinion not be said to have derived from services rendered in connection with the mining for diamonds simply because it was paid as a result of the sale of the vessels and not earned through services rendered. The question is whether the money so recouped could, in terms of the Act, be deemed to be derived in connection with services so rendered. In my opinion not. The money received for the sale of the vessels was in the nature of a capital accrual, although deemed as income in terms of sec. 1(h) as 14(4) of the Act, and the vessels were not sold and the money recouped in order to fill a hole in income. It was further the business of the respondent to render services in connection with the mining for diamonds. It was not its business to sell vessels.

[36] There was therefore no direct connection between the sale of the vessels and the business of the respondent and the Special Income Tax Court was correct when it found that the recoupment was to be taxed in terms of the provisions of paragraph

3(1)(a) of Schedule 4 of the Act and not in terms of paragraph 3(1)(c) thereof.

[37] Although Counsel for the appellant relied on the provisions of sec. 18(1)(a) to support his submission that if the scheme of the Act is taken into consideration it would follow that the recoupment of the vessels should be taxed under paragraph 3(1)(c), both Counsel agreed that whether the reductions were made under sec 17(1)(e) or sec 18(1)(a) would not influence the outcome of this matter. I agree. It is therefore also not necessary to decide this issue.

[38] In the end, and even if one accepts for the sake of argument, that the income derived from services rendered in connection with the mining for diamonds is covered by the definition of “mining” and ‘mining operations” the result would not have been different.

[39] In the result the appeal is dismissed with costs.

(Signed) G.J.C. Strydom

STRYDOM, A.J.A.

I agree.

(Signed) J.D.G. Maritz

MARITZ, J.A.

I agree.

(Signed) F.M. Chomba

CHOMBA, A.J.A.

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