



The 2007 South African Mineral and Petroleum Resources Draft Royalty Bill: an independent analysis

by F.T. Cawood*

Synopsis

This paper reviews the third Draft Mineral and Petroleum Resources Royalty Bill of 2007, and this analysis identifies potential areas for further consideration by the National Treasury before the new regime becomes official. At its basic level, a royalty regime consists of two elements: the base and the rate that must be applied to the base. Deciding on an acceptable royalty rate is complex and can be done only after understanding the base and after an extensive analysis of all variables affecting the competitiveness of the regime. The proposed royalty rate of the third Draft is calculated by means of a formula that provides for a sliding rate depending on the profitability of the mine. The base is a sales revenue definition that approximates net smelter return. The regime proposed in the third Draft Bill is a significant improvement on previous drafts and, with minor refinements, should stand the test of time.

Introduction

The 2007 Draft Mineral and Petroleum Resources Royalty Bill (MPRRB, 2007) was published on 06 December 2007. The media statement that accompanied the announcement of the MPRRB stated that the purpose of the Bill is to give effect to the objectives of the Mineral and Petroleum Resources Development Act (MPRDA, 2002), the principal Act for mineral development in South Africa (SA). This draft bill is the third attempt to establish a money bill¹ to compensate the State for the depletion of non-renewable national mineral resources by mining companies. The first attempt was the Draft Mineral and Petroleum Royalty Bill (MPRB, 2003) and the second the Draft Mineral and Petroleum Resources Royalty Bill (MPRRB, 2006). Both the 2003 and 2006 drafts were improvements on the historic regime, whose old system allowed for site-specific royalties to be negotiated with the Department of Minerals and Energy (DME) in

the case of State-owned mineral rights. The past system also had inadequate controls for effective governance during the calculation, declaration and collection of royalty payments to the State. Despite these improvements, the drafts were criticised² mainly for the following reasons:

- Insensitivity to the fundamental economic principle called ability-to-pay. The royalty rates were specified and based on a definition of sales value. The second draft made provision for some relief for refined metal products to promote beneficiation; and
- Mineral discrimination in that there were higher rates for some minerals whereas others were exempt from royalties. This approach incorrectly assumed uniqueness was determined by commodity type. It disregarded the fact that uniqueness is a function of market price and cost of delivery to the market.

What changed from 2006 to 2007? First, National Treasury produced a much clearer and more appropriate bill. Second, the problems associated with the ability-to-pay and discretion for relief were addressed by the introduction of a formula, which calculates a royalty rate by using the profitability of the operation as the main mechanism for fixing the royalty rate. Deeper analysis of the formula shows that the rates will range from 0% to an absolute maximum of 8%. Third, the fundamental problem of not allowing the additional costs associated with product value-addition to be deducted before applying the royalty rate has been adequately addressed by introducing a base that approximates a sales revenue value for the mineral product mined, called net smelter return (NSR). In its simplest form, NSR is calculated as sales revenue minus transport and beneficiation costs.

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¹Section 73(2) of the South African Constitution empowers the Minister of Finance to develop Money Bills, hence the involvement of the National Treasury.

²There were several submissions by a wide range of stakeholders that expressed the same or similar concerns.

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The release of the third Draft was the product of an intensive negotiation phase following the two earlier drafts, after which National Treasury considered and balanced the views it received and held a series of workshops and discussions during 2007. Stakeholders were given a final opportunity to comment on the issue before starting the parliamentary process in 2008 for promulgation in 2009. Public comment on the new system, which comprises the following documents, closed on 29 February 2008:

- Draft MPRRB (2007). The Main Section headings of the MPRRB are indicated in Appendix A
- Draft Explanatory Memorandum for the MPRRB (2007)
- Draft MPRR Administration Bill (2007).

Preamble

The preamble of the third MPRRB is not as detailed as that of the second Draft, which recognized the non-renewable nature of minerals, acknowledged State custodianship (and ownership) of minerals, and affirmed the State's obligation to provide for economic and social development and to consider the need for international competitiveness, efficiency, certainty and stability in the minerals sector. The third Draft reads:

'To impose a royalty on mineral resources and to provide for matters connected thereto.'

It is suggested that the wording of the third Draft be revisited to include the following essential concepts:

'To further provide for the State's role as custodian of the Republic's mineral and petroleum resources, to impose royalties and to provide for matters connected therewith.'

Part I: Definitions

The definitions appear in Section 1 of Part I of the MPRRB, most of which do not warrant discussion. An extractor is deemed a person who wins or recovers a mineral resource in respect of that person's mineral resource right granted in terms of the MPRDA. Extractors are, therefore, directly linked to the geographical area of the mineral resource right. The definition of a mineral resource is as defined in Section 1 of the MPRDA. For the purpose of the MPRRB, the definition of mineral includes petroleum products. A mineral resource right is used as a generic term for the following rights and permits issued in terms of the MPRDA:

- Prospecting right for minerals
- Exploration right for petroleum
- Retention permit
- Mining right for minerals
- Mining permit for small-scale operations
- Production rights for petroleum.

Transfer of production, which event triggers the royalty, means the initial disposal of beneficial ownership by an extractor, theft or destruction of the mineral resource. It is unclear why theft and destruction are considered relevant, because there can be no revenue in such cases. In addition to the definitions in Part I, The Administration Bill and Explanatory Memorandum provides further clarity.

Part II: Basic Royalty Regime

The MPRRB is silent on the issue of double payment of royalties³, but the media statement provides some direction.

Like its predecessor in the second Draft, it encourages communities and mining companies to enter into negotiations to provide for a situation where state royalties are not affected by the arrangement. Without dwelling further on the issue because of the sacrifices National Treasury have already made in other areas, the author's previous observation⁴ still stands, namely that whereas it is appropriate to convert royalties into equity stakes when dealing with affluent communities, such conversion becomes less appropriate when dealing with poor communities who rely on a constant and predictable stream of royalties.

The third Draft is also silent on whether or not mineral royalties will qualify as a deduction for calculating taxable income (TI) in terms of the Income Tax Act (1962). Because of the regressive nature of value-based royalties, investors will want this as a justified assurance.

Charging provision

The charging provision (Section 2) provides for extractors to pay royalties for the benefit of the National Revenue Fund. The implication is that the proceeds will not be ring-fenced and distributed along with other revenue collections according to the national allocation scheme. The calculation of the royalty is as follows:

Royalty for assessment period = Royalty rate × Base, where Base means gross sales value less allowable deductions over a six-month assessment period.

Royalty rate

The royalty rate (Section 3) fluctuates according to EBITDA (operating profit or OP) and is determined by means of the following formula:

$$\text{Rate} = [\text{EBITDA} \times 100] \div [\text{Aggregate gross sales} \times 12.5]$$

The nature of the formula is sliding-scale with profitability (EBITDA) as the mechanism for determining the rate. When the rate results in a negative number, it means a zero royalty. The concept is based on the fundamentals of the formula⁵ developed by Cawood (1999). The original formula is more elegant, and if the MPRRB formula were to be restated in Cawood's form to give the same answer, it will read:

$$R\% = x\% \div 12.5, \text{ where}$$

$$R\% = \text{the royalty rate; and}$$

$x\%$ ⁶ means EBITDA divided by sales revenue, expressed as a percentage.

³MPRDA Schedule II, Section 11(1) provides for community royalties to continue after the five year conversion period after aligning old-order rights with the MPRDA.

⁴See Cawood (2007) for an explanation of this view.

⁵ $Y\% = 1 + [x\% \div 50]$, which allowed for the rate to slide between 1 and 3% when there are profits. The structure of the formula made it possible for the rate to be less than 1% when $x\%$ (or profitability) is negative, but never 0%.

⁶The original intention and correct way to interpret the x -factor in gold mining taxation is explained by Van Blerck (1992) as follows "The factor ' x ' is the ratio, expressed as a percentage, of mining taxable income (before excess mining capital recoupments, and before assessed losses or deductions not attributable to the particular gold mine) to the mining income similarly so determined" He illustrated the definition as follows:

	R million
Mining income = gross mining revenue	960
Less Tax deductible working cost	(490)
Mining working profit	470
Less Tax deductible capital expenditure	(240)
Profit after capital expenditure	230
(X-factor = 230/960 = 23,96%)	

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It seems that the above concepts were applied by the National Treasury in a way that they accommodate the different expectations and needs of the diverse range of stakeholders. However, potential problems may arise when the original intentions are not understood, which intentions were first, to apply the rate to a NSR base (which is true for the MPRRB), second, to use a familiar accounting calculation as an indicator of profitability⁷, third, to ensure that compensation will be fair and internationally competitive to both the State and mining companies, and finally, that the State will receive a minimum royalty regardless of the economic cycle.

The factor of 12.5 in the formula determines the maximum royalty rate, i.e. 8%. Table I demonstrates how the formula causes the rate to slide between a minimum rate of 0% and a (theoretical) maximum of 8%. It is expected that, using the parameters in the formula along with traditional levels of profitability for the SA mining industry, the average rate would be between 2% and 3%. Although there was an overall reduction in the royalty rate from 2006 to 2007 for some minerals, Table I demonstrates that the maximum rate increased from 5% to 8%.

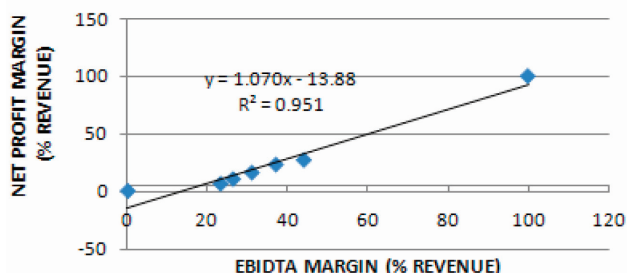
EBITDA is the acronym for earnings before interest, taxes, depreciation and amortisation as determined for financial reporting purposes. The intention of the National Treasury is to identify the earnings directly attributable to the winning and recovery of mineral resources. It is essentially a revenue-less-expenses calculation that approximates the more familiar OP calculation. Upon further examination of the meaning of EBITDA, it was found that there first is a significantly positive relationship between EBITDA and net profits (NP) for the global mining industry (Figure 1) and second, EBITDA is consistently higher than NP (Figure 2).

The advantages of EBITDA are that it is a successful measure of profitability because it is '...useful in terms of evaluating firms in the same industry with widely different capital structures, tax rates and depreciation policies' (Bloomsbury, 2003); it is an '...acceptable accounting measure to analyse the profitability between companies and industries because it eliminates the effects of financing. It is expressed as a percentage of sales to be a measure of core operating profitability' (Wayman, 2002); and if reported and

applied consistently according to the GRI Sustainability Reporting Guideline as contained in the King II report⁸, it will also:

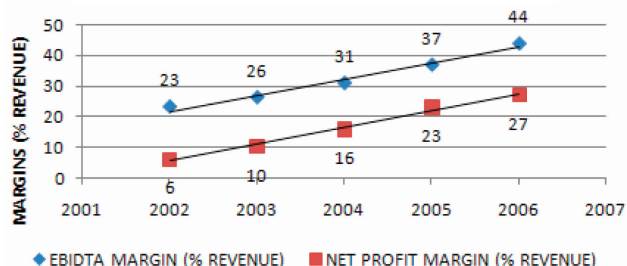
- Facilitate comparison over time, i.e. gives consistency; and
- Facilitate comparisons across mineral extractors, i.e. provide for accuracy, clarity and neutrality.

Despite the advantages above, EBITDA may not work because of some shortcomings. First, it is an unacceptable measure of cash flow because it dresses up a company's earnings by adding cash required for working capital and the replacement of old equipment to profits⁹, second, the immediate capital write-off scheme for mine development cost in SA has the potential to cause a significant gap between EBITDA and cash flow earnings; third, EBITDA is a non-GAAP measure that allows discretion and is often used inconsistently¹⁰. Furthermore and, most importantly, a survey of SA mining company annual reports revealed that very few mining companies report EBITDA consistently from year to year—if reported at all. Additional problems arise when EBITDA is further adjusted¹¹ to account for new acquisitions, mergers, changes in accounting policy and impairment. In contrast, all SA mining companies already report OP and profit before tax (PBT).



Sources: Review of Global Trends in the Mining Industry, PWC, 2004–2007

Figure 1—Relationship between EBITDA and NP



Sources: Review of Global Trends in the Mining Industry, PWC, 2004–2007

Figure 2—Gaps between EBITDA and NP

EBITDA (%)	Y% = (EBITDA ÷ R%) ÷ 12.5
-30	0.0
-20	0.0
-10	0.0
0	0.0
10	0.8
20	1.6
30	2.4
40	3.2
50	4.0
60	4.8
70	5.6
80	6.4
90	7.2
100	8.0

⁷That is x%, which is profit before tax divided by sales revenue, expressed as a percentage. This same scheme is used by the Income Tax Act for gold mining companies.

⁸King II Report on Corporate Governance for South Africa, IOD Johannesburg, March 2002.

⁹www.thefreedictionary.com.

¹⁰www.investopedia.com.

¹¹For example, see Exxaro, 2006.

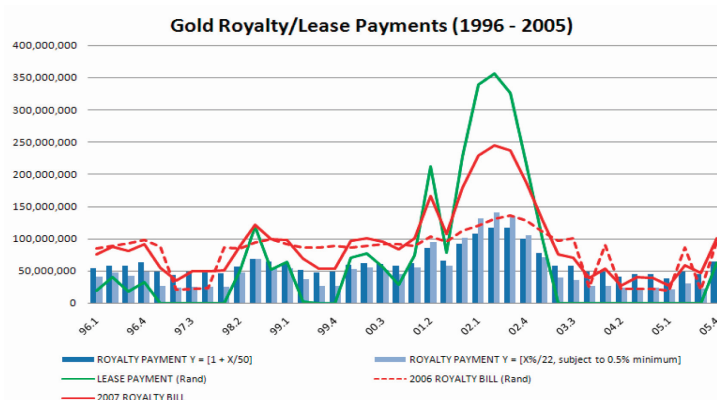
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Table II

Impact of EBITDA and PBT on the royalty rate

Impact of EBITDA and NP on treasury formula				
Company	EBITDA/OP (%R)	PBT (%R)	Royalty rate (EBITDA÷R%)÷12.5	Royalty rate (PBT÷R%)÷12.5
Anglo Platinum 2006	41	42	3.3	3.4
Anglogold Ashanti 2006	8	6	0.7	0.5
ARM 2007	45	35	3.6	2.8
BHP Billiton 2007	47	46	3.7	3.6
De Beers 2006	17	14	1.4	1.1
Goldfields 2007	39	21	3.1	1.7
Harmony 2007	15	13	1.2	1.0
Impala Platinum 2007	46	36	3.7	2.9
Kumba/Exxaro 2006	37	32	3.0	2.6
Palabora 2006	32	15	2.5	1.2
PPC 2007	39	39	3.1	3.2
Transhex 2007	23	10	1.9	0.8
AVERAGES			2.6	2.1

Sources: Company annual reports and MPRRB (2007)



Sources: COMSA gold mine quarterly statistics¹² and MPRRB (2007). The lease payment was calculated based on the lease consideration formula for Beatrix¹³

Figure 3—Comparison of different royalty schemes using actual gold production and financial statistics

Although it may be perceived that EBITDA, because of the higher amount, will contribute more revenue to the State coffers, Table II demonstrates the actual difference in the effective royalty rate using different definitions of profit is not that important. Another observation is that the difference between OP and PBT is significantly smaller for large diversified companies compared to single mine companies. It was also found that the reporting of OP and EBITDA is not consistent at all, while PBT always have the same meaning and has been proposed as the most reliable and consistent indicator of profitability. There is, therefore, a case to use PBT as an indicator of profitability, rather than EBITDA.

One can foresee some problems in the structure of the formula of the MPRRB, which could be avoided by learning from what happened in the past. The first lesson learned is that whenever a scheme did not provide for a minimum rate, it became open to abuse and manipulation of the payment towards nil. This debate on whether or not there should be minimum royalties has a long history. In SA, it dates back to the reports of the first commission of inquiry under the chairmanship of Frames (1917 and 1918). The mandate was to inquire into and report on the desirability of the State expanding its mining activities in the eastern Witwatersrand

goldfields. In the author's opinion, this Commission could have made a significant contribution to mining taxation if the submission of a certain I.J. Haarhoff was implemented. The report reads 'Mr I.J. Haarhoff, a resident of Pretoria, objected to State mining on the ground that it would become a political engine, and suggested that the Government should claim a royalty on the output, irrespective of the profits, and this royalty should be based on a sliding scale... It was pointed out to the witness that it would be unfair for the Government to exact a royalty on the gross production of gold from an unpayable mine, but the witness was not deterred by any consideration of this sort from pressing his scheme, and said he would leave the matter to the Government to arrange in the event of the property being unpayable' (p. 25, par. 154).

The second lesson learned is that the SA gold mines are unique in many respects, which means that they have very specific problems. Any form of taxation has the potential to have a significant impact on their pay limits, reserves and labour relations. Figure 3 shows a comparison of different

¹²Available from www.bullion.co.za.

¹³ $Y\% = 15 - 90/X$, where y is the lease rate and x is profitability expressed as a percentage.

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royalty schemes as applied to the actual quarterly reported statistics on the gold mine members of SA Chamber of Mines over a ten-year period. If the proposed royalty formula were compared to the scheme of the second Draft Bill, which was already negatively perceived by stakeholders, one comes to the conclusion that the third Draft will, over a period, result in more hardship for the gold sector as a whole. Despite this negative statement, one must appreciate that marginal mines will be better off under the third Draft compared to the second Draft because of the automatic recognition of profitability through the formula structure.

The potential solution is to heed Cawood's original intent of:

$Y\% = \text{Minimum royalty} + \text{allowance for higher royalties}$ in times of high profitability, subject to the provision that a special royalty can be negotiated with government for extraordinary mineral projects

As Figure 3 illustrates, the structure of the formula is such that it would not be necessary to negotiate a special case for gold if the range from minimum to maximum is narrowed. To achieve this objective, a minimum royalty of 0.5% should be considered since the mechanism of the formula will automatically provide for a maximum rate of 5% if a factor of 22, instead of 12.5, is used in the formula. It is, therefore, recommended that:

- PBT divided by revenue (expressed as a percentage), that is $X\%$ as used in the tax formula for gold mines, is used instead of the EBITDA scheme; and
- The formula be refined to $Y\% = x\% \div 22$, subject to a minimum rate of 0.5%

The net effect would be that the rates of Table I will change to those indicated in Table III. Not only will gold mines be accommodated in the scheme, but state revenue will become more predictable, as illustrated in Figure 3.

Aggregate gross sales

Aggregate gross sales (Section 4) are the total amount received or accrued to the extractor upon the transfer of minerals during the assessment period, which amount includes:

- Face value reductions or discharges on outstanding obligations
- Adjustments to fair market value
- Allowance for financial assistance
- Amounts received from insurance payments
- Premiums paid on options.

The reason why the royalty base has a high probability of success is first, because it represents a balance of the views and comments received on the earlier drafts, and second, it essentially is a NSR-based royalty, which represents the price of the mineral before value-addition. Definitions in the literature for NSR value include 'NSR is the amount of money which the smelter or refinery pays to the mining operator for the mineral product and is usually based on spot, or current price of the mineral, with deductions for the costs associated with further processing...[and]...the transportation costs involved in delivering the mineral product to the buyer¹⁴' and 'NSR...means the amount actually paid to the mine or mill owner from the sale of ore ...¹⁵'. This definition has been proven internationally as the most sensible base for the purpose of calculating royalties and is well known for its status as a trade-off position. This interpretation complies with the internationally accepted definition of a mineral royalty, which is aimed at compensation for the loss of the resource—but not after value has been added to it. For these reasons, all costs incurred after the minerals have been severed from the ground should be deducted from gross revenue in determining the base.

Allowable deductions

The allowable deductions (Section 5) for the purpose of determining the royalty base are costs associated with mineral processing beyond the initial readily saleable condition, which includes costs associated with screening, crushing, washing, sintering, sorting, smelting and refining. The result is that the costs for beneficiation performed in SA,

¹⁴www.minval.com, accessed 24/5/2007.

¹⁵www.canadianroyalties.com, accessed 24/5/2007

EBITDA (%)	Royalty Bill $Y\% = \text{EBITDA}\% \div 12.5$	NP (%) $x\% = (1.07 \times \text{EBITDA}) - 13.88$	Proposed rate $Y\% = x\% \div 22$
-30	0.0	-46	0.5
-20	0.0	-35	0.5
-10	0.0	-25	0.5
0	0.0	-14	0.5
10	0.8	-3	0.9
20	1.6	8	1.3
30	2.4	18	1.8
40	3.2	29	2.3
50	4.0	40	2.8
60	4.8	50	3.3
70	5.6	61	3.8
80	6.4	72	4.3
90	7.2	82	4.7
100	8.0	93	5.2

Sources: MPRRB (2007) and Figure 1.

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in addition to those for transportation after processing, are subtracted from the aggregate gross sales value. The intention is to prescribe the allowable deductions by way of regulation, which deductions will not include:

- Stewardship costs
- Management fees
- Overhead or administration costs
- Marketing costs
- Depreciation charges
- Interest.

The media statement quantifies the qualifying deductible expenditure and expresses it as a percentage of sales revenue. An independent comparison revealed some alarming differences (See Table IV), which require further investigation. The reasons why these percentages differ from commodity to commodity and even for the same mineral are because of the following site-specific issues:

- Economies of scale and efficiencies at operations
- Selling of intermediate and by-products
- Mining grade and location of the mine
- Complexity of the processing required and market specifications
- Impact of exchange rates (revenue in international currency and cost in local currency)
- Volatility in world prices over time
- Reporting inconsistencies and definitions used in reports.

Deemed amounts and transfers

An arm's-length value (Section 6) is required when first, transfer occurs before the mineral is in a readily saleable condition, i.e. in the case of intermediate products, second, export occurs without transfer and third, the extractor uses the mineral as an input to a process for further beneficiation. Value determination will then become part of the general transfer pricing strategy of the company as governed by SARS Practice Note No. 7.

Write-off for bad debts

Bad debt is allowed to be deducted from the royalty base (Section 7) and could be rolled over (presumably once) if it exceeds the royalty payment. On the assumption of a minimum royalty being introduced, the risk to the State would be minimized. The Explanatory Memorandum explains that royalties would be triggered when an extractor re-acquires mineral resources after these having been written off as a bad debt

Table IV

Estimated allowable deductions as a percentage of revenue

Mineral	Media statement	Estimate
Gold	0.4%	18.0%
Diamonds	7.4%	5.0%
PGM	8.0%	16.0%
Manganese	19.5%	NA
Mineral sands	21.4%	NA
Coal	21.6%	NA
Chrome	23.4%	NA
Iron ore	27.9%	27.0%

Currency translation

Currency translation (Section 8) is applicable to both income and allowable deductions in foreign currency. The spot (exchange) rate on the date of receipt or payment, whichever is applicable, applies to these circumstances.

Part III: Reliefs

Small mining business relief

Section 9 provides for the exemption from the royalty payment when the gross sales (or turnover) is less than five million rand during the assessment period or the royalty payment is less than R50 000. Such relief is applicable only when the extractor is a SA resident and the person is duly registered as an extractor. However, the royalty becomes payable when the extractor is entitled to participate (directly or indirectly) in more than 50% of the profits of another extractor, which is a positive aspect for stimulating and assisting small-scale miners.

Exemption for sampling

The royalty is not payable upon transfers for sampling purposes (Section 10) provided the aggregate gross sales upon transfer is less than R20 000. Unlike the second Draft Bill, which provided specific incentives for exploring oil and gas fields, the petroleum industry will be treated the same as the minerals sector. This approach is probably correct because the formula-style concept automatically compensates for the high capital outlay. Despite this observation and because of the important role petroleum products play in the national energy strategy, the National Treasury should remain sensitive to the need for incentives in offshore petroleum exploration.

Part IV: Anti-avoidance rules

Arm's-length value

Any amount used for the calculation of the base may be adjusted by the Commissioner to reflect arm's-length values. Section 11 describes the arm's-length value as the open market value determined in the ordinary course of business between independent parties acting in good faith (without regard to the royalty), so that no conflict of interest exists in the transaction. The transaction amount must be without any special favour, concession or advantage to any person.

General anti-avoidance rule

In terms of Section 12, any scheme aimed at reducing or avoiding the royalty amount may result in penalties. To establish such schemes, the abnormality and arm's-length tests must be applied to the situation. The Bill also provides for additional rules to be determined and enforced by the Commissioner. An arm's-length price for connected persons generally means a price, terms and conditions that would have been adopted when independent (unrelated) parties do business. The arm's-length value calculation complies with SARS (1999) Practice Note 7 on Transfer Pricing. This means that companies are already familiar with valuations of this nature, which will reduce compliance cost and provide for consistency in reporting. However, it may be necessary for companies to amend their existing transfer pricing policies to incorporate mineral royalty issues.

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Part V: Fiscal guarantee

Duration

The Minister of Finance may conclude a binding Fiscal Stability Agreement (FSA) with extractors (Section 13) in respect of an existing mineral resource right or in anticipation of the extractor acquiring a mineral resource right in the future. This provision is positive and gives meaning to the investment requirement that extraordinary investments may require special tax arrangements. Understandably, this option is not available for holders of retention and mining permits. Another point to keep in mind is that the FSA is not automatic but requires negotiation and agreement with the authorities. This process will provide for some flexibility in the understanding of and treatment of special cases. A FSA guarantees the terms and conditions for the duration of the right and provision can be made for the agreement to survive a disposal of the resource right. An extractor may unilaterally terminate the FSA at any time. Assurance is also given for whenever there is a FSA (Section 14), future amendments of Parts I, II and III of the MPRRB will not affect these. Apart from stability in terms of the MPRRB, no other laws may impose additional mineral royalties, and provision is made for compensation (or an alternative remedy) in case of injury.

The fiscal stability provision of the third Draft is fundamentally different from that of the second Bill, which provided for a fixed royalty rate determined upon birth or renewal of the development right issued in terms of the MPRDA and remains applicable for the duration of the right. Such a guarantee is no longer possible because of the sliding-scale nature of the third Draft. However, it will boost investor confidence if Part V includes an assurance that the variables of the new formula, especially the factor 12.5 that affects the maximum rate, will remain valid for the duration of the right.

Part VI: Closing items

Upon promulgation the Act will be binding on the State (Section 15). It will be called the Mineral and Petroleum Resources Royalty Act of 2007 and be effective from 1 May 2009 (Section 16).

Draft MPRR Administration Bill

The MPRRB will be strengthened with a supporting Administration Bill, which deals with general administration matters. As a general comment on administration issues, the proposed system will be a significant improvement on the historic system when the DME was responsible for the collection of royalties.

Conclusion and recommendation

In conclusion, the third Draft represents a balance between the contents of the first two drafts and the feedback National Treasury received to date. There is no off-the-shelf universal or best practice mineral royalty solution, which means that any royalty regime reflects a trade-off of vastly different positions. The process followed leading to the release of the third Draft is proof that stakeholder consultation is alive and well in SA. For this reason, the Bill should not only work for the complex SA situation but should also be used internationally in the search for leading practices. Despite this statement, there is still room for further consideration of the

issues by National Treasury and Parliament. After analysing the third Draft MPRRB, the following issues discussed in this report are emphasized for further consideration by the National Treasury and/or during the parliamentary review process:

- The wording of the Preamble should include the following essential concepts: 'To further provide for the State's role as custodian of the Republic's mineral and petroleum resources, to impose royalties and to provide for matters connected therewith.'
- The inclusion of a statement that mineral royalties will qualify as a deduction for calculating TI in terms of the Income Tax Act.
- Replace the EBITDA variable in the formula with the familiar PBT or the x-factor as applied to gold mining taxation in SA;
- Make the royalty rate subject to a minimum rate of 0.5%, which will allow for a nominal compensation during hard times when profits are few, but the reserve base continues to be depleted;
- Increase the factor of 12.5 in the formula to 22 which, when combined with the proposed minimum rate of 0.5%, will allow for a maximum royalty rate in the order of 5%; and
- As part of the fiscal guarantee, give assurance that changes to the variables of the formula, especially the factor that governs the maximum rate, will not cause an increase of the rate over the life of the resource right.

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Appendix A

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MPRR Administration Bill

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