Press Statement on the Mineral and Petroleum Royalty Bill

20 March 2003

Consultation process with stakeholders

Cabinet approved the release for comment of the Mineral and Petroleum Royalty Bill. The Royalty Bill will be fully accessible on the National Treasury website (at:www.treasury.gov.za) as from Thursday, 20 March 2003. It is anticipated that approximately 4 weeks will be allowed for comments from stakeholders, which will be considered together with oral evidence submitted to the respective Parliamentary Committees during the hearings process on this matter. Hearings are scheduled to occur during May/June.

Rationale for Royalty Bill

The Royalty Bill gives effect to the Minerals and Petroleum Resources Development Act, No. 28 of 2002. The proposed royalty regime imposes a quarterly charge on holders of mineral rights for the extraction and transfer of South African mineral resources. This Bill recognises that the Nation is entitled to a consideration for the extraction of its non-renewable mineral resources. South Africa is not alone in charging a royalty for its mineral resources. Most countries with significant mineral resources impose such a charge. The royalty is levied in addition to income tax but scores as a deduction, as it constitutes a deductible expense in the production of income.

It is important to note that most non-marginal mines generate on extraction so-called resource rents[1], which are a function of the scarcity value of minerals. These rents can be taxed/shared between Government and the operators without impacting negatively on the economic viability of the project. The charging regime contained in the Royalty Bill strikes a balance between the need for adequate compensation and the imperative of

[1] Resource rent refers to the surplus return over and above input costs, including capital, labour and materials. Differently put, resource rents are excess profits over the minimum rate of return, which is required to justify an investment into a mining venture.

maintaining the international competitiveness of the mining sector. The royalty rates fall well within internationally competitive margins that can be sustained for the foreseeable future.

Ad valorem royalty base and regime

The royalty is an *ad valorem* charge in the form of a certain percentage of consideration withheld on the gross sales value of the mineral commodity extracted. No deduction for costs can be taken against gross sales income.

(i) The use of a gross *ad valorem* charge is consistent with international best practice. International experience with profit-based royalty regimes suggests that it could be avoided by artificially inflating costs, thereby reducing royalty collections to marginal levels.

(ii) As a general rule, the gross value of any mineral resource will equal its readily tradable 'fair' market price to the extent published by the Department of Minerals and Energy or international commodity price lists. This price represents the best approximation of a mineral resource's intrinsic value extracted from South African territory.

(iii) The Bill also provides a mechanism that in the event of the Department of Minerals and Energy not being able to publish a readily available market price, the stated value of a mineral resource for the royalty must at least be equal to the actual gross sales price of the mineral transferred. Hence, the Bill provides for upward value adjustments to address deliberate under-valuations or avoidance issues. For instance, Government has a right to increase the value above the gross sales price if that price does not fully reflect the arm's length value of the mineral resource transferred.

Royalty rate structure

The royalty rates range from one per cent to eight per cent depending on the mineral commodity classification as per Schedule 1 of the Royalty Bill. The rates chosen are eminently reasonable, falling on the lower half of the international scale. The more notable mineral resources listed such as gold and platinum are set at rates of 3 and 4 per cent respectively and below. The Royalty Bill charges the highest rate of 8 per cent on diamonds, which is also reasonable given the fact that South Africa's neighbours charge a rate of up to 10 per cent for the same mineral resource.

Exemptions and reductions

(i) In addition, the Bill provides for certain exemptions and reductions of rates. In the case of *marginal mines,* the Royalty Bill provides the Minister of Finance with the authority to issue regulations that partially or wholly exempt from the royalty regime marginal mining operations. The purpose of this exemption is to ensure that the royalty does not force the closure of low-grade mines, thereby causing a loss of employment.

(ii) Another exemption is granted to holders of a prospecting permit for all *minerals extracted for analysis, bulk sampling or other similar testing.* However, this exemption for sampling does not apply to diamonds and gemstones because small quantities with substantial value can still be extracted with little cost, even for mere sampling.

(iii) The exemption will also apply to a wide variety of minerals that are used for domestic brick-making, public infrastructure construction, cement manufacturing and agriculture. Also, it is proposed that the royalty for bituminous coal intended for domestic use – and which is mostly of a lower grade than internationally used coal - is one per cent. Most of the minerals falling under this exemption have relatively small values and, hence, the revenue potential is limited.

(iv) With regard to *oil and natural gas* the royalty rate for oil and gas is halved for any holder of oil production rights if the holder initially discovers an economically exploitable deposit within the same area as the oil production right in question. This rate will vary between 0,5 per cent and 1,5 per cent (rather than the standard 1-to-3 per cent). A mineral rights holder with exploration rights will additionally be exempt with respect to oil and gas extracted with respect to exploration rights for sampling purposes.

Fiscal stabilisation provision

The rules also seek to enshrine maximum certainty for investors by minimising administrative discretion and maximising clarity of administration. In order to allay uncertainty concerning rates in a material way, the Royalty Bill contains rates that are sustainable for the foreseeable future. As an added measure of assurance, the Royalty Bill contains a Fiscal Stabilisation provision that will act as a contractual guarantee for a stable set of rates if mining rights holders are willing to pay a premium. In terms of this measure, a mineral rights holder is guaranteed to retain the initial applicable royalty rate upon conversion to new order rights if that holder pays a premium equal to the lesser of 2 per cent or 50 per cent of the initial royalty rate. Hence, a mineral rights holder with a normal royalty of 2 per cent must pay an additional 1 per cent for the guarantee. The Fiscal Stabilisation provision will remain in effect for the duration of the right, excluding renewals and extensions (i.e., no more than 30 years).

Special withholding rules for diamonds

(i) Diamonds create special enforcement concerns, especially in terms of establishing fair market value of the thousand or more categories of diamonds and the specific problem posed by small individual diamond diggers. Many diamond diggers can extract and sell diamonds at great profit without Government detection.

(ii) In order to remedy these enforcement problems, the Royalty Bill provides a special set of withholding rules for authorised diamond purchasers. These purchasers are far fewer in number and easier to regulate than individual diamond diggers. Under these withholding rules, all diamond purchasers are required to collect and pay the royalty on behalf of any diamond digger out of diamond sale proceeds. The amount withheld on purchase will act as credit against any royalty paid or payable by the diamond digger in order to ensure that no diamond is subject to a double charge.

(iii) The Royalty Bill contains an exception for authorised diamond purchasers who acquire diamonds from large-scale diamond mining companies. Companies of this kind represent less of an enforcement concern and withholding in these situations could create a cash-flow problem for significant local companies, thereby undermining international competitiveness.

Financial implications

From 2007 onwards the anticipated royalty collections should achieve their full potential, as this year constitutes the cut-off date for the conversion to new order mining rights.

Schedule 1

Substance Classification and Royalty Rates

Group	Substance	Royalty Rates %
1	Salt, sand, stone, sandstone, late, gravel, clay, concrete, mortar, plastar, brick, dolorite, limestone, shale, gypsum, limestone, perlite, and phosphate rock extracted by a mineral extractor outside of the exemption described under section 12.	1
2	Oil and gas: natural gas and natural gas condensate petroleum crude offshore production where the water depths are deeper than 500 meters.	1
3	Alumino-silicates (andalusite, sillimanite, kyanite), asbestos, ammonium sulphate, barytes, zirconium oxide uranium oxide, kaolin, talk, magnesite, mica, silica, sulphur, sodium sulphite, mineral pigment, pyrophylite, dimension stone (granite, norite), and perlite.	1
4	Anthracite and bituminous coal (low ash and steam)	2
5	Antimony, copper, iron, manganese, lead, zinc, cobalt, nickel, silicon, tin, and vermiculite.	2
6	Oil and gas: natural gas and natural gas condensate petroleum crude onshore and offshore production where the water depths are shallower than 500 meters.	3
7	Gold, silver, vanadium, chromite, and titanium dioxide (Ilmenite, rutile).	3
8	Platinum group metals: platinum, paladium, rhodium, iridium, ruthenium, and osmium.	4
9	Amethyst, quartz (smoky quartz, citrine, rose quartz), cryptocrystalline quartz (jasper, opal), or chalcedony (blue lace agate, moss agate, onyx, rainbow chalcedony), tiger's eye, blue asbestos (crocidolite), beryl (emeralds, aquamarine, morganite, heliodor), chrysoberyl (cat's eye, alexandrite), corundum (rubies, sapphires), garnet (jade, hydro-grossular, spessartine), Iolite, kyanite, sodalite, sugilite (royal lavulite or royal azel), tourmaline, verdite (serpentine), and topaz.	5
10	Unpolished natural diamonds	8

Schedule 2: Cross-country analysis of royalty regimes – rest of the world

COUNTRY	GROSS SALES VALUE	PROFIT - BASED	NET SMELTER RETURN/NARROW VERSION OF PROFIT-BASED	NEGOTIATED CONTRACT	NONE
Canada		X			
Greenland				X	
Sweden					X
USA	In lieu of royalties, severance taxes				
Australia	X				
China	X				
Mexico	X				
Poland	X				
Argentina	X		X	X	
Bolivia	X				
Brazil	X				
Peru					X
Chile					X
Indonesia	X				
Kazakhstan				X	
Uzbekistan	X				
Ireland	X				
Russia	X				
Papua New Guinea	X		X		
Philippines	X				

Cross country analysis of royalty regimes – Africa

COUNTRY	GROSS SALES VALUE	PROFIT - BASED	NET SMELTER RETURN/NARROW VERSION OF PROFIT-BASED	NEGOTIATED CONTRACT	NONE
Angola	X				
Botswana			X		
Burkina Faso	X				
Ghana	X				
Ivory Coast			X		
Lesotho	X				
Malawi	X				
Mauritius					X
Mozambique	X				
Namibia	X				
Swaziland			X		
Tanzania	X				
Zambia			X		
Zimbabwe	X				

Cross country analysis of royalty regimes – World summary table

COUNTRY	GROSS SALES VALUE	PROFIT - BASED	NET SMELTER RETURN/NARROW VERSION OF PROFIT-BASED	NEGOTIATED CONTRACT	NONE
World total	22 (=65%)	1 (=3%)	7 (=21%)	3 (=9%)	5 (=15%)
African countries	9 (=64%)	0 (=0%0	5 (=36%)	0 (=0%)	1 (=7%)
Total number of countries analysed	34 countries, 14 are African		NOTE: a country can adopt more than one System		

Schedule 3: Royalty rates in % - comparisons across commodities

COUNTRY	GOLD	PLATINUM	DIAMONDS	COAL	INDUSTRIAL MINERALS	IRON ORE	COPPER
Argentina	0-3	0-3	0-3	0-3	0-3	0-3	0-3
Canada – Quebec	20%/taxable income	20%/taxable income	20%/taxable income	20%/taxable income	20%/taxable income	20%/taxable income	20%/taxable income
Canada – British Columbia	15% of taxable income	15% of taxable income	15% of taxable income	15% of taxable income	15% of taxable income	15% of taxable income	15% of taxable income
Canada – Ontario	18% of taxable income	18% of taxable income	18% of taxable income	18% of taxable income	18% of taxable income	18% of taxable income	18% of taxable income
China	4	--	4	1	2	2	2
Greenland	negotiated	negotiated	negotiated	negotiated	negotiated	Negotiated	negotiated
Russia	6	8	8	4	3.8 – 7.5	4.8	8
Indonesia	2	--	10	13.5	1	2.5	2.5
Mexico	1.5	--	--	1.53	1.5	--	1.5
Kazakhstan	negotiated	negotiated	negotiated	negotiated	negotiated	Negotiated	negotiated
Papua New Guinea	2	--	--	--	2	--	2
Philippines	23	--	--	--	2	2	2
Poland	10	--	--	2	6	--	3
Uzbekistan	4	--	24	5.4	1.5 - 3	3	7.9
Australia	2.5	--	7.5	7.5	--	2 – 7.5	5 – 7.6
Ireland	1.5 – 4.5	1.5 – 4.5	1.5 – 4.5	1.5 – 4.5	1.5 – 4.5	1.5 – 4.5	1.5 – 4.5
Bolivia	1 - 7	--	3	--	1	1	1
Botswana	3 - 10	3 - 10	3 - 10	3 - 10	3 - 10	3 – 10	3 – 10
Lesotho	5 – 10	5 – 10	10	5 – 10	5 – 10	5 – 10	5 – 10
Namibia	?	--	10	4	--	--	--
Malawi	5 – 10	5 – 10	5 – 10	5 – 10	5 – 10	5 – 10	5 – 10
Mozambique	3 – 10	3 – 10	3 – 10	3 – 10	3 – 10	3 – 10	3 – 10
Swaziland	1 – 2.5	1 – 2.5	--	1 – 2.5	1 – 2.5	1 – 2.5	1 – 2.5
Tanzania	3	--	5	3	3	3	3
Zambia	2 – 5	2 – 5	5	2 – 5	2 – 5	2 – 5	2 – 5
Zimbabwe	2 – 10	2 – 10	2 – 10	2 – 10	2 – 10	2 – 10	2 – 10
Burkina Faso	3	--	7	4	4	4	--
Ghana	3 – 12	--	3 – 12	3 – 12	3 – 12	3 – 12	3 – 12
Ivory Coast	3	--	3	2.5	--	2.5	2.5
Angola	2 – 5	2 – 5	7.5	2 – 5	2 – 5	2 – 5	2 – 5
South Africa - proposed	***3***	***4***	***8***	***2***	***1***	***2***	***2***