
**“Chamber of Mines Submission on the third Draft
Mineral and Petroleum Royalty Bill”**

“Presentation to the Portfolio Committee on Finance”

19 March 2008

Parliament, Cape Town



CHAMBER DELEGATION

Mr. Roger Baxter, Chief Economist, COM

Dr. Michael Dale, Attorney: Deneys Reitz

**Mr. Paul De Mare, Head of Tax: Africa, Anglo American
South Africa Limited**

Mr. Anton van Achterbergh, Legal Adviser: COM

OUTLINE OF PRESENTATION

A. PRIMARY MAIN ISSUES

B. SECONDARY MAIN ISSUES

C. CLAUSE BY CLAUSE COMMENTS

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A. PRIMARY MAIN ISSUES

A1 OVERARCHING SUBSTANTIVE ISSUES

A2 PRE-MPRDA TAILINGS AND MINE DUMPS

A3 POST-MPRDA TAILINGS, MINE DUMPS AND STOCKPILES

A4 COMMUNITY ROYALTIES

A5 FISCAL GUARANTEE

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A1: OVERARCHING SUBSTANTIVE ISSUES:

The Chamber of Mines:

- Welcomes progress made and appreciates the willingness of Treasury and Parliament to engage on the detail of this critically important Bill.
- Broadly supports the formula based royalty system.
- Supports the encouragement of smelting/refining/beneficiation via deductions in terms of the base.

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However, the Chamber has a number of substantive issues that require further input:

- The proposed royalty formula needs to be adjusted to provide an appropriate balance between the needs of the government and those of the companies/investors.
- There needs to be a clear separation between the mineral extractor and processing/beneficiation activities.
- The proposed new formula presents specific challenges for the mature gold sector.
- The issue of double royalties requires resolution.
- Royalty proceeds, or a substantial portion thereof, should be ring-fenced for investment in sustainable development.

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Governments and investors have differing objectives:

“Governments favor methods that are *stable, transparent, and equitable* and that generate continual revenues, are *easy* to administer, and are amenable to distribution to a variety of government entities and stakeholders.

Companies, on the other hand, prefer royalty approaches that are *stable and predictable*, are based on the *ability to pay*, allow the early recovery of capital, *respond* to downturns in market prices, do not distort production decisions such as cut-off grade or mine life, can be deducted from taxable income for the general income tax, do not add significantly to operating costs, and are amenable to distribution directly to affected parties.”

Professor James Otto

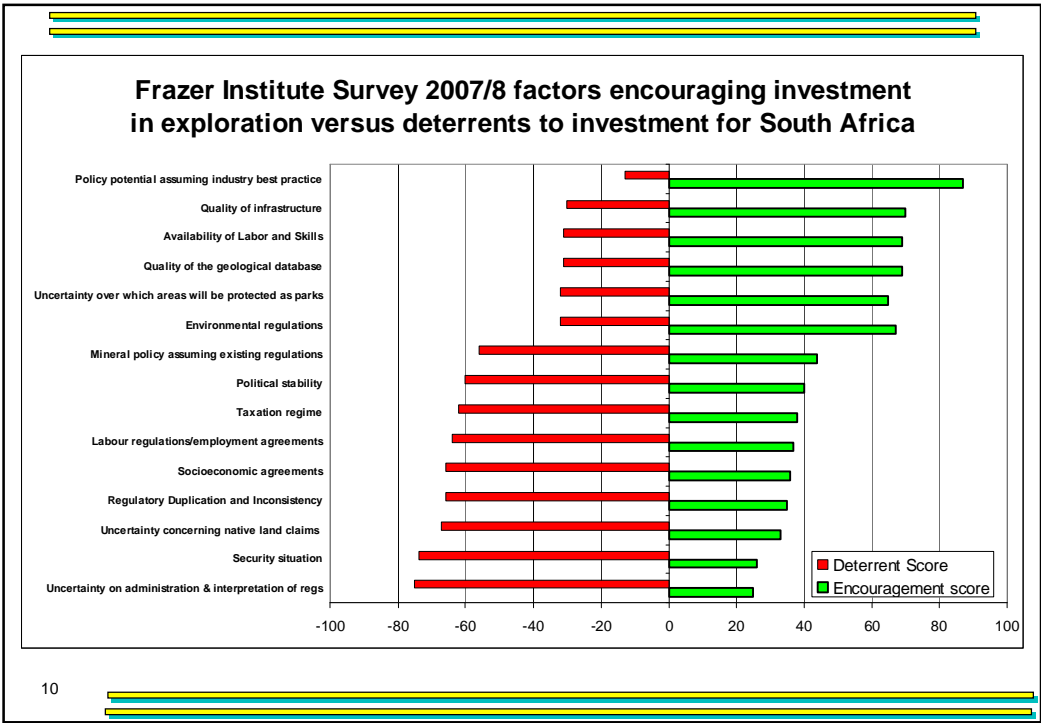
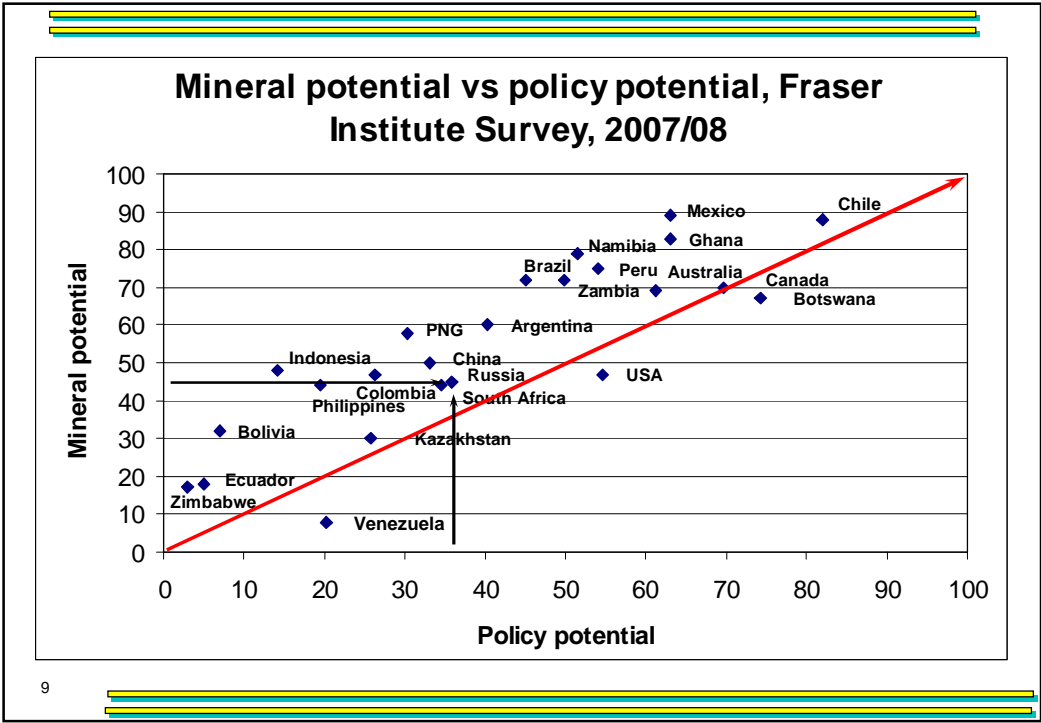
**THE KEY ISSUE IS HOW TO BALANCE THE INTERESTS OF
GOVERNMENTS AND INVESTORS**

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The Chamber focused on Key Areas:

- Recognise sovereign right of state to introduce a royalty
- Competitiveness
- Stability
- Predictability
- Responsiveness to changes in commodity cycles
- Reducing impact on costs, cut-off grades and life of mines
- Ease of administration
- Automaticity of relief to marginals/start-up operations
- Ring fencing proceeds for sustainable development

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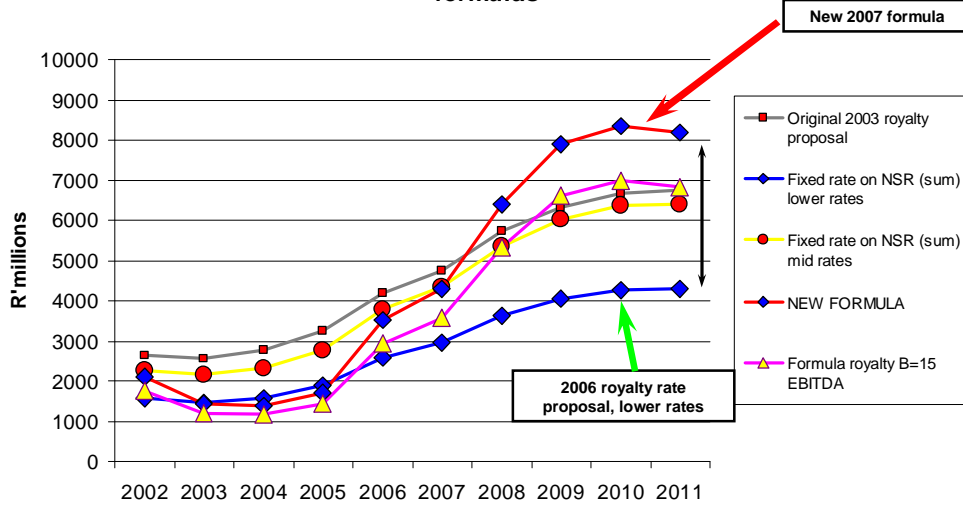


The Formula requires adjustment:

- The formula approach is supported by the Chamber.
- However, the specifics of the formula were based on data for the period 2002 to 2006, which may have inadvertently captured a period of time which is not fully reflective of the overall commodity cycle.
 - The 2002-2006 data captures a period where the rand exchange rate appreciated by nearly 50% against the US\$ and resulted in a commodity bear market for South African miners.
 - The Chamber has collated data for the top 5 minerals by value (PGMs, coal, gold, iron ore & diamonds) for the 10-year period 2002 to 2011 to get a more balanced look at the troughs & peaks in the rand commodity cycle.
 - In the period 2007 to 2011, top 5 minerals pay substantially higher rates than originally envisaged, which will severely affect cash flows, investment & the competitiveness of the sector.
- To provide a more balanced formula, COM suggests B factor needs to be changed and serious consideration be given to taking off capex

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Top 5 Minerals royalty sums payable per year based on different formulas



The 2006 fixed rate proposal, using the lower rates, was considered as the option by the Chamber because all the gold and PGMs mined in SA are already refined so a 1.5% rate for gold and a 3% rate for PGMs would have applied.

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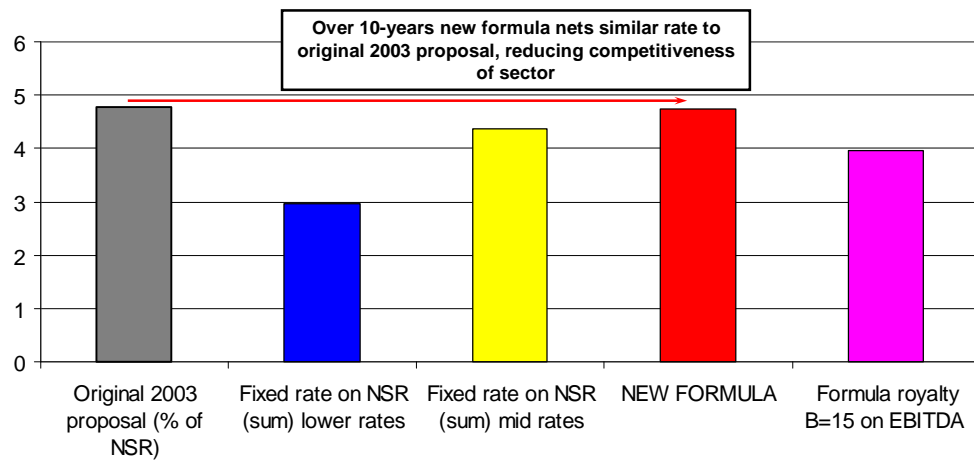
The international trends in Royalty rates:

“Although NSR rates as high as 5% have been noted in the past, values in more recent years tend to range from 1 to 3 percent of net smelter revenues”

Professor James Otto, World Bank Mining Royalties Study, 2006

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Royalties payable by the top 5 minerals, based on the 2006 fixed rate proposals versus the 2007 formula proposal, weighted average rate as % of NSR for the period 2002 to 2011



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Separation of Mining from Refining

The Treasury has stated on several occasions that the royalty applies to the *mineral resource extractor*, and that their intention is not to levy the royalty on the value created by the further smelting and refining of minerals into higher value products. In essence, the 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.

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The new formula presents key challenge to SA's gold sector

- In 2007 South African gold production was some 260 tons, roughly a quarter of the production "Everest" of 1000 tons achieved in 1970.
- The SA gold mining sector is mature and much of the remaining ore resources are deep, requiring significant capex and long term certainty from a planning perspective.
- Preserving and extending the life of the sector have important ramifications for employment, value creation and export earning for South Africa.
- The new royalty proposal will result in the gold sector paying 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. This could significantly affect the ability of the sector to generate cash flows for reinvestment.
- 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.

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The double royalty issue requires resolution:

- 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.

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Ring-fencing royalty proceeds for investment in sustainable development:

- 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.

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A2 PRE-MPRDA TAILINGS AND MINE DUMPS (WRITTEN SUBMISSIONS, PARA A2.3)

m CLAUSES IN BILL

2(1) and definitions of “extractor”, “mineral resource”, and “mineral resource right” in clause 1

m THE ISSUE

(1) Royalty is a State resource rent
National Treasury Slides 7 and 8

- Material mined from the earth is owned by the holder of the right to mine ¹ not by the State

¹ **De Beers Consolidated Mines Ltd v Mondira Pula Diamonds CC & Others, unreported NCD Case 496/04, para 25:**

“I therefore have no hesitation in coming to the conclusion that the Stadium Dump is made up exclusively of material, debris and tailings emanating from the Applicant’s mines and which therefore belonged to the Applicant.”

De Beers Consolidated Mines Ltd v Ataqua Mining (Pty) Ltd & Others, unreported OPD Case 3215/06, para 68(xi) and (xii):

“The diamonds in the ore were severed from the mother rock. Then the ore became a new object. That vested ownership in mineral title holder ... tailings are in a unique place in which minerals can be found after someone

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- Therefore, no justification for resource rent in respect of pre-MPRDA dumps

(2) Royalty will be payable by holders of mining rights
National Treasury Slide 55

- Currently, no mining right required for old dumps ²
- Therefore old dumps would not be subject to royalty
- However, MPRDA Amendment Bill B10B – 2007 proposes to amend the definitions of “residue stockpile” and “residue deposit” to include dumps produced under old order right. Thus, royalties would be payable on pre-MPRDA dumps

has taken them out of the earth and processed them to some extent. Unmined materials are different: they are in the ground ... tailings are different: the owner of the tailings has, while exercising a legal right, made later extraction by improved means possible.”

Trojan Exploration Co (Pty) Ltd & Another v Rustenburg Platinum Mines Ltd & Others 1996(4) SA 499 (A) at 534 F-H:

“... when a cession of mineral rights is effected, both the cedent and cessionary intend that the transfer of the rights will ultimately result in the transfer of the ownership in the minerals to the cessionary, if and when the minerals are severed from the land ... a new movable res is then created which is the object of separate ownership.”

² **De Beers Consolidated Mines Ltd v Ataqua (supra), para 68 and para 68(xii):**

“... [pre-MPRDA] tailings dumps ... are not subject to control by the MPRDA ... it is not part of the heritage to which section 3(1) of the MPRDA refers.”

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- Therefore exemption from royalty on pre-MPRDA dumps is necessary

(3) State consideration has previously been paid on some pre-MPRDA dumps ⇒ Duplication

(4) Exemption from royalty would promote sustainability of development of pre-MPRDA dumps

m SUBMISSION

An express exemption should be provided in respect of pre-MPRDA dumps.

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A3 POST-MPRDA TAILINGS, MINE DUMPS AND STOCKPILES SUBMISSIONS, PARAS A2.1, A2.2, A2.4)

m CLAUSES IN BILL

2(1) and the definitions of "*extractor*", "*mineral resource*", and "*mineral resource right*", in clause 1

m THE ISSUE

- Royalties are payable on post-MPRDA dumps.
National Treasury Slide 55
- Sale of tailings, mine dumps or stockpiles as a whole (whether sale of going concern or otherwise) prematurely triggers "transfer" and hence royalty payment on arms length value at deemed readily saleable condition

m SUBMISSION

Shift royalty liability to the acquirer of the tailings, dumps or stockpiles

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A4 COMMUNITY ROYALTIES (SUBMISSIONS, PARA A4.3)

m CLAUSES IN BILL

None

m THE ISSUE

- Community royalties are perpetuated in item 11 in schedule II MPRDA
National Treasury Slide 5 and 56
- No set-off of Community Royalties against State Royalties
è Duplication
National Treasury Slide 6
- Constitutional inequality per s9, Constitution, 1996 : private lessor #community lessor
- Canadian example in National Treasury slide 6 incorrectly contrasts Canada with SA:

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ÿ multiplicity of royalties # only one royalty

ÿ pages 124 – 125 of World Bank book : examples of private royalty:

- ∨ transfer or letting of right
- ∨ land use consideration to landowner

ÿ Applies also to SA:

- ∨ mining rights transferable or lettable (s11 MPRDA; Mining Titles Registration Act, 1967)
- ∨ nothing preventing land use royalty consideration to landowner

ÿ Distinguishing feature in SA: pre-existing community royalties perpetuated by item 11 # non-perpetuation of other pre-existing private royalties

ÿ Notable Canadian exception regarding collection by Government of royalties for aboriginal groups è akin to SA Community royalties

- Conversion of community royalties to equity:

National Treasury Media Statement, Page 3

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- ÿ does not remove duplication
- ÿ may not be achievable in practice

m SUBMISSION

Community Royalties should be set off against State Royalties

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**A5 FISCAL GUARANTEE (SUBMISSIONS PARAS A6, A6.1, A6.2
AND COMMENTARY BY PROF T WÄLDE)**

m CLAUSES IN BILL

13 and 14

National Treasury Slides 43, 44 and 45

m THE ISSUE

- Reason for fiscal guarantee agreements: long-term stability and certainty due to high risk, high capital, price volatility, and area dependence

National Treasury Slide 43

- Balancing of State sovereignty with attraction of mineral and petroleum investment
- Nevertheless, perceived vulnerability to legislative change overriding both law and fiscal guarantee agreement: domestic courts bound by domestic legislative change
- Example: fiscal guarantee provisions in petroleum OP26 mining

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leases, prospecting leases and prospecting subleases, nevertheless overridden by MPRDA è international petroleum companies invoked provisions for international arbitration and international law è s61 and schedule 3, Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 and s26B and 10th schedule, Income Tax Act, 1962 (item 8 in which empowers conclusion of stabilisation agreements) (all inserted by Revenue Laws Amendment Act, 2006)

Dale et al, South African Mineral and Petroleum Law,
Pages sch II – 90 -111 particularly 91 and 102

- Financial guarantee agreements are more attractive to investors if governed by domestic law applied in accordance with accepted rules of international law and the practices of the international mining and petroleum industry and if subject to international arbitration
- Need for authorising provision in Bill that fiscal guarantee agreements contain such provisions

Wälde and Ndi, Stabilising International Investment Commitments :
International Law versus Contract Interpretation 31 Tex. Intl L. J. 216 at
248 – 249, Para VII ("Choice and Conflict Of Law")

- Additionally, fiscal guarantee agreements would be more attractive to investors if rights acquired thereby enjoy protection of property in clause 25, constitution, 1996

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m SUBMISSIONS

- That provision be made for fiscal guarantee agreements at the election of the extractor to be governed by international law and to be subject to international arbitration
- That it be expressly provided that the rights acquired in terms of fiscal guarantee agreements constitute property as contemplated in s25, Constitution, 1996 ³

³ Suggested clauses

"(9) Any agreement described in subsection (1) shall, should the extractor so require, include provisions that:

- (a) *it will be governed by the laws of South Africa applied in accordance with accepted rules of international law and with the practices of the international mining or petroleum industry depending on whether the agreement relates to minerals or to petroleum;*
 - (b) *any dispute in relation thereto or in terms thereof:*
 - (i) *will be decided in accordance with such rules of law as may be agreed by the parties and in the absence of such agreement will be decided in accordance with subsection (9)(a); and*
 - (ii) *will be subject to the jurisdiction of a South African court of competent jurisdiction, of national or international arbitral tribunals, of mediation, of expert determination, or a combination of the foregoing, as the extractor may elect at the time of the dispute.*
- (10) *Notwithstanding anything to the contrary, and insofar as this is not already so by operation of law, the rights acquired by the extractor in terms of an agreement described in subsection (1) shall be deemed to constitute property for purposes of section 25 of the Constitution of the Republic of South Africa, 1996."*

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B. SECONDARY MAIN ISSUES

B1 JOINT VENTURES

B2 PETROLEUM INCENTIVES

B3 LEASE OF STATE'S INTEREST IN PRECIOUS STONES MINES

B4 PREVIOUS STATE CONSIDERATION

B5 EXEMPTION FOR RESEARCH, MARKETING AND SIMILAR PURPOSES

B6 SET-OFF OF EXPORT DUTY

B7 OTHER TAXATION LAWS

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B1 JOINT VENTURES (SUBMISSIONS, PARA A4.1)

m CLAUSES IN BILL

4(1) and definition of "*transfer*" in clause 1

m THE ISSUE

- In joint ventures (or partnerships), transfers occur as between joint venturers (or partners), thus triggering royalty prematurely
- Joint ventures (or partnerships) are not expressly recognised as one person for purposes of the Bill (#VAT Act, 1991)

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m SUBMISSION

Joint ventures (or partnerships) should be regarded as one person for purposes of the Bill⁴

⁴ **Suggested wording**

- That the definition of "person" in clause 1 include reference, as does VAT Act, 1991, to:

"any body of persons corporate or unincorporated"

- That the definition of "transfer" in clause 1 contain the following additional wording:

"but does not include any such disposal of the mineral resource by a partner or joint venturer to another partner or joint venturer, but which latter partner or joint venturer shall thereupon be deemed to be the extractor of such mineral or petroleum"

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B2 PETROLEUM INCENTIVES (SUBMISSIONS, PARA A4.2)

m CLAUSES IN BILL

10 (exemption for sampling)

m THE ISSUE

- Exploration rights not exempt

National Treasury Slide 40

- Production right incentive (if holder the discoverer) not carried forward

Bill 2003, clause 11(2)

Bill 2006, clause 10(2)

m SUBMISSION

- Exploration rights should be exempt
- Production rights held by discoverer should enjoy incentives proposed in previous drafts

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**B3 LEASE OF STATE'S INTEREST IN PRECIOUS STONES MINES
(SUBMISSIONS PARA A4.4)**

m CLAUSES IN BILL

None

m THE ISSUE

- Item 9(7) in schedule II MPRDA: leases of State's share continue on existing terms and conditions
National Treasury Slide 56
- Existing terms and conditions include lease consideration perpetuated by s47(1)(d), Minerals Act, 1991:

ÿ Private precious stones rights:

- per State: lease payments continued
- per Industry: lease payments ceased on 31 December 1993

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ÿ State precious stones rights : lease payments continued

- No set-off of perpetuated lease consideration against State Royalties
è Duplication

m SUBMISSION

Lease consideration should be set off against State Royalties

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B4 PREVIOUS STATE CONSIDERATION (SUBMISSIONS PARA A4.5)

m CLAUSES IN BILL

16 (commencement)

m THE ISSUE

- Clause 16: Act applies to minerals transferred on or after 1 May 2009, irrespective of date of mining
- Conversions to new order rights could occur prior to 1 May 2009
- Per s71 and schedule 3, Taxation Laws Amendment Act, 2004, previous State consideration continues until 30 April 2009
National Treasury Slide 56
- Per s47(1)(d), Minerals Act, 1991, State consideration continued where State was the mineral right holder
- Some previous State consideration was based not on profits, but rather on percentage of cost, rand per ton, etc., i.e. not

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- dependent on disposal
- From date of conversion (prior to 1 May 2009) to 30 April 2009, previous State consideration still payable; from 1 May 2009 new State Royalty payable, on same mineral ÷ Duplication

m SUBMISSION

- Set-off of previously paid State consideration against State Royalties
- Amendment of Clause 16 to refer to minerals "mined and transferred" on or after 1 May 2009

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B5 EXEMPTION FOR RESEARCH, MARKETING AND SIMILAR PURPOSES (SUBMISSIONS PARA A4.6)

m CLAUSES IN BILL

None

m THE ISSUE

On p12 of the Chamber's comments on the second draft, 2006, it requested an exemption on transfers of minerals for research, marketing or similar purposes

m SUBMISSION

Exemption for minerals transferred for research, marketing or similar purposes

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B6 SET-OFF OF EXPORT DUTY (SUBMISSIONS PARA A4.7)

m CLAUSES IN BILL

None

m THE ISSUE

On p15, para (a), of its submissions on the second draft, 2006, the Chamber requested set-off against State Royalties of payments of export duties, failing which a duplication results

m SUBMISSION

Set-off of Export Duty against State Royalties

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B7 OTHER TAXATION LAWS (SUBMISSIONS PARAS A7, A7.1 AND A7.2)

m CLAUSES IN BILL

None

m THE ISSUE

- Royalty should be deductible expense in calculation of income tax
National Treasury Media Statement, First Draft, 2003
- Royalty should be zero-rated for value-added tax

m SUBMISSION

- Income Tax Act, 1962 be amended to provide for royalties as deductible expense
- Value-Added Tax Act, 1991 be amended to apply zero-rate of VAT to royalties

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C. CLAUSE BY CLAUSE COMMENTS

In what follows, only drafting suggestions not flowing from the comments in Parts A and B above, will be mentioned

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C1 CLAUSE 1 : DEFINITIONS

C1.1 "*Extractor*" and "*Mineral Resource Right*" (submissions paras B1.1, B1.1.1, B1.1.2)

- Lessees and sublessees of rights
- Undivided shares in rights

C1.2 "*Transfer*" and "*Mineral Resource*" (paras B1.2.4 and B1.2.5)

- Restriction to voluntary transfers
- "Mineral" rather than mineral "resource"

C2 CLAUSE 2 : CHARGING PROVISION

C2.1 National Revenue Fund # Special Socio-Economic Development Funds (submissions para B2)

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C2.2 Charging elements to exclude VAT (submissions para B3)

C3 CLAUSE 3 : ROYALTY RATE

Roll-over of excess expenditure into future assessment periods (submissions para B4)

C4 CLAUSE 5 : ALLOWABLE DEDUCTIONS

- All transportation expenditure on surface to rank for deduction (submissions para B8.2)
- Definition of "*processing*" should be aligned with that in s1 MPRDA (submissions para B10)

C5 CLAUSE 7 : RIGHT OFF FOR BAD DEBTS

The limitation to the immediately preceding assessment period should be removed (submissions paras B12 and B13)

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C6 CLAUSE 9 : (SMALL MINING BUSINESS RELIEF) AND CLAUSE 10(EXEMPTION FOR SAMPLING)

- Amounts exclusive of VAT (submissions B14 and B15.2)
- Amounts capable of inflationary increase by Minister (submissions B14 and B15.2)

C7 CLAUSE 11 : (ARMS LENGTH VALUE)

- Values should be exclusive of VAT (submissions para 16)
- Normal discounts should be allowable (submissions para 17.1)
- In options or rights of first refusal, value should be as at grant of option or of right of first refusal (submissions paras 17.2 and B5)

C8 CLAUSE 12 : (GENERAL ANTI-AVOIDANCE RULE)

Presumption (reversal of onus) potentially offends rule of law in s1(c), Constitution, 1996 (submissions para B18)

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C9 CLAUSE 13 : FISCAL GUARANTEE : DURATION

- Royalty determination where only some rights are subject to guarantee (submissions para B19)
- Express empowerment of Minister to conclude agreement (submissions para B20.1)
- Express obligation of Minister to conclude agreement (submissions para B20.2)
- Clarification of date of grant of application (submissions para B21.1)
- Extension of one year period (submissions para B21.2)
- Disposal to include letting and subletting (submissions para B22.1)
- Freedom of assignment relating to mining rights and production rights (submissions para B22.2)
- Termination as to some rights (submissions para B24)

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- Technical amendments relating to substitutions of rights; to retention permits, reconnaissance permissions, reconnaissance permits and technical co-operation permits; and to assignees (submissions paras B25, B26 & B27)
- Development of model stability agreement (submissions para B28)

C10 CLAUSE 14 : FISCAL GUARANTEE: TERMS AND CONDITIONS

- Amendments relating to whole Act, not only to parts I, II and III (submissions para B30.1)
- Inclusion of other laws (submissions para B30.2)
- Inclusion of assignees (submissions para B30.3)
- All (not only material) adverse economic impacts to rank (submissions para B32.1)
- Compensation to relate to restoration of economic balance (submissions para B33.2)
- Non-affecting of legitimate transactions (submissions para B34)

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C11 CLAUSE 15 : ACT BINDING ON STATE AND APPLICATION OF OTHER LAWS

Clause 15 to be subject to clause 14 (submissions para B35)

C12 CLAUSE 16 : SHORT TITLE AND COMMENCEMENT

Clarification of promulgation date (submissions para B36.1)

C13 ADMINISTRATION BILL, CLAUSE 4 : RETURNS AND ASSESSMENT PERIODS

- Returns within sixty days (submissions para B38.1)
- Power to extend period for returns (submissions para B38.2)
- Express power to vary length of assessment periods (submissions para B38.3)
- Opportunity to comment on the rules (submissions para 38.4)

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C14 ADMINISTRATION BILL, CLAUSE 15 : APPLICABILITY OF INCOME TAX ACT

Express provision that Income Tax Act to apply to exclusion of MPRDA (submissions para B40.1)

C15 ADMINISTRATION BILL, CLAUSE 16, RULES

Opportunity to comment on the rules (submissions para B42)

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A3 INITIAL READILY SALEABLE CONDITION, AND USE IN MANUFACTURING PROCESSES (SUBMISSIONS PARAS A3.1 A3.2, A3.3, AND A5)

m CLAUSES IN BILL

5(1)(B), 6(1), 6(3) AND 11

m THE ISSUE

- Determination of "initial readily saleable condition" and of "manufacturing processes", left to regulation

National Treasury Slides 35 and 37

- Regulations not available
- Where initially readily saleable condition is determined and what manufacturing processes are determined, have large impact on royalty
- Initial readily saleable condition has impact on arms length value

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m SUBMISSION

- These aspects should be dealt with by schedule to the Act, not by regulation
 - Chamber requests opportunity to comment on such regulations or schedules
-