

CAA

CHARTERED
ACCOUNTANTS
ACADEMY



Taxation of Income Accruing from mining operations

Learning outcomes

- Special provisions applying to miners, namely the methods of claiming capital allowances

Mining

- Miners assessed in the same manner as any other taxpayer;
- Main difference is the method of claiming capital allowances;
- The capital redemption allowance(CRA) replaces SIA, W&T, scrapping allowance.
- 6 year prescription on loss carryovers not applicable to miners. Why?

Mining

Relevant Sections

Definitions - section 2

Mining recoupments - section 8(1)(j)

Allowable deductions :-

- prospecting expenses - section 15(2)(f)(ii)
- capital redemption - section 15(2)(f)(i) and 5th schedule
- Section 15(2(a))

Mining

In terms of Section 2 “mineral” includes any valuable crystalline or earthy substance forming part of or found within the earth’s surface and produced or deposited there by natural agencies but does not include petroleum or any clay (other than fire-clay), gravel, sand, stone (other than limestone) or other like substance ordinarily won by the method of surface working known as quarrying;

Mining operation

➤ Includes:

- i. Any operation for the purpose of winning a mineral from the earth.
- ii. subsequent smelting and refining , by the same taxpayer of minerals won from the earth
- iii. any other operation recognised by the Commissioner , such as the re-working of mine – dumps.

Mining- Prospecting expenses

PROSPECTING (S15(2)(f)(ii))

- Refers to expenditure incurred by a person on operations either in searching for a potential claim or in searching for minerals after a claim has been pegged.
- A binding election is available to claim such expenditure from current income from any source or carry forward the expenditure to be allowed against income from mining operations in any subsequent year.
- Expenditure may include;
 - Survey costs
 - Sinking of boreholes
 - Digging of trenches and pits
 - Any other prospecting and other exploratory works undertaken for the purposes of acquiring rights to mine minerals

Capital Redemption Allowance (CRA) – Sect 15 (2) (f) (i) a.r.w 5th schedule

Definition of Capex: 5th Sched–

Capital expenditure for mining purposes is defined as :-

- (i) Expenditure on buildings, works or equipment, lease premiums,
- (ii) shaft sinking (including sumps, pump chambers, stations and ore bins accessory to a shaft) ;
- (iii) expenditure incurred prior to commencement of trade on preliminary surveys, boreholes, development, general administration and management, interest on loans ;
- (iv) and, expenditure incurred on or after the 1st April, 1988, on any permanent building used for the purposes of—mine schools, nursing homes and clinics.

NB:

Capital expenditure does not include cost of claims and goodwill or company flotation expenses

CRA (cont.)

➤ Current Capital Expenditure(CCE)

Capital expenditure incurred in a current year

➤ Unredeemed balance of Current Capital Expenditure(UBCE)

The balance of capital expenditure not extinguished by the CCE ; preproduction expenditure forms the UBCE when production commences.

➤ Recoupment

Amount accruing from sale , damage , destruction or other disposal of asset on which capital redemption allowance or an allowance on replacement of asset has been claimed;

it does not include in the case of damage / destruction of assets an amount exceeding original cost.

Methods of Calculating CRA

- The redemption allowance can be calculated using either of three methods commonly referred to as
 - Life of mine
 - Mixed method
 - New mine method
- The taxpayer has to make an election of the method preferred.

Life of mine – 5th sched para 2

- The current year's capital expenditure is added to the balance of unredeemed capital expenditure brought forward at the commencement of the current year of assessment. The total capital expenditure is then divided by the approved estimate life of the mine (in years), counting from the beginning of the current year of assessment.
- $$\text{CRA} = \frac{\text{CCE} + \text{UBCE} - \text{Recoupment}}{\text{Estimate of life (years)}}$$
- A taxpayer who adopts the life of the mine basis in respect of a particular mine is permitted to change subsequently to the 'mixed basis'.

Life of Mine - cont

“estimate of the life of the mine” means the number of years not exceeding –

- (a) In the case of a mine operated for the purpose of producing lead or zinc or lead and zinc, ten years;
- (b) In the case of a mine operated for the purpose of producing iron, five years;
- (c) In the case of any other mine, twenty years
- (d) Where a taxpayer adopts this basis , he submits to ZIMRA an estimate of the number of years for which operations are expected to continue based on the certified estimates of ore reserves.
- (e) The capital expenditure ranking for CRA (less recoupments) is divided by the life of mine calculated from the commencement of year of assessment concerned.

Life of Mine - example.

Life of mine

- A company had an unredeemed balance of capital expenditure of \$200,000 as at 1 Jan 2013.
- Current capital expenditure is \$120,000 ;
- During the year the company sold machinery for \$40,000.
- The mine estimates its life of mine to be four years from the end of the year of assessment.

CRA

URBCE	200,000
Recoupment	<u>(40,000)</u>
	160,000
CCE	<u>120,000</u>
	<u>280,000</u>

CRA $280,000 / 5 = 56.000$

New Mine Method

New Mine Method (paragraph 4(4))

- This method is only available to those carrying on operations in a new mine as defined. This method allows the taxpayer to deduct all capital expenditure brought forward and current in the first year of production. Thereafter, capital expenditure is allowed in the year in which it is incurred.
- A new mine is defined as an undertaking which commenced regular production on or after 1/04/1968, or recommencement of a mine which has changed ownership and has been reorganised with substantially new development and new plant.
- $CRA = CCE + UBCE - \text{Recoupment}$.

Mixed Method

Mixed Method (paragraph 4(2))

- Under this method this method the taxpayer can make an election to claim a portion of unredeemed capital expenditure brought forward at the beginning of the year, by applying the life of the mine method to it. In addition to that portion, the whole of the capital expenditure incurred in the current year is allowed in full.
- $$\text{CRA} = \text{CCE} + \frac{(\text{UBCE} - \text{Recoupment})}{\text{Life of mine (years)}}$$

Restrictions on certain assets

➤ Passenger Motor vehicle

USD 10,000

➤ Staff housing

- **US\$10 000** on a building used mainly as a dwelling by an individual shareholder where he is one of not more than four individuals who control the company, where the building was erected on or after the **1st January, 2009**;
- **US\$50 000** in respect of any building used mainly as a dwelling by staff employed at the school, hospital, nursing home or clinic—
- No restrictions on dwellings for mine employees
- **US\$50 000** on a building used mainly as a school, hospital, clinic or nursing home in connection with the taxpayer's mining operations

Recoupment (Sect 8(1) j)

- A miner's recoupment is generally the proceeds on disposal
- A recovery (insurance proceeds) in respect of damage or destruction of an asset restricted to deductions claimed.
- Restriction if the asset sold has been subject to a limit.
e.g. A motor vehicle acquired for \$20,000 is sold for \$15,000

$$\begin{aligned}\text{Recoupment} &= \frac{15\,000 \times 10,000}{20,000} \\ &= \$7,500\end{aligned}$$

Example

RESTRICTIONS ON CERTAIN ASSETS

➤ Example

During the year ended 31 Dec 2012, a mining company incurred the following capital expenditure :

School building	\$ 70,000
Teacher's house	60,000
Finance director's house	80,000
Staff canteen	120,000

Calculate CRA.

Example (cont.)

RESTRICTIONS ON CERTAIN ASSETS

➤ Solution

School building (restricted)	\$ 50,000
Teacher's house (restricted)	50,000
Finance dir's house (allow)	80,000
Staff canteen (allow)	<u>120,000</u>
CRA	<u>300,000</u>

Transfer of assets

- Where assets are transferred between companies under the same control, or between husband and wife or in a scheme of localization if the taxpayer so elect, that the amount of capital expenditure ranking for redemption in the hands of the transferor at the time transfer is made shall rank as capital expenditure for redemption in the hands of the transferee and be deemed to be a recoupment from capital expenditure in the hands of the transferor.

General Administration and Management fees

Section 16 (1) r

- To be prohibited as a deduction is general administration and management fees paid by a subsidiary or holding company or a local branch (where the parent is a foreign company engaging in local mining operations). In respect of such expenditure as is paid before commencement of production to the extent that it exceeds 0.75% of:

- $A - (B + C)$

Where,

- A – Represents the total expenditure qualifying for deduction in terms of s 15.
 - B – Represents general administration and management fees paid outside Zimbabwe.
 - C – Capital redemption allowance (section 15 (2) (f) (i))
- In the case of such expenditure as is paid after commencement of production to the extent that it exceeds 1% of the above formula.

2.6 Example

- The following expenses were incurred by A Ltd during the year ended 31 December 2012:

Administration fees paid outside Zimbabwe	\$120,000
Depreciation	60,000
Other tax deductible expenses	<u>420,000</u>
Total	<u>600,000</u>

Capital redemption allowances = \$50,000.

Allowable fees = 1% [A - (B+C)]
= 1% [600,000 – 60,000 + 50 000) - (120,000 + 50,000)]
= **\$4,200**

Disallowable s 16(1) r = 120,000 – 4,200
= **115,800**

Questions

