

Portfolio Committee on Finance

Mineral and Petroleum Resource Royalty Bill

Response Document

13 May 2008

1. BACKGROUND

The Mineral and Petroleum Resource Bill gives effect to policy framework arising from of the Mineral and Petroleum Resources Development Act (Act No. 28 of 2002), the MPRDA.

The MPRDA *inter alia* provides for:

- All mineral rights to vest with the State;
- The conversion of “old order” rights into “new order” rights by 1 May 2009; and
- The imposition of mineral royalties by the State – section 3(2).

The 3rd draft of the Mineral and Petroleum Resources Bill was published for comment on 06 December 2007. The National Treasury requested public comments by 29 February 2008. The Portfolio Committee on Finance also requested public comments.

The National Treasury received thirty comments (twenty nine written, one orally) (see Table 1); nine of these written comments were also directly submitted to the Portfolio Committee on Finance. In addition one comment / briefing was made only verbally to the PCOF. The National Treasury briefed the PCOF on 4 March 2008 and the PCOF held public hearings on 11 and 19 March 2008.

The 1st draft of the Mineral and Petroleum Resources Royalty Bill was published by the National Treasury for comment on 20 March 2003 and the 2nd draft was published for comment on 11 October 2006. The National Treasury received substantial comments on both the earlier drafts and an attempt was made to incorporate most of the major comments into the 3rd draft of the Bill. Most of those who commented on the 3rd draft of the Bill acknowledged that many of their comments from the earlier drafts were taken into account in the 3rd draft of the Bill.

Table 1: Comments on the 3rd draft of the Royalty Bill

1. Anglo American South Africa Limited	16. M. Van Blerck – Standard Bank (PCOF – oral only)
2. Assmang Limited	17. SAMDA
3. Bapo Ba Mogale Community – Eiser & Kantor Attorneys	18. Implats
4. BHP Billiton – Manganese & Coal	19. Ingonyama Trust
5. BHP Billiton – Petroleum	20. LRC (Legal Resource Centre)
6. Chamber of Mines	21. Xstrata
7. Chamber of Mines – Thomas Walde	22. Trans Hex Group Limited
8. COSATU	23. Zululand Anthracite Colliery
9. De Beers	24. Michael Schroder – OM Value Equity Investments
10. Gold Producers' Committee – COM	25. Clay Brick Association Ltd
11. Stephen Meintjies	26. ArcelorMittal
12. OPASA (Offshore Petroleum Association of South Africa)	27. Aquarius
13. OPASA – Ernst Young (David Clegg, - Fiscal Stability)	28. Revenue Watch Institute
14. PASA (Petroleum Agency of South Africa)	29. PetroSA
15. Routledge Modise	30. SARS

2. COMMENTS

The comments received were both of a policy and technical nature. This response document will largely deal with the main policy issues raised. Some of the technical issues will also be noted.

The main policy issues raised are:

- a. The tax base, e.g. definition of aggregate gross sales, allowable deductions, the definition of first (initial) readily saleable state, absence of regulations (as mentioned in the draft Bill) in this regard and difficulties that some integrated businesses will experience (e.g. steel).
- b. Linked to the definition of the tax base are questions around market value or deemed market value and transfer pricing - the valuation of transactions between connected persons.
- c. The tax / royalty rate. Although most commentators are of the view that the formula used to determine the royalty rate is an improvement on (and is more equitable than) the various specific rates for the different minerals as per the previous two draft Bills. They also argue for changes to two of the parameters of the formula.
- d. Community royalties.
- e. State lease payments, e.g. Precious Stone Act, 1964 (section 74, Diamonds) and State Share of Profits (Manganese).
- f. Earmarking some of the royalty revenues to fund development initiatives in mining communities and mining labour sending areas.

- g. Why the need to make provision for bad debts?
- h. Relief for small miners.
- i. Relief for marginal mines.
- j. Unique position of petroleum sector.
- k. Unique position of gold mining.
- l. Fiscal stability provisions.
- m. Mining dumps and tailings.
- n. Deductibility of mineral royalties for Income Tax purposes.
- o. VAT on mineral royalty payments to the state.
- p. Clay to manufacture bricks should be exempted.
- q. Implementation date: extracted and / or transferred on or after 1 May 2009.
- r. Sale of mines as going concerns.

2.1.1 Tax base, deductible expenses, integrated companies, etc.

The concept of the readily saleable state of a mineral was introduced to define the point beyond which “true beneficiation” takes place. This point might differ from mineral to mineral and hence the initial idea of including the details in regulations.

Comment 1: Tax base and deductible expenses

- *“Instead of gross revenue a more net base is to be used through the allowance of certain deductions from gross, such as the beneficiation costs, transport, ports, insurance, smelting, refining, sorting, etc. For most minerals the deduction of these costs provides a more reflective value against which the royalty should be applied and recognises the significant efforts made by companies to beneficiate minerals in South Africa. The Treasury proposals are supported by the industry”. (Chamber of Mines).*
- *“Treasury, via regulations, will define for each mineral what the first sellable product is, which is really where the royalty formula should be applied. However, there is confusion where fully integrated mining/smelting/refining/alloying companies are concerned as to where the first sellable product is and if there can be an equitable separation of mining from the other activities. While much will be left to the as yet unpublished regulations, the Chamber will need to clarify with Treasury issues around the separation, arms length pricing and transfer pricing”. (Chamber of Mines).*
- *“It is difficult to assess the ambit of what is to be considered as processing “beyond its initial readily saleable condition” in the absence of knowing what beneficiation will be prescribed by the Minister by way of regulation. The Chamber would argue that this is now ready to be contained in a schedule to the Bill, rather than being left to regulation”. (Chamber of Mines).*

- *“It is Implats’ understanding from various discussions with Treasury that in terms of the platinum group metals (pgms) “readily saleable condition” is pgms in the form of **concentrate** or, which is the first saleable condition of these metals and the form in which junior mining companies sell their products to other companies for further processing to final refined product”. (Implats).*
- *“the tax base for Ferrochrome should be determined on the lesser of NSR as contemplated in clause 5 of the 3rd draft Bill or the value at which the ore is processed by the PSV (Pooling and Sharing Venture) into a “readily saleable condition” which as set out above is the point of transfer to the Ferrochrome smelters” (Xstrata Alloys – Merafe Resources)*
- *The above views of the Chamber of Mines are supported in separate submissions by De Beers, BHPBilliton, Xstrata, Aquarius, Anglo American, Assmang, Implats and ArcelorMittal. Some of these submissions also argue that certain management and overhead expenses related to beneficiation should be viewed as allowable deductible expenses. It is, furthermore, argued that beneficiation expenses incurred outside South Africa should be deductible.*
- *“The vast majority of deductible “beneficiation expenses” would be deductible in the hands of companies who smelt, refine and process PGM, as opposed to companies such as QAPSA whose concentrating activities simply comprise “processing” as indicated in the media statement”. (Aquarius)*
- *“This 3rd draft bill provides for a serious downward variation of the Tax Base, from a State Royalty Tax Base of a gross sales value applicable at extraction and transfer of a mineral to a State Royalty Tax Base of gross sales value less allowable beneficiation related expenses and transport expenses between the Seller and the Buyer of the final product. All these expenses are not defined but subject to some future Regulations that the Minister might introduce”. (COSATU / NUM).*
- *“Accordingly we are calling for the reinstatement of the provisions on published tradable values. The use of gross sales value should be retained as the default option to be implemented in the absence of a published tradable value. Further, provision should be made requiring the DME to review the published tradable values at least annually or more frequently depending on fluctuations in commodity prices. We are seriously concerned about the real possibilities of manipulation which will be allowed through the introduction of these undefined beneficiation and transport costs by this 3rd draft”. “Apart from gross sales value being the predominant practice internationally, it will counteract practices by mining companies trying to evade royalty costs through the use of transfer pricing or understating their profits”. (COSATU / NUM)*

- *“We again state that we believe that the royalty tax base should be profit rather than gross revenue. (SAMDA)*
- *“Regulations are anticipated defining a mineral resource’s “readily saleable condition.” We would suggest that regulations similarly will be needed to define “process of manufacture” as conceptions may differ across industries. It could be preferable to simply impose the royalty at the first “marketable” stage – i.e. the first point at which a reasonable arm’s length price or reasonable basis for value can be determined. This point will vary across minerals”. (Revenue Watch – New York)*

Response 1:

- The comments are noted and partially accepted. The proposed net smelter return (NSR) tax base (gross sales minus allowable deductions) in the 3rd draft was intended to arrive at a tax base that will not tax beneficiation and thereby discourage value addition to our minerals. However, to arrive at a common value (base) that achieves this objective by way of allowable deductions has proved to be more complex than initially thought. A combination of the 2nd and 3rd draft of the Bill are proposed.
- The approach will be to make use of the broad distinction between refined and unrefined minerals and adjust the rates accordingly. In essence, gold and its by-products and oil and gas will use the refined formula because these minerals are as a rule as sold in “refined” form. The unrefined formula will be used by most of the other minerals. Platinum Group Metals are sold in either condition so either formula will apply depending on the circumstances.
- The formulas will be as follow:
 - Firstly, (**Option A**) defining the tax base as gross sales minus the costs of transporting the final product to the buyer. This formula will be applicable in the case of refined metals, Gold, refined PGM (precious metals) and also oil and gas. The Minister will have the regulatory power to extend this list.
 - Secondly (**Option B**) the concept of “readily saleable state” or “first marketable stage” or “concentrate” or “a concentrate equivalent” will be defined for each mineral in a schedule to the Act or by way of regulation. Most of the main minerals can be accommodated in this regard (e.g. PGM ore, Iron Ore, Manganese Ore, Chrome Ore and Coal, Diamonds (rough), etc).

Comment 2: Integrated companies – beneficiation activities

- *“The fact that beneficiation costs can be deducted from gross sales value will not alleviate the problem or address the discrepancy in a meaningful way. It is apparent that the beneficiation of products will be penalized as long as the gross sales value of the beneficiated product is retained as the basis for the determination of the royalty payable”. (ArcelorMittal).*
- Deemed transfer event (section 6(3)) – “If an extractor uses a mineral resource in a process of manufacture as determined by the Minister by way of regulation, ...”. *“Although the rationale for introducing this provision is appreciated, it is again respectfully submitted that it is unlikely that the achieved goals will be reached through this means”. (ArcelorMittal).*
- *“In order to avoid distortions in the market, the effective tax rate on both extraction and processing activities should not differ significantly based on the level of integration of mining companies. This is clearly not the case in the Draft Royalty Bill as we understand it”. “In most royalty regimes internationally, royalties accrue upon extraction, using the wellhead, mine-mouth or similar price of ore for calculations. Such a system has the benefit of allowing greater comparability across firms as well as capturing mine-specific advantages”. (Revenue Watch)*
- *“When the Company initially disposes of the mineral resource, it does so when the mineral resource is extracted and is dispatched to its smelter or works for processing. The sales value of the mineral resource, once processed and refined to alloy stage, at the smelter or works, is significantly higher than the mineral resource when first extracted and disposed of at mine level. The South African mining industry consists of companies who extract mineral resources for the purpose of selling to third parties for processing, as well as companies who **extract and process** the mineral resources. The situation described above would result in companies that **extract and process** mineral resources being discriminated against in that they will be taxed at a much higher rate than the companies that simply extract and sell their mineral resources”. (Assmang).*
- *Deductions of imports from gross sales (e.g. imported LNG.) (PetroSA), and from independent third parties (Xstrata Alloys – Merafe Resources)*

Response 2:

- These comments are noted and the response to the comments with respect to the tax base (Response 1) should address most of the concerns raised here. For an integrated company a deemed sale event can be defined at the point where the “concentrate” or “concentrate equivalent” or product in a “readily

saleable state” or “first marketable stage” is transferred to be further refined. Therefore, for minerals included under the “unrefined” category, where such minerals are sold beyond their readily saleable condition it will be deemed that the sale occurred at their readily saleable condition as defined in the regulations – following general industry practices.

2.1.2 Tax / royalty rate

Both the 1st and 2nd drafts of the Bill provided for different specific royalty rates for the different types of minerals. In the first draft Bill the rates varied from zero per cent for sands and gravel (aggregates) to 8 per cent for diamonds. The 2nd draft Bill included dual rates for certain refined and unrefined minerals, with a lower rate for refined minerals, equal to half the rate for the unrefined mineral. The royalty rate for diamonds in the second draft Bill was reduced to 5 per cent.

The 3rd draft Bill moved away from specific rates which vary for different types of minerals to a formula that determines the royalty rate for a mining company. The formula is equal to: $Y = X/B$, where

Y = the royalty rate,
X = EBITDA / Gross sales
B = 12.5

EBITDA is equal to earnings before interest, taxes, depreciation and amortization. The value for B was set to ensure that the royalty rate varies between 1 and 5 per cent with an average around 2.4 per cent. The assumption being that X will vary between 10 and 60, with an average of around 30. When X approaches 0 the mine becomes marginal and the royalty rate accordingly decreases, providing automatic relief to the “marginal mines”. During a commodity price boom it is expected that X will increase with a consequential increase in the average royalty rate. The State thus shares in both the upside (windfall) and downside (risk) of the mining industry.

Comments:

- *The most important feature of the third draft Bill is the proposal by Treasury that the royalty be shifted to a formula based system. Formula systems are at the cutting edge of global best practice and deal with a number of issues such as automatic relief for marginal mines and start-ups, the state sharing in the benefits of bull markets as well as easing the burden during tough times, the eliminating of discrimination between minerals, doing away with the flawed two tier royalty proposal, etc. At a general level the Chamber’s members fully support the move to a formula*

based system. However, the Chamber has some specific comments on the formula which are designed to find an appropriate balance between the needs of the State and the competitiveness needs of the mining sector. (Chamber of Mines)

- Based on modelling done by the Chamber for the period 2002 to 2011, an average B factor of about 20 would equalise the gap between the proposed 2007 EBITDA formula and the 2006 fixed rate proposal in terms of the quantum of royalty collected by the State. (Chamber of Mines)
- Mining is an exceptionally capital intensive sector. In particular, large scale underground and deep level mines have very large capital expenditures just to provide the **sustaining environment** for mining to take place, while large open cast mines employ large scale capital intensive machinery. To continue to enhance the competitiveness and stability of the proposed new royalty system, the Chamber proposes that the Treasury should consider shifting from an EBITDA formula to an EBIT formula (like the Chilean royalty system). (Chamber of Mines, BHP Billiton, Implats, De Beers)
- “Implats proposes that Treasury consider the following options that recognise the mining industry’s significant commitments and which will place us in the same reasonable position as per the Second Royalty Bill where a 3% royalty rate on refined pgms was envisaged. The options in order of preference for the Implats Group are:
 - Total capital expenditure deduction; or
 - Cap royalty rate at a maximum 3%; or
 - EBITDA and a B value of 15; or
 - EBIT and a B value of 12.5.
- “South Africa’s forecasting and management of royalty revenues would be enhanced by a simpler formula. One option is to use a standard royalty with a fixed rate and a base measured relative to realized sales values and as a minimum charge while employing the proposed formula as a supplemental or super royalty. (Revenue Watch)
- EBITDA is central to the determination of the royalty rate in the Draft Royalty Bill, but there is very little information within the bill to explain how it would be calculated. In the case of mineral operations that are vertically integrated, will EBITDA “attributable to mineral resources” be publicly available?(Revenue Watch)
- The exclusion of a fixed royalty rate for refined minerals is supported. The introduction of a formula based royalty based on EBITDA is welcomed. However, we believe consideration should be given to an increase of the (B) factor. The proposed formula is based on historic data which does not represent the current economic climate where mineral prices are so much higher and hence the formula should be relooked at in light of the higher profitability. We believe a factor of 15 should be applied to the formula as a factor of 12,5 would be too penal. (Anglo American South Africa Limited)

- *“In calculating the Rates the Bill provides for the consideration of the company’s profitability and it introduces a new formula that takes into account the company’s earnings before interest, taxation, depreciation and amortisation (EBITDA). The Bill through its new rate averages provides for the grossly reduced rates for all categories of our minerals. These provisions do not only represent deviation from the objectives, the spirit and the letter of MPRDA but are designed to provide no meaningful revenue to the State for the compensation of our irreplaceable minerals that shall have been extracted out of the land for the exclusive benefit of monopoly capital”. (COSATU)*
- *“The terms as underlined, as measured for financial reporting purposes, are not defined and in all likelihood will be problematic to define. The concern is that depending on which accounting principles are applied to a set of trading results, i.e. GAAP, IAS or IFRS, a different EBITDA will be arrived at. This could in reality result in either a reduced or increased EBITDA. At the same time it is recognized that Treasury/SARS cannot be prescriptive to taxpayers on the accounting standards to be adopted as this is regulated by SAICA”. (SARS)*
- *“Clearly the EBITDA referred to should be in relation to income in relation to the extraction of minerals only, i.e. the EBITDA should be split into mining and non-mining? The legislation is not clear on this?” (SARS)*
- *“How will EBITDA be computed for “financial reporting purposes”? Will it include dividends, hedging expenses and other items on an accrual basis? Revenue Watch)*
- *“Although DBCM regards the formula based royalty rate proposed in the third draft of the Bill as a more equitable basis of determining the royalty rate, in that it provides relief in periods of poor commodity prices while providing government a boost in times of commodity price booms, it is untenable that the royalty rate should exceed, over the life of the operations, a royalty rate in excess of that proposed in the second draft of the Bill”.(De Beers)*
- *“It is not clear why the multiplier factor is 12.5 for the entire mining industry. Current forecasts suggest that DBCM will have an average royalty rate in excess of 5%. In many years the royalty rate is likely to exceed 5% and in some cases even 6%. Treasury should therefore consider raising the multiplier factor from 12.5 to 15”. (De Beers)*
- *“A variable rate of this nature will provide some protection to a mining prospect or an operating mine when mineral prices decline, or if costs rise disproportionately, and SAMDA would like to commend the thinking that went into this aspect of the Bill. (SAMDA)*

Response:

- The formula to calculate the royalty rate helps to achieve the following objectives:
 - It overcomes the main problem with respect to various specific rates; they are perceived to be discriminatory. It is often difficult to justify why certain minerals are taxed at a higher rate. The underlying, often unspoken reason seems to be the perception that some minerals are more valuable and therefore more profitable than others. If this is true, the correct implementation of the formula should achieve the objective of differential rates in a more equitable manner.
 - Assuming that we have managed to identify a consistent tax base, the variable royalty rate takes account of “affordability” and is therefore more equitable.
 - To the extent that there is a case to accommodate marginal mines, the formula does so automatically.
 - If correctly designed, the formula will also ensure that government shares in the gains during times of commodity price booms. There should, therefore, be no or little concern that government will not share in such windfall gains.
 - The formula should thus be designed in a manner that results in lower rates during low levels of profitability (probably subject to a minimum rate) and the rates should increase during times of higher levels of profitability. The expected “average” rate over the full commodity cycle or cycles should provide guidance on the “reasonableness” of the formula and resulting rates and not the rate or rates during any particular year.
- It is obvious that the royalty rate is not independent of the definition of the tax base. The broader the base the lower the rate and *vice versa*, the narrower the tax base the higher the tax rate.
- To the extent that the Bill allows for a smaller (narrower) tax base (the value of the mineral as a concentrate or its equivalent), the rates should be higher compared to the bigger (broader) base defined as the refined product.
- Taking into account concerns raised about the capital intensive nature of most mining operations, we recommend that EBIT instead of EBITDA be used. However, this will necessitate the inclusion of a minimum royalty rate above zero.
- Two formulas are proposed:
- Formula 1 where Option A is used as the tax bases (gross revenue of the **refined** product less transport costs of the final (refined) product to the buyer).

- **Y = 0.5 + X/12.5**, where **X = EBIT/Gross sales**.
 - **A maximum rate of 5 per cent is proposed.**
 - Gold, other refined metals (e.g. refined PGM) and Oil and Gas must use Option A and Formula 1.
- **Formula 2** where Option B is used as the tax base (gross revenue (at market value) of the **concentrated (or its equivalent)** product (sold or deemed to have been sold) less cost of transporting the concentrated (or its equivalent) product to the buyer, or the smelting / refining facility.
 - **Y = 0.5 + X/9**, where **X = EBIT/ Gross sales**.
 - **A maximum rate of 7 per cent is proposed.**
 - All the other minerals including rough diamonds must use Option B as the tax base and Formula 2 for the rates.

Table 1: Estimated Royalty Rates

Profitability	Refined	Unrefined "Concentrate"
	Formula 1	Formula 2
EBIT / Gross sales (%)	Min: 0.5	0.5
	B: 12.5	9.0
0	0.5	0.5
10	1.3	1.6
15	1.7	2.2
20	2.1	2.7
25	2.5	3.3
30	2.9	3.8
40	3.7	4.9
50	4.5	6.1
56	5.0	6.7
58.5	5.2	7.0
70	6.1	8.3

- EBIT will be defined as taxable income (as defined in the Income tax Act) plus interest payments. This will accommodate the concerns by SARS and the Revenue Watch Institute that the accounting definitions of EBITDA or EBIT are not adequately defined. Where EBIT is negative it will be assumed to be zero for the purpose of calculating the royalty rate. It should be noted that mineral royalties payable will not be included in the calculation of EBIT for the purpose of the formula calculation of the royalty rate.
- The EBIT should be in respect of the value of the “mineral resource” as defined by the tax base. In the same way that the gross sales refers to gross sales of the mineral resource up to the level of “concentrate” or its equivalent or alternatively the refined stage.

Table 2

	Mining: R million: StatsSA, P0044	2006	2006	2007	2007
1	Turnover received	203,467		291,737	
2	Interest paid	5,398		6,794	
3	Depreciation	15,358		19,667	
4	Net profit before taxation	42,271		82,161	
5	Total capital expenditure	36,090		33,777	
6	Book value of assets	192,607		216,116	
	% Gross revenue:				
7	Net profit before taxation	20.8%		28.2%	
8	EBIT (Depreciation)	23.4%		30.5%	
9	EBIT (Capital expensing)	13.2%		25.7%	
10	EBITDA	31.0%		37.2%	
	<u>Estimated Royalty Rates</u>		<u>Rate</u>		<u>Rate</u>
	<u>Refined: $Y = 0.5 + X/12.5$</u>				
11	EBIT (Depreciation)	23.43	2.37	30.5	2.94
12	EBIT (Capital expensing)	13.24	1.56	25.7	2.55
	<u>Unrefined: $Y = 0.5 = X/9.0$</u>				
13	EBIT (Depreciation)	23.43	3.10	30.5	3.9
14	EBIT (Capital expensing)	13.24	1.97	25.7	3.4

2.1.3 Community royalties

The media statement by the National Treasury released on 6 December 2007 reads:

“A number of traditional communities currently receive royalty payments from mining operators who mine on their land. Item 11 of Schedule 2 of the Mineral Resources Petroleum Development Act (Act No. 28 of 2002) (the “MPRDA”) provides that communities will continue to receive such royalties regardless of whether these royalties are paid with respect to “old order” or “new order” mining rights.

Communities and mining companies are encouraged to enter into negotiations to, where appropriate, convert the financial interest of communities into equity stakes in the operating companies. These negotiations will of necessity require that the role-players will have to make some concessions in order to ensure lasting and sustainable arrangements.”

Comments:

- *The statement from the Treasury setting parameters for this draft bill introduces a new provision for specific Communities who have been receiving Royalty payments from mining operators that mine on ‘their land’ encouraging them to enter into negotiations to convert their financial interests into equity stakes in the operating companies. We support this provision and call for amendments to be effected on Schedule II of the MPRDA given its contradiction of other provisions of the same ACT. (COSATU)*
- *“The Treasury has provided no relief in the Royalty Bill for the double royalty issue. While Treasury is encouraging mining companies with existing royalty arrangements with tribal communities to convert such contracts into equity stakes, there are some serious challenges in doing so. While it may not be in the realm of Treasury, the Chamber urges government to look at mechanisms to resolving the double royalty issue”. (Chamber of Mines, Anglo American South Arica Limited, Trans Hex, Zululand Anthracite Colliery (Pty) Ltd)*
- *“At present income received by way of royalties is allocated by the Board to beneficiary communities for community benefit projects. In terms of the draft Bills this income will in future be paid into the National Revenue Fund thus depriving our communities, many of whom are rural based and with little or no income streams and with a high unemployment rates, with a direct source of revenue. (Ingonyama Trust)*
- *“The Community has from time immemorial occupied ancestral land covering a number of farms in the Brits/Odi Magisterial Districts of the North West Province. The Community is approximately 35 000 strong, and although a very small minority have achieved financial success, the vast majority are poverty stricken. Unemployment is high. Many of the farms have Platinum Group Metals (PGMs), Chrome and Granite ore bodies in, on and under them. A legacy of Colonial and Apartheid times is that no Black Community in South Africa owns its land. Instead, each community is the sole beneficiary of a separate trust which owns each community’s land, of which the Minister of Agriculture and Land Affairs is currently the Trustee. The Community, represented by its Trustee from time to time, has been and is currently party to a number of agreements with different Mining Companies, which presently and will shortly extract mineral resources covered by the agreements. In terms of all the said agreements the Community currently, and for some time, has been*

receiving royalties and will receive them in the future. However the Community has learned that the Chamber of Mines (the Chamber), and maybe others, will make representations to the Committee to have the Bill amended so that, from 1 May 2009 all Contractual Royalties are abolished". (Bapo Ba Mogale Community – Eiser & Kantor Attorneys)

Response:

- The views as expressed in media Statement of 6 December 2007 still stand. Community royalties are protected in terms of the MPRDA and this will continue be the case. No deductions for the payment of community royalties will be allowed against the payment of mineral royalties to the State. As mentioned, where deemed appropriate communities and mining companies are encouraged to consider equity participation for the said communities. However, if communities prefer to continue to receive royalty payments they are free to choose so.

2.1.4 State lease payments and State Share of Profit

Historically mining companies that mined on State land were required to make lease payments to the State. There are numerous mineral / mining lease agreements. There is an assumption that many of these lease payments will come to an end once the new mineral royalty regime comes into force on 1 May 2009.

However, the MPRDA, Act 28 of 2002 (Item 9(7) of Schedule 2) specifically provides that lease payments in terms of section 74 the Precious Stones Act, 1994 will continue to be payable, in addition to any mineral royalty payments to the State.

Comment:

- *"Item 9(7) may have application, for example, in the context of De Beers' Finsch Mine in the Northern Cape. The imposition of a royalty in addition to any lease consideration that remains payable in terms of item 9 (7) in the case of Finsch Mine would for the period 2009 to 2014 be roughly equivalent to a gross revenue royalty of eleven percent over that same period. This would clearly amount to an unfair form of double taxation". (De Beers)*
- *"The South African manganese mines are currently paying a State Share of Profit) SSOP that amounts to approximately 10.125% of the taxable income (profits) to the State for the exact same purposes, as the State Royalty. While Samancor Manganese believes that the new royalty will not be imposed in addition to the SSOP, the Third Draft Royalty Bill is silent on this issue and requires clarification in this regard in order to avoid*

confusion and to provide certainty. Samancor Manganese therefore proposes that the Royalty Bill should contain a provision that explicitly addresses this issue. The absence of such clarity exposes Samancor Manganese, which contributes to the SSOP, to multiple royalty regimes". (BHP Billiton SA Limited)

- In 1994, through pro active engagement between Trans Hex and the then Government, it was agreed the royalty payments due to the State in terms of the Mining Lease be paid to the Namaqualand community by means of the Namaqualand Diamond Trust Fund (NDTF), which fund is specifically mandated by the community to utilise such funds for infrastructural and community development projects in the seven rural areas in the Namaqualand District. Unlike the Alexkor area, the community is not the mineral right holder of the area covered by the Trans Hex State mining lease and the royalty payments to it via the NDFT, came about by negotiations with the state. We would request that a deduction be provided for such payments in the Bill. If not, we would be subject to double payments, i.e. one to the community, and one to the State. This we submit is inherently unjustifiable and unreasonable. It also gives rise to a form of unfair discrimination in that companies which have not previously agreed to payment of royalties to communities will not be subject to this double payment, and would therefore have an unfair commercial advantage over companies who are forced the make double royalty payments. (Trans Hex.)*
- "PetroSA currently makes Royalty payments to the State, in respect of OP26 rights, as consideration for the removal and disposal of minerals. These Royalty payments are made to PASA, an organ of the state. The current royalty paid to PASA by PetroSA, is calculated at 2% of production of the FA flat form, Sable and Oryx Sales. (PetroSA).*
- "In terms of s71 of, read with schedule 3 to, the Taxation Laws Amendment Act, 2004, lease, royalty or other similar payments to the state in terms of old order rights or OP26 rights remain payable until 30 April 2009 notwithstanding that conversion of the old order right or OP26 right might have occurred prior to that date". (Chamber of Mines)*

Response:

- The general view is that most lease payments to the state were a form of mineral royalties that should cease once the new more comprehensive mineral and petroleum royalty regime commences on 1 May 2009.
- In terms of a proclamation of the early 1900s the State was entitled to a majority participation interest in any proclaimed kimberlite diamond mine.
- "Lease considerations" payable in terms of item 9 (7) of Schedule 2 of the MPRDA (by De Beers in the case of Finsch mine) will continue to be

payable to the State (in addition to the new mineral royalties). The historical contractual arrangement between De Beers and the State in this regard is that the State is entitled to a 70 per cent undivided share (ownership) in Finsch mine and the “lease consideration” in this context are payments in lieu of dividends and not royalties.

2.1.5 Earmarking of revenue

As a general rule and in line with good public finance theory and policy the National Treasury is not in support of earmarking tax revenue streams. Earmarking of tax revenues places limits Government's ability to allocate scarce resources according identified (and changing) priorities, and may lead to sub-optimal allocations. Though there are limited exceptions, e.g. the Road Accident Fund Fuel Levy and the Skills Development Levy, . these cannot serve as a precedent, as it is also possible to still provide on budget funding that would indirectly link a portion of certain tax revenue streams to identify expenditure needs, e.g. the plastic bag levy.

Comment:

- *“In our previous submissions we registered serious concerns that no provision had been made for the ring-fencing of at least a portion of the royalty revenue generated into a dedicated national fund directed at benefiting workers, communities adjoining mining operations and labour sending areas”. (COSATU)*
- *“Many rural communities serve as “labour sending areas” to mine operations, from which they receive no direct benefit. At the same they suffer general problems of severe underdevelopment. Mining communities and workers have to suffer harmful effects to their health as a result of mining operations. Further, the nature of mining relates to diminishing natural resources. The inevitable closure of a mine not only leads to wide-scale retrenchments, but also has devastating implications for communities. Provision has been made to mitigate these factors in terms of the prescribed social and labour plans that mining companies are required to submit and finance. We believe that provision should be made to supplement this through revenue received from royalties”. (COSATU)*
- *“Accordingly we are strongly calling for the allocation of at least a part of royalty revenue to a dedicated national fund, which we propose be established as the Labour and Social Development Fund. On the basis of the number of areas of socio-economic development that must be covered, we believe that a minimum of 50% of royalty revenue should be ring fenced for allocation to the Labour and Social Development Fund”. (COSATU)*
- *“The practice of dedicating royalty revenues is used in some jurisdictions to build on the sustainable development principles of turning some of the financial capital realized from mining into long term capital in the form of human capital development and infrastructure development. The*

Chamber has proposed to Treasury that royalty streams be ring-fenced for attribution towards development in major labour sending areas and in areas around mines. This will help create sustainable capital in these areas and supplement the significant contributions already made by the mining sector through local government local economic development projects and in terms of the social and labour plans administered by the DME". (Chamber of Mines)

Response:

- The earmarking or ring-fencing of mineral royalty revenues is not supported. Apart from earmarking specific tax revenues not being in line with sound fiscal policy, this would negate the underlying principle of the MPRDA that the minerals of our country belong to all South Africans, and hence any resource revenue or benefits should be for all South Africans. Government also does not support the setting up of a dedicated national fund, given the need for accountability for spending and past experience of other dedicated funds.
- However, government is amenable to consider an on-budget spending programme targeted at mining and labour supplying communities directed at human and / or local economic development, where these are properly justified, on a partnership basis. In this regard a clear framework to prioritise projects, develop effective partnerships, and governance guidelines will be critical.
- It should also be noted that mineral royalties revenues will tend to be cyclical, especially given the commodity price cycle, and such revenues may decline over the long term as a result of the gradual depletion of our mineral resources.

2.1.6 Bad debts

Comment:

- *"The Bill makes provision for the mineral resource extractor to claim credits against a State royalty for writing off bad debts or where the extractor subsequently reduces the original sale price after transfer of the mineral resource.*
- *This provision opens considerable loopholes for the evasion of State royalties. Extractors may fraudulently misrepresent a transaction as constituting a bad debt or as resulting in a decrease in the sales price in order to claim the credit. Further it would appear very unlikely, taking into account the nature and high value of mineral transactions, that an extractor would not take steps to protect himself / herself from such an*

eventuality. While the Bill attempts to provide a safeguard by excluding application of this clause to transfers between connected persons, this is far from adequate. The monopolistic nature and inter-connectedness between different sections of the value chain of the mining industry provides ample opportunity to manipulate transactions in order to fraudulently benefit in terms of this clause. Accordingly we are calling for the deletion of this provision” (COSATU).

Response:

- Accepted but for slightly different reasons. The bad debt provision will be deleted in its entirety.
- The extractor is in theory liable for the mineral royalty when the mineral has been extracted / won. This is the appropriate interpretation given that the mineral royalty is a resource rent and not an ordinary tax. It is only for practical (and primarily cash flow) reasons that the royalty payments become legally due when the mineral is sold or deemed to have been sold.
- The extractor will have to keep records of both minerals extracted / won and sold or deemed to have been sold. An annual reconciliation will be required and royalties will be payable on any discrepancies. Also see response to 2.1.13

2.1.7 Relief for small miners

Comment:

- *“The small mine relief is inefficient. As it is structured, the effect of the small mine relief provision is that government would be giving small miners ore free of charge. That is, the government would be effectively subsidizing an input (value minerals) which may lead to economic inefficiencies. It would be more effective and efficient to charge a standard royalty and provide a tax credit against income tax. Moreover, it may be difficult to administer the small mine relief provision in the Draft Royalty Bill in the context of a sizeable small mining sector as both output and turnover must be monitored.” Transition rules from small mining to the regular regime will be needed (as well as from the regular regime to small mining); at a minimum, miners should be required to stay in the regular regime for a specific period in order to avoid arbitrage via regime choice. Finally, the relief is based in part on turnover, but turnover is not adjusted for inflation”. (Revenue Watch Institute)*
- *“It is noted, as in the case of the 2006 draft Royalty Bill, small time extractors may qualify for relief in terms of section 9 subject to inter alia a maximum turnover of R5.0 million and a royalty liability of R50 000. This relief is however subject to review, assessment period by assessment period. In this regard it is noted that there is a “hard cut off” provision*

which could have the effect of discouraging growth on increased productivity. We suggest that consideration be given to provisions being made for these limits (R5.0 million and R50 000) to be periodically adjusted by the Minister by Regulations and this will provide more flexibility in inflationary times. (Ingonyama Trust)

- *“Clause 8 of the 2006 Bill provides that an extractor qualifying as a small mining business will only be liable for State royalties that exceed R50 000. In order to qualify the small mining business would have to be a domestic company in respect of which the gross sales value of transferred mineral resources did not exceed R5 million during an assessment period. Further neither the mining company concerned nor any other person holding an ownership interest in it should hold more **than 20 per cent** ownership in another mining extracting company. We are concerned that the 3^d draft bill does stipulate very minimum conditions in the application of this provision. In addressing the ownership patterns of a qualifying small business, this bill provides for an increase of the direct or indirect shareholding from 20% to 50%. This represents a downward variation from the previous bills and provides for an opportunity to extractors to splinter their ownership stakes across various companies and therefore effectively evade the State royalty. (COSATU)*

Response:

- The monetary thresholds of R5.0 million and R50 000 per six month period (or R10 000 and R100 000 per annum respectively) will be adjusted from time to time.
- The comments by the Revenue Watch Institute with regard to the efficiency of the current small miner’s relief will be investigated with a possible review at a later stage. For now the current relief measures will remain unchanged.

2.1.8 Relief for marginal mines

Comment:

- *“Formula systems are at the cutting edge of global best practice and deal with a number of issues such as **automatic relief for marginal mines and start-ups**, the state sharing in the benefits of bull markets as well as easing the burden during tough times, the eliminating of discrimination between minerals, doing away with the flawed two tier royalty proposal, etc.” (Chamber of Mines)*
- *Unlike the 2nd draft Bill – “The 3rd draft Bill does not make provision for the relief of marginal mines. We believe this is a serious omission and accordingly call for its reinstatement. We are (also) calling for the insertion of an appropriate definition of marginal mines. Possible consideration should be given to incorporating elements of section 52 of*

the Mineral and Petroleum Resources Development Act on “notice of profitability and curtailment of mining operations affecting employment” as quoted below”:

*“(a) where prevailing economic conditions cause the profit to revenue ratio of the relevant mine to be less than six per cent on average for a continuous period of 12 months; or
(b) if any mining operation is to be scaled down or to cease with the possible effect that 10 per cent or more of the labour force or more than 500 employees, whichever is the lesser, are likely to be retrenched in any 12-month period.” (COSATU)*

Response:

- As mentioned in the response above (see paragraph 2.1.3; the discussion of the royalty rates) one of the advantages of the formula based royalty rates is that adjustment in the royalty rates provides automatic and smooth relief for marginal mines. The Chamber of Mines has acknowledged this. It is our understanding that COSATU now also acknowledges this advantage of the formula.

2.1.9 Gold mining

Comment:

- *“While the gold mining companies accept the reasoning for the introduction of the formula based system as encapsulated in the third draft, the impact on the gold sector will mean that the sector will pay royalties up to some three times higher than the 1.5% fixed rate from the second draft, despite the sector reinvesting some 70% of the benefits of higher gold prices in capex (with R12 billion invested in 2006/07) of which 70% is designed just to sustain existing production. With limited deductions from gross revenue in determining the base for the formula and such a large jump in royalty amounts, the ability of the sector to generate the cash flow necessary to sustain investment and production may be compromised. The gold producers are therefore proposing that Treasury consider the option of providing for a differential B factor for the gold sector or a once off election of the 1.5% fixed rate. (Chamber of Mines)*
- *“The first draft was released in March 2003 which provided for a royalty for gold of 3% of revenue received. The second draft was released October 2006 and provided for a royalty of 1,5% of revenue for refined gold and 3% for unrefined gold. It should be noted that 100% of the gold produced by ourselves is refined, and hence the 3% provision here would not have applied at all. Indeed, it is provided in the Precious Metal Act that no gold*

can be sold unrefined". (Chamber of Mines – Harmony, Gold Fields and AngloGold Ashanti – Gold Producer’s Committee)

Response:

- There is a general acknowledgement that whilst the 2nd draft Bill made some progress to address concerns raised on the 1st draft Bill there were some serious defects in the 2nd draft. One of these defects was the proposed dual royalty rate structure – also acknowledged by the Chamber of Mines (page 2 of the Chamber’s submission notes that one of the benefits of the formula is – **“doing away with the flawed two tier royalty proposal”**).
- The proposed different specific rates for different minerals, as per the second draft Bill, were subject to much criticism. It would, therefore, be inappropriate to use the 1.5 per cent of refined gold in the 2nd draft Bill as a bench mark or reference point. Gold like any other refined mineral should be subject to the same formula, especially given that we are now proposing that EBIT should be used instead of EBITDA, and fully taking into account capital expenditure. The fact that gold might have higher capital expenditure requirements, compared to some other mining operations, will provide them with some additional relief.

2.1.10 Petroleum sector

The petroleum sector (crude oil and natural gas) in South Africa is very small. A few oil and gas deposits have been identified along the South African coast line and PetroSA has been exploiting gas deposits in the Southern Cape (previously Mosgas). The Offshore Petroleum Association of South Africa (OPASA) represents eight companies that are currently undertaking exploration activities for oil and gas along our coastline. A few are already at the production stage – although on a very limited scale.

Comments:

- *“The offshore oil and gas exploration and production industry is very high risk and can require multi-billion dollar capital investment at the outset but proportionately low ongoing expenditure, whereas the mining of minerals onshore does not have the same risk factor and has a relatively small initial outlay but significant operating expenditure. The industry may be said to be unique in these respects. (OPASA)*
- *It is clear that the global trend is moving towards fixed royalty rates. Not only will fixed royalty rates give certainty they will also induce, promote and sustain investment in South Africa. (OPASA)*
- *For the typical offshore oil and gas project, the single biggest “expense” during production is OPEX (i.e. Operational Expenses). Excluding OPEX as a deduction results in the EBITDA / Revenue (“X”) being > 90% in nearly all reasonable scenarios throughout the project life. (OPASA)*

- *“The proposed “Petroleum Exploration Incentive” as contained in section 10 of the 11 October 2006 draft of the bill shall continue to remain incorporated in the Bill. (OPASA)*
- *“.. (Petroleum) projects tend to have a much higher and earlier capital expenditure profile and, consequently lower ratio of operating expenditure to revenue once in operation, than mining projects. The proposed mechanism (formula) is unusual and will result in overall royalty rates that are significantly higher than previously proposed. The Agency also has the view that the proposed mechanism will negatively affect its attempts to portray the fiscal regime applicable to upstream projects in South Africa as “attractive”. “It is, therefore, recommended to return to the mechanism and rates proposed in the second draft for application to the upstream petroleum industry” (PASA)*
- *“PetroSA currently makes Royalty payments to the State, in respect of OP26 rights, as consideration for the removal and disposal of minerals. These Royalty payments are made to PASA, an organ of state. The current royalty paid to PASA by PetroSA, is calculated at 2% of production of the FA flat form, Sable and Oryx Sales. (PetroSA)*
- *A fixed rate provides for certainty and is easier to administer for the extractor and National Treasury. The absence of a deduction for capital expenditure means the oil and gas industry is penalised by the formula (PetroSA)*
- *PetroSA is currently the only producer and consumer of gas in South Africa. There is no transfer or sale of gas to another party, merely the production and utilization of gas by the same entity. The FA-EM transfer price used in the determination of the PASA royalty is the gas condensate price at the refinery gate, accordingly we wish to confirm the suitability of the FA_EM transfer price as the arm’s length price which should be used to determine the gross sales value” (PetroSA)*
- *“We request that provision is made in the legislation for the deduction of imported minerals from gross sales or the apportionment of gross sales, to ensure that only South African source minerals are taxed where blending of minerals occurs prior to transfer”. (PertoSA)*
- *“Our analysis shows that since annual operating expenses for an oil field are 5% to 10% of revenue, the computed royalty rates under the proposed formula will be in the range of 7% to 9%. Once an oil and gas field is brought on stream the annual operational expenditures are relatively low. (Forest Exploration International (SA) (PTY) LTD).*
- *“Therefore, if Treasury wishes to take a formula-based approach for the royalty calculation, in addition to operating expenses, earnings must be adjusted for accelerated interest, taxes, depreciation and amortization. However, for the simplicity of calculation, predictability of future obligations, and the uniformity of royalty burdens on all producers as well as financiers of these projects, Forest strongly recommends that the Treasury continue to compute royalty as a fixed percentage of future revenues”. (Forest Exploration International (SA) (PTY) LTD).*

- *“The OP26 regime incorporated guarantees by the State of fiscal stability, including specified royalty rates for the duration of the contract. The State’s undertakings included maintaining the stability of legal, financial, operational, customs and economic provisions”. (BHP Billiton)*
- *“BHP Billiton Petroleum, therefore, submits that provision should be made in the Third Draft Royalty Bill to ensure that the royalty rates will not exceed the rates stipulated and agreed to in the OP26 Sub-leases and the Mining Leases”.*
- *“BHP Billiton Petroleum, therefore, proposes the re-introduction of a fixed royalty rate of between 1,5 and 3%, as contemplated in the Second Draft Royalty Bill, for off-shore exploration and production”.*
- *“In the event that National Treasury does not accept the proposal, BHP Billiton petroleum proposes the following amendments to the formula:*
 - *Implementation of different “B” factors for on-shore minerals / on-shore gas / off-shore shallow water/off-shore deep water projects;*
 - *Base calculation of “X” on Earnings Before Interest and Taxation (“EBIT”) and not EBITDA. This will generate low royalties early on in the project life during the period that the initial capital investment is being recovered, but would increase with time as facilities became fully depreciated and production ramped up to the final plateau rate;*
 - *Allow operating expenses to be deductible”.*
- *“The formula does not make allowance for capital expenditure. The oil and gas industry is capital intensive with front loaded high value capital expenditure. The absence of a deduction for capital expenditure means that the oil and gas industry is penalised by the formula. The royalty may be used as an incentive to encourage additional capital investment in the country and drive-up prospectively (prospecting?) by including capital expenditure. (PetroSA)*

Response:

- The National Treasury could initially not make an informed decision on the impact of a revised royalty rate structure on the oil and gas sector given the paucity of data.
- There are, however, doubts that it will be any more administratively complex to apply a formula based royalty regime in the oil and gas sector compared to the rest of the mining sector.
- The proposed use of EBIT and a capping of the maximum royalty rate should hopefully make the formally based royalty regime more acceptable and durable.
- The formula based royalty structure will make the signing of a fiscal stability agreement more acceptable for government, as it would allow for some sharing in potential upside gains as a result of higher commodity prices. As noted government also shares in the risk on the downside.

2.1.11 Coal bed Methane

Comment:

“Unconventional gas – coalbed methane (CBM): Anglo Coal is endeavouring to develop unconventional onshore gas resources as an alternative to coal-fired power generation. They consider the Waterberg region to host the most commercially prospective accumulation of CBM in South Africa.

- Anglo Coal is of the view that: “In the deeper parts of the (Waterberg) coalfield to the east, the coal seams contain a significant CBM gas resource, which has the potential to be economically exploited. Degassing of the possible underground mineable areas in the deeper part of the coalfield would be beneficial as this would have to be done for safety purposes prior to mining”. CBM is the commercial exploitation of methane gas ahead of coal mining and makes the eventual coal mining safer. However, they argue that: “The application of the estimated royalty rate results in the project falling further below the investment hurdle rate” and therefore request some temporary relief.

Response:

- “Coalbed methane is a form of natural gas extracted from coal beds. It is one of the cleaner fossil fuels, but producing it is one of the most environmentally unfriendly resources extraction practice, putting local landscapes and hydrologies at risk of permanent destruction.”
- “Coalbed methane is shipped in the same pipelines as natural gas and sold in the same markets. Burning coalbed methane has the same greenhouse gas generating issues as natural gas. The so-called “clean” fossil fuel, natural gas and coalbed methane has lower levels of pollutants than do oil or coal. However, a typical coalbed methane project involves big-scale industrialization of the landscape – hundreds of closely spaced wells, pumps, interconnecting roads, powerlines, and pipelines, as well as compressors that run 7/24 to move the gas to larger pipelines, and water disposal facilities. Coalbed methane drilling also produces vast quantities of water. The water is often saline, and is sometimes toxic. Even when it is potable, there can be too much of it. Disposing of the water can overwhelm local fields, streams, and groundwater”.

- The request by Anglo Coal to consider special royalty relief measures for (unconventional) coalbed methane / coal gas projects was received only recently and although such projects could help to augment the country's energy supplies the case for royalty relief needs further investigation. Environmental concerns related to coalbed methane projects raised in other countries suggest that such projects should be evaluated with care.
- We are of the view that the revised EBIT, taking into account 100% capital expensing for income tax purposes in the case on mining companies should provide more than adequate relief for such projects.

2.1.12 Fiscal stability

Given its long lead time and location specific nature, investments in mining and oil and gas exploration and production is viewed as being high risk. Some mining companies have argued for and many governments have agreed to provide some form of a fiscal stability for mining companies prior to them committing large sums of money in sunk capital expenditure. To date the only agreement of this nature has been OP26 for oil and gas companies. Most of the provisions of the OP26 agreements have now been incorporated into the tenth schedule of the Income Tax Act.

Both the previous two drafts of the Royalty Bill contain provisions for fiscal stability. The mining industry welcomes the fiscal stability provisions but would like to see it strengthened. Other commentators have expressed some reservations in this regard.

Comment:

- *"In the interests of investor confidence, stability agreements are often stated to be governed by general principles of international law and to be subject to international arbitration. This affords the investor greater protection than does purely domestic law, should the legislature subsequent to the conclusion of a stability agreement nevertheless repeal the founding statutory provisions such as clauses 13 and 14 and impose a more onerous fiscal regime. The Bill should be amended to address this matter". (Chamber of Mines – Prof. Thomas Wälde)*
- *"For the sake of greater predictability and reduction of discretion, the Minister should not only be empowered but also obliged to conclude stability agreements". (Chamber of Mines – Prof. Thomas Wälde)*
- *The Chamber favours the removal of the restriction in clause 13(4). At the very least, there should, in facilitation of investment, re-investment, expansion and attractiveness to investors, be a facility for assignment of the stability agreement, firstly, where the mining or production right is used to obtain funding or financing and secondly, where the acquirer has at*

least the same level of technical and financial ability as the current holder. (Chamber of Mines – Prof. Thomas Wälde)

- *It would be desirable for a new provision to be inserted, directing the Minister of Finance, after consultation with interested and affected parties to develop a model stability agreement within a stipulated period (e.g. six months) after 1 May 2009. Compare s100(2) of the MPRDA in regard to the development of the Mining Charter. (Chamber of Mines – Prof. Thomas Wälde)*
- *“We are further concerned about the implications of such provisions, which will most likely benefit large monopoly mining capital and ironically work against smaller and newer entrants who do not have existing monopoly rights. These provisions essentially do not allow the State to benefit from the review of rates in response to changes in the economic environment including a boom in commodity prices. Accordingly we are proposing that this provision be revised to limit the period of the guarantee to 10 years and that the rate must be pitched at slightly higher percentage than the applicable rate. This would provide a reasonable period of security around which mining companies may plan to cater for rate fluctuations. (COSATU)*
- *“The stabilization provisions (Sections 13 and 14) are too general and asymmetric. We appreciate the extractors’ (and investors’) desire for a stable economic environment. We believe, however, that stabilization clauses such as the one proposed might in fact be destabilizing. If revenues are not reasonable relative to investor returns, then political pressure for structural change can create sharp and significant adjustments in the fiscal regime, whereas allowing the government to make marginal adjustments in a transparent manner would be less disruptive for investors”. (Revenue Watch Institute)*
- *“The fiscal guarantee is extended to provide protection against the imposition (direct or indirect) of any other royalty or similar charge on the transfer of extracted mineral resources imposed (Section 14(2)). The fiscal guarantee does not offer true fiscal stability as it does not afford protection in respect of the introduction of all new taxes, duties, levies and charges specific to extractors. Namely, the introduction of another tax with a leviable base other than gross sales value of mineral resources extracted. For example, an environmental levy such as carbon emission / flaring.. Training levy on mining net profits or salaries specific to the oil industry as seen in other oil producing countries; Customs, Vat and Fuel levies on unrefined fuels such as LNG and CNG; and Surface area taxes. (PetroSA)*
- *“BHP Billiton Petroleum is of the view that the fiscal arrangements secured, historically, should continue to apply, (subject to there being no conflict with the provisions of the MPRDA and the Constitution) in respect of any Exploration Rights and Production Rights. This includes any royalty payments. BHP Billiton Petroleum does not believe that the fiscal guarantee, contained in clauses 13 and 14 of the Third Draft Royalty Bill,*

will adequately address the proposal made by BHP Billiton, namely that it is necessary to preserve the historical relaxations and fiscal arrangements, which were contained in the OP26 Leases and Subleases. BHP Billiton Petroleum therefore submits that provision should be made in the Third Draft Royalty Bill to ensure that the royalty rates will not exceed the rates stipulated and agreed to in the OP26 Subleases and the Mining Leases". (BHP Billiton)

- *"Whilst the Bill provides for fiscal guarantees, in Part V, to ensure long term stability to the mining industry and to attract investors to have certainty before committing substantial operating funds, the downstream industry is much more "exposed" and subject to apparent change at any time. The beneficiation of products require substantive investments, often in excess of what is required to establish a mining venture, and it is not clear why "certainty" would be granted to the mining industry whilst the companies that embark on the beneficiation of mineral products, should not enjoy similar protection. It is, therefore, important that the concept of fiscal guarantee, obviously subject to conditions as may be set by Treasury, be extended to deemed transfer events in terms of Section6(3)" (ArcelorMittal).*

Response:

- This is clearly a contestable area that requires very careful consideration. Providing a fiscal guarantee for oil and gas companies via OP26 is one aspect, providing a fiscal guarantee for the mineral royalty regime is somewhat different.
- There is no need to subject the proposed fiscal guarantee to international law and this suggestion is not accepted.
- The formula based royalty regime should address the valid concerns raised by both COSATU and the Revenue Watch Institute. The National Treasury shares these concerns and it is, therefore, necessary to ensure a robust royalty regime that would require no or minimal changes in the light of changing economic and socio-political conditions.
- The fiscal guarantee will be clarified; however, it will be limited to the royalty rate structure and allow for some flexibility in the case of mergers and acquisitions.

2.1.13 Mining dumps and tailings

The Mineral and Petroleum Resources Royalty Bill is based on the policy framework as contained in the Mineral and Petroleum Resources Development Act (MPRDA) (Act No. 28 of 2002). As a principle, the mineral royalties should apply to the extraction / winning of all minerals. At issue is the effective implementation date and as well as the ambit of the MPRDA.

Should royalties be payable:

- a. On minerals contained in mining dumps and tailings that were established from mining operations prior to 1 May 2009; and
- b. On minerals that were extracted / won but not transferred (sold) before 1 May 2009?

The court recently ruled (13 December 2007 in *De Beers Consolidated Mines Ltd v Ataqua Mining (Pty) Ltd & Others* (Free State Provincial Division Case 3215/2006) that the MPRDA does not apply to pre-MPRDA (old) mining dumps and tailings. The Department of Minerals and Energy is in the process of amending the MPRDA to explicitly provide that the MPRDA does apply with respect to old order mining dumps and tailings.

Comment:

- *“It is De Beers’ view that the disposal of diamonds recovered from tailings dumps that were created prior to the commencement of the MPRDA (“old order dumps”) should not attract a royalty”. (De Beers)*
- *We would accordingly align ourselves with the suggestion of the Chamber of Mines in this regard that the definition of “mineral resource” should be amended by the insertion of the following words at the end of the definition:*
 - *“, but does not include any such mineral or petroleum that was initially severed from the earth or from water other than by virtue of a mineral resource right”.*
- *“If, either judicially or legislatively, old dumps become subject to the MPRDA, then recovery of minerals from old dumps will be subject to royalty. If such recovery is undertaken by the former common law owner of the dump, then the imposition of a royalty is inequitable since the dump was produced before the State became the custodian on 1 May 2004 of the mineral resources in the dump. Irrespective, therefore, of whether or not such old dumps are brought within the ambit of the MPRDA, an exemption from royalty in respect of such old dumps should be provided in the Royalty Bill, i.e. in respect of dumps produced under right or title other than a right or permit granted or issued in terms of the MPRDA. Such exemption would further promote the sustainability of development of such pre-MPRDA dumps”. (Chamber of Mines)*
- *Furthermore, a State Royalty would in many instances have previously been paid on a per ton basis in respect of minerals mined under previous mining law regimes (such as the Mining Rights Act, 1967 and the Precious Stones Act, 1964, and even under the Minerals Act, 1991 in respect of State-held mineral rights as indeed also contemplated by s71 read with schedule 3 of the Taxation Laws Amendment Act, 2004). Double taxation*

of pre-MPRDA dumps may thus occur if the present royalty is again levied on the same dump material. (Chamber of Mines)

- *“In order to determine the volume of dump material on existing pre-MPRDA dumps, it could be provided that the owner of a dump must within a stipulated period (such as ninety days) after 1 May 2009 and again, thereafter, within a stipulated period (such as ninety days) after material mined from land by virtue of a mineral resource right is first deposited on the dump, lodge with the Commissioner a written certificate by a registered land or mine surveyor, certifying the volume of material on the dump as at 1 May 2009 and as at the time immediately prior to such first depositing”. (Chamber of Mines)*
- *“In terms of the prevailing law, there is a general presumption against the retrospectivity of a piece of legislation, unless the particular piece of legislation makes specific provision for the retrospective application. This aspect becomes important not only in respect of historical arisings, but also in respect of historical arisings which have been mixed, and also historical arisings which have been extracted, but not yet transferred prior to the date of commencement of the Third Draft Royalty Bill, once enacted”. (BHP Billiton)*
- *“In addition, while the Third Draft Royalty Bill would not be retrospective in its application, it may be possible to argue that the royalty will become payable, on transfer, even though the mineral resource was extracted prior to 1 May 2008. While it may be argued further, that the royalty will only apply if the physical act of extraction and transfer occurs after 1 May 2009, as a result of the uncertainty, BHP Billiton proposes that this aspect should be clarified”. (BHP Billiton)*
- *Given the recent court ruling: “This Bill, by linking its operations and definitions to the MPRDA, effectively excludes the possibility of imposing state royalties in respect of minerals found in tailing dumps.” To exclude royalties from tailings dump means to deny the nation the right to any compensation for the loss of its minerals resources”. (COSATU)*

Response:

- Mineral royalties will be payable on the all minerals that are subject to the MPRDA. The amendments to the MPRDA will clarify any uncertainties with regard to royalties’ payable on minerals contained in old mining dumps and tailings. There does not appear to be a need to make any specific provisions for this issue in the Royalty Bill.
- The practical difficulties to separate pre-MPRDA (pre 2002), pre-1 May 2009 and post 1 May 2009 mining dumps and tailings might be unduly complicated in some instances.

2.1.14 Effective date of implementation

Comment:

- *“The Chamber suggests that the wording of clause 16 be amended to refer to mineral resources both mined and transferred on or after 1 May 2009. However, if clause 16 is not amended in this way, then the royalty will be payable in respect of any minerals, even minerals mined before 1 May 2009, which are transferred on or after 1 May 2009. That could lead to a duplication of payments to the State where pursuant to the old order right or OP26 right prior to its conversion, or after conversion by virtue of s71 read with schedule 3 of the Taxation Laws Amendment Act, 2004, payments have already been made to the State based on minerals mined rather than on minerals disposed of”. (Chamber of Mines)*

Response:

- This suggestion is not accepted.
- The legal liability to pay the royalty will remain on minerals transferred on or after 1 May 2009.
- As a transitional measure, provision will be made to allow for deductions for certain lease payments to the State (only for those that legally terminate on 30 April 2009).
- However, it will also be expected of extractors to keep records of all minerals extracted and those minerals transferred or deemed to have been transferred in order to do an annual reconciliation. The extractor will be held liable for royalties on any discrepancies.

2.1.15 Deductibility of mineral royalties for Income Tax purposes

Comment:

- *“The National Treasury’s media statement on the Draft Bill, 2006, indicated that the royalties would be deductible in the calculation of income tax. The Chamber understands that the National Treasury intends to make express provision for this by way of an amendment to the Income Tax, 1962 and supports that concept”. (Chamber of Mines, De Beers, Anglo American, Aquarius)*

Response:

- An amendment to the Income Tax Act is not necessary. The deductions already exist under current provisions of the Income Tax Act, section 11(a). If necessary SARS could issue an interpretation note to further clarify this issue.

2.1.16 VAT on mineral royalties

Comment:

- *“Although the Chamber understands that the State may not be a vendor for Value-Added Tax purposes insofar as payments to it of royalties are concerned, the Chamber suggests that insofar as the royalties might be or become subject to Value-Added Tax, the Value-Added Tax Act, 1991 be amended to 0-rate the royalties for Value-Added Tax purposes”. (Chamber of Mines)*

Response:

- As a **resource rent** royalties should, in principle, be subject to VAT at the standard rate, similar to the provision of any other commercial rental. There is no justification to consider zero-rating mineral royalty payments.
- However, the practical implication of mineral royalties payable to the State is that it will fall outside the scope of the VAT framework and will by default not be subject to VAT. National Government is not a VAT vendor. No amendment to the VAT Act is, therefore, deemed necessary.

2.1.17 Clay to manufacture bricks

Comment:

- *“ .. brick making clays, shales and sands are a true commodity, there is no possibility of exporting brick making raw materials. They are simply not readily saleable until beneficiated into fired bricks. This places them in stark contrast to iron ore and coal which is readily saleable after extraction and before beneficiation”.*
- *“clay fired brick is an essential element in the domestic building industry. Clay is an input cost to the manufacturer of building bricks, pavers and blocks. Royalties on clay would be inflationary to the extreme detriment of the industry”.*

Response:

- This suggestion is not accepted.
- Clay, sands and aggregates, in general, are resources that are subject to depletion and should be subject to a resource rent like any other mineral.

The fact that it is a resource that will not be exported is not a decisive argument.

- Many non-mining countries have implemented special “aggregate” levies that are similar in their intent to a mineral royalty regime.
- Subjecting aggregates to the mineral royalty regime will also help to address problems with illegal activities in this sector and its consequential environmental damages.

2.1.18 Ring fencing

Comment:

- *“Though it is not stated explicitly, we infer from the text of the Draft Royalty Bill and the accompanying explanatory materials that EBIDTA will be an aggregate value calculated for all mineral resources won or recovered by an extractor in South Africa. Thus, the royalty will not be ring-fenced. A ring-fenced royalty insures that costs from new or marginal investments do not reduce the State’s share of revenues from more profitable mines. The purpose of the royalty is to compensate the owner of the mineral reserves, the state in this case, for the depletion of these non-renewable assets. The resource owner should be compensated more for high quality low cost mines relative to lower quality high cost marginal mines other things equal. An average may distort decisions and reduce revenues and impeded relative efficient production given administrative costs.” (Revenue Watch Institute)*

Response:

- This valuable observation is noted. The approach to be followed is one that would ensure a reasonable return for the state and at the same time an attempt has to be made to minimize the tax compliance burden of extractors, especially where more than one type of mineral resource is being extracted. The graduated royalty rate as derived from the formula should ensure that higher grade ore bodies contribute more and the lower grade ore bodies that might be close to being marginal are provided with adequate and automatic relief. On average, the net effect of ring fencing or aggregation in this context should net out.

2.1.19 Administration

Comment:

- *“Royalties due to the State are based on a self assessment basis similar to that of the Value Added Tax (“VAT”) system. As a result of the self assessment, the figures can be verified on the information pertaining to the return. The self assessment basis places reliance on the taxpayer to*

be compliant and honest similar to that of the VAT system. We therefore suggest that the same penalties apply for the Royalty declarations as they do for VAT. We are thus of the view that a penalty imposition, based upon the provisions of the VAT Act, as mentioned, would encourage compliance and timeous submissions of the necessary returns. The application of the Income Tax penalties for late submission would however not create the same compliance". (SARS)

Response:

- This suggestion is accepted.