

REPUBLIC OF SOUTH AFRICA

**DRAFT MINERAL AND PETROLEUM RESOURCES
ROYALTY BILL**

*(As introduced in the National Assembly (proposed money Bill))
(The English text is the official text of the Bill)*

(Minister of Finance of Finance)

06 December 2007

[B ?—2007]

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BILL

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

BE IT ENACTED by the Parliament of the Republic of South Africa, as follows:—

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Part I

Interpretation

Definitions

1. (1) In this Act, unless the context indicates otherwise—
 - “**aggregate gross sales**” means aggregate gross sales as described in section 4;
 - “**allowable deductions**” means aggregate expenditures as described in section 5;
 - “**extractor**” means a person that wins or recovers a mineral resource (or that has a mineral resource won or recovered on that person’s behalf) in respect of that person’s mineral resource right;
 - “**mineral resource**” means a mineral or petroleum as defined in section 1 of the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002), including any property wholly or partly recovered, derived, or consisting of that mineral or petroleum;
 - “**mineral resource right**” means a prospecting right or retention permit, exploration right, mining right or permit, or production right granted (or should have been granted) under the Mineral and Petroleum Resource Development Act, 2002 (Act No. 28 of 2002);
 - “**person**” includes an insolvent estate, the estate of a deceased person, and any trust;
 - “**Republic**” means the territory of the Republic of South Africa, including the territorial waters, the contiguous zone and the continental shelf referred to respectively in sections 4, 5, and 8 of the Maritime Zones Act, 1994 (Act No. 37 of 1994);
 - “**royalty**” means the royalty imposed under this Act;
 - “**Administration Act**” means the Mineral and Petroleum Resources Royalty Administration Act, 2007 (Act No. ? of 2007); and
 - “**transfer**”, in relation to an extractor, means the—
 - (a) initial disposal of beneficial ownership by that extractor of that extractor’s mineral resource; or
 - (b) theft or destruction of that extractor’s mineral resource.
- (2) Unless the context indicates otherwise, a word or expression to which a meaning has been assigned in the Administration Act bears the meaning so assigned for purposes of this Act.

Part II

Basic royalty regime

Charging provision

2. (1) An extractor must pay a royalty for the benefit of the National Revenue Fund as described in subsection (2).

(2) The royalty payable during an assessment period is determined by multiplying the royalty rate described in section 3 for that assessment period by the amount by which the aggregate gross sales for that assessment period exceeds the amount of allowable deductions for that assessment period.

Royalty rate

3. (1) The royalty rate equals—

$$\frac{\text{earnings before interest, taxes, depreciation and amortization}}{\text{aggregate gross sales for the assessment period}} \times 100 \times 12.5$$

(2) A negative rate under subsection (1) is deemed to be a rate of zero.

(3) For purposes of subsection (1), “**earnings before interest, taxes, depreciation and amortisation**” means the earnings of the extractor arising during an assessment period before taking into account interest, tax, depreciation, and amortisation in respect of those earnings as measured for financial reporting purposes, but only to the extent those earnings are attributable to mineral resources won or recovered by the extractor (or on behalf of the extractor).

Aggregate gross sales

4. (1) Aggregate gross sales equal the aggregate of amounts received by or accrued to the extractor for mineral resources transferred during an assessment period.

(2) For purposes of subsection (1), the aggregate amounts received or accrued include—

- (a) the face value reduction or discharge of an outstanding obligation;
- (b) the fair market value of property, financial assistance, service or other benefit;
- (c) an amount received by way of insurance, indemnity or guarantee; and
- (d) any premium paid in respect of an option on a mineral resource.

(3) To the extent an amount of aggregate gross sales received or accrued is not quantifiable, that amount is deemed received or accrued in the assessment period the amount becomes quantifiable.

Allowable deductions

5. (1) Allowable deductions equal the aggregate of expenditures incurred by the extractor during an assessment period in respect of—

- (a) the aggregate amount received by or accrued to the extractor for the extractor's mineral resources taken into account as aggregate gross sales during that assessment period;
- (b) processing a mineral resource which is transferred during that assessment period beyond its initial readily saleable condition as associated with beneficiation as prescribed by the Minister of Finance by way of regulation; and
- (c) the transportation (including throughput) of a mineral resource which is transferred during that assessment period to the extent the transportation expenditures arise after processing the mineral resource beyond its initial readily saleable condition as described in paragraph (b).

(2) Notwithstanding subsection (1), an extractor may not deduct—

- (a) stewardship costs;
- (b) management fees and management related service fees;
- (c) general overhead and administration costs;
- (d) marketing;
- (e) depreciation charges; and
- (f) interest charges.

(3) To the extent an amount of allowable deductions in respect of an expenditure incurred is not quantifiable, that amount is deemed incurred in the assessment period the amount becomes quantifiable.

(4) For purposes of this section, “**processing**” means all forms of screening, washing, sintering, sorting, smelting, and refining performed within the Republic for purposes of recovering or deriving (in whole or in part) any property consisting of that mineral resource.

Deemed amounts and transfers

6. (1) If a mineral resource is transferred before the mineral resource is in its readily saleable condition as described in section 5(1)(b), the amount received or accrued in respect of the transfer must be deemed to be equal to the arm's length value of the mineral resource for purposes of section 4.

(2) If an extractor exports a mineral resource from the Republic without transfer, the mineral resource is deemed—

- (a) transferred on the date of export of the mineral resource; and

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- (b) transferred for an amount received or accrued equal to the arm's length value of the mineral resource on the date described in paragraph (a).
- (3) If an extractor uses a mineral resource in a process of manufacture as determined by the Minister of Finance by way of regulation, the mineral resource is deemed—
 - (a) transferred on the date immediately preceding the date on which the process of manufacture commences; and
 - (b) transferred for an amount received or accrued equal to the arm's length value of the mineral resource on the date described in paragraph (a).

Write off for bad debts

7. (1) An extractor must reduce the amount of royalty payable for an assessment period by an amount equal to so much of any royalty paid or payable in the assessment period or prior assessment period as is calculated with reference to aggregate gross sales that are written off as bad debts during that assessment period.

(2) If during an assessment period the amount of the reduction described in subsection (1) exceeds the royalty payable described in that subsection, the excess amount is deemed to arise; and reduce the amount of royalty payable, during the immediately succeeding assessment period.

(3) If an extractor writes off as a bad debt an amount of aggregate gross sales in relation to a mineral resource as described in this section and that mineral resource is subsequently reacquired by that extractor, the reacquired mineral resource is deemed not to have been initially transferred by the extractor.

Currency translation

8. An amount of—

- (a) aggregate gross sales received by or accrued to; or
- (b) allowable deductions in respect of an expenditure incurred by,

an extractor during an assessment period in a currency other than the currency of the Republic must be translated to the currency of the Republic by applying the spot rate on the date on which the amount was received or accrued or the expenditure was incurred.

Part III

Reliefs

Small mining business relief

- 9.** (1) An extractor is not liable for the royalty otherwise imposed during an assessment period if—
- (a) the extractor does not have aggregate gross sales that exceed R5 million during the assessment period;
 - (b) the royalty that would otherwise be imposed on the extractor for the assessment period would not exceed R50 000;
 - (c) the extractor is a resident as defined in section 1 of the Income Tax Act (Act No. 58 of 1962) throughout the assessment period; and
 - (d) the extractor is duly registered with the Commissioner as described in section 2 of the Administration Act throughout the assessment period.
- (2) Notwithstanding subsection (1), an extractor is liable to pay the royalty during an assessment period if—
- (a) the extractor, at any time during the assessment period, is entitled to participate (directly or indirectly) in more than 50 per cent of the profits of any other extractor;
 - (b) any other extractor is entitled, at any time during the assessment period, to participate (directly or indirectly) in more than 50 per cent of the profits of the extractor; or
 - (c) any other person is entitled, at any time during the assessment period, to participate (directly or indirectly) in more than 50 per cent of the profits of the extractor and more than 50 per cent of the profits of any other extractor.

Exemption for sampling

- 10.** An extractor that transfers mineral resources that are won or recovered for sampling purposes pursuant to a prospecting right as defined in section 1 of the Mineral and Petroleum Resources Development Act is not liable for the royalty otherwise imposed in respect of the transfer of the mineral resources if the aggregate gross sales of the mineral resources do not exceed R20 000.

Part IV

Anti-avoidance rules

Arm's length value

11. (1) To the extent earnings taken into account by an extractor under section 3 differ from earnings that the extractor should have taken into account had those earnings been determined at arm's length values, the Commissioner may adjust the earnings to reflect their arm's length value for purposes of section 3.

(2) If an amount of aggregate gross sales received or accrued in respect of a mineral resource is less than the arm's length value of the mineral resource on the date of its transfer, the Commissioner may adjust the amount received or accrued to reflect the arm's length value of the mineral resource for purposes of section 4.

(3) If an amount of allowable deductions in respect of an expenditure incurred by an extractor exceeds the amount that would have been the arm's length value of the expenditure, the Commissioner may adjust the expenditure to reflect the arm's length value of the expenditure for purposes of section 5.

(4) For purposes of this Act, "**arm's length value**" means the open market value at which two or more independent persons acting in good faith (without regard to the royalty) would freely agree to transact in the ordinary course of business so that no conflict of interest exists in the transaction and the transaction occurs without any special favour, concession or advantage to any person.

General anti-avoidance rule

12. (1) Notwithstanding anything in this Act, if the Commissioner is satisfied that a transfer, operation, scheme or understanding (whether enforceable or not and even if entered into or carried out before the commencement of this Act), including any steps thereto—

- (a) has been entered into or carried out in manner that is not normally employed for bona fide businesses purposes other than the obtaining of a royalty benefit;
- (b) has created rights or obligations that are not normally created between persons dealing at arm's length; or
- (c) has been entered into or carried out solely or mainly for purposes of obtaining a royalty benefit,

the Commissioner may determine the royalty, penalties, and interest imposed by this Act and the Administration Act (and the amount thereof) as if the transfer, operation, scheme, or understanding had not been entered into or carried out, or in a manner that the Commissioner in the circumstances deems appropriate for the prevention or diminution of the State royalty benefit.

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(2) A decision of the Commissioner under subsection (1) is subject to objection and appeal as described in section 15(1)(d) of the Administration Act, and whenever in proceedings relating thereto it is proved that the relevant transfer, operation, scheme, or understanding results in (or would result in) a royalty benefit, it is presumed that the transfer, operation, scheme, or understanding was entered into or carried out solely or mainly for purposes of obtaining a royalty benefit until proof is provided to the contrary.

(3) For purposes of this section, “**royalty benefit**” means a reduction, avoidance or postponement of the royalty payable under section 2.

Part V

Fiscal guarantee

Duration

13. (1) The Minister of Finance may conclude a binding agreement with an extractor—
- (a) in respect of the extractor’s mineral resource right; or
 - (b) in anticipation of the extractor acquiring a mineral resource right,

that guarantees the terms and conditions described in section 14 will apply in respect of the right for as long as the extractor holds the right.

(2) A binding agreement relating to the anticipated transfer of a mineral resource described in subsection (1)(b) has no force and effect if a mineral resource right is not granted in respect of that mineral within one year after the Minister of Finance concludes the agreement.

(3) If an extractor disposes of a prospecting or exploration right granted under the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) to another person, and that right is subject to a binding agreement described in subsection (1) on the date of the disposal, the extractor may assign all of the rights held by the extractor under the agreement to the other person.

(4) If an extractor disposes of a mining or production right granted under the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) to another person, and that right is subject to a binding agreement described in subsection (1) on the date of the disposal, the extractor may assign all of the rights held by the extractor under the agreement to the other person only if both the extractor and the other person fall within the same group of companies as defined in section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962) on the date of the disposal.

(5) If an extractor is party to a binding agreement described in subsection (1), the terms and conditions described in section 14 will apply to all participating interests subsequently

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held by the extractor under the mineral resource right in respect of the agreement for as long as the extractor holds that mineral resource right in respect of that agreement.

(6) The extractor that concludes a binding agreement described in subsection (1) may unilaterally terminate the agreement at any time with effect from the day after the last day of the assessment period during which the extractor terminated the agreement.

(7) For purposes this Part,

(a) a prospecting right, a renewal of the prospecting right and an initial mining right converted from any prospecting right or renewal thereof held by an extractor are all deemed to be one and the same mineral resource right in the hands of the extractor to the extent those rights relate to the same geographical area; and

(b) an exploration right, a renewal of the exploration right and an initial production right converted from an exploration right or renewal thereof held by an extractor are all deemed to be one and the same mineral resource right in the hands of the extractor to the extent those rights relate to the same geographical area.

(8) For purposes of this Part—

(a) “**mineral resource right**” does not include a retention permit or a mining permit granted under the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002); and

(b) “**Minister of Finance**” means the Minister of Finance, the Director-General of the National Treasury (if so delegated by the Minister of Finance) or to any other person within the National Treasury (if so delegated by the Director-General after having been delegated by the Minister of Finance).

Terms and conditions

14. (1) Legislation amending Parts I, II and III of this Act will have no force and effect in respect of the transfer of a mineral resource by an extractor that is party to an agreement described in section 13(1) to the extent those amendments result in the extractor being liable to pay an amount in terms of this Act which is greater than an amount that would have been payable in the absence of the amendments.

(2) Legislation directly or indirectly imposing a charge on the transfer of mineral resources in addition to (or in lieu of) this Act will have no force and effect in respect of the transfer of a mineral resource by an extractor that is party to an agreement described in section 13(1), unless that charge is an export levy that can be avoided by beneficiating the mineral resource within the Republic.

(3) If non-observance by the State occurs after the conclusion of a binding agreement described in subsection (1) and the non-observance has a material adverse economic

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impact on the determination of the royalty payable by the extractor that is party to the agreement, the extractor is entitled to compensation for the loss of market value caused by that non-observance (and interest at the prescribed rate calculated on the compensation from the date of non-compliance) or to a remedy that otherwise eliminates the full impact of the non-observance to the same extent.

(4) Notwithstanding subsection (1), Parts I, II and III may be amended for purposes of preventing the avoidance of their principles and intent.

Part VI

Closing items

Act binding on State and application of other laws

15. This Act will bind the State, and a provision in any other law will not be construed as applying or referring to the royalty unless the royalty is specifically mentioned in the provision.

Short title and commencement

16. This Act will be titled the Mineral and Petroleum Resources Royalty Act, 2007, and will come into operation in respect of all mineral resources transferred on or after 1 May 2009.

REPUBLIC OF SOUTH AFRICA

(DRAFT) EXPLANATORY MEMORANDUM

FOR

**THE MINERAL AND PETROLEUM RESOURCES
ROYALTY BILL, 2007**

06 December 2007

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**EXPLANATORY MEMORANDUM FOR THE MINERAL AND PETROLUUM
RESOURCES ROYALTY BILL, 2007**

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BACKGROUND

Section 73(2) of the Constitution requires that only the Minister of Finance may introduce money bills. The Bill described in this explanatory memorandum is required for purposes of giving effect to the money related provisions of the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) (hereinafter referred to as the “MPRDA”).

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SECTION-BY-SECTION EXPLANATION

Part I: Definitions

Most of the definitions contained in this section are self-explanatory. However, the definitions of “extractor”, “mineral resource”, “mineral resource right” and “transfer” are worthy of note.

Firstly, the royalty applies only in respect of geographical areas within the confines of a “mineral resource right.” The term “mineral resource right” covers geographical areas for which mineral and petroleum resource permits or rights are granted under the MPRDA (or for which permits or rights under the MPRDA should have been granted in the case of illegal operations). Mining activities outside South Africa (i.e. the Republic) do not fall within the scope of the royalty (even if conducted by South African persons).

Secondly, the royalty applies only to a person qualifying as an “extractor.” An extractor is a person that “wins or recovers” a mineral resource within a

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geographical area pursuant to the MPRDA as described above for that person's own benefit (or for the benefit of that person by another party). Contractors winning or recovering minerals on behalf of others fall outside the royalty regime.

Thirdly, the royalty applies only in respect of mineral resources. As stated above, a mineral resource must come from a geographical area within the potential ambit of the MPRDA. Moreover, mineral resources are defined to include minerals and petroleum as defined in the MPRDA. Mineral resources also cover property wholly or partly recovered, derived or consisting of minerals and petroleum as so defined. Stated differently, minerals or petroleum will not lose their technical "mineral resource" status merely because these items are processed, beneficiated or otherwise transformed.

Example 1. Facts. Company X owns all the shares of Company Y and Company Z. Company Y operates a platinum mine in South Africa subject to the MPRDA. Company Z operates a platinum mine in Zimbabwe. Company X operates a platinum smelter and refinery. Company Y and Company Z each sell platinum for R50 000 to Company X. Company X smelts and refines the platinum, followed by sale to unrelated parties for R90 000. Assume all sales prices are at arm's length.

Result. Company Y is a mineral extractor subject to the royalty on sale of the unprocessed platinum to Company Z at the R50 000 amount. Company Z is outside the royalty regime because the mine is not within the ambit of the MPRDA, and Company X is outside the royalty because Company X is not an extractor.

Example 2. Facts. The facts are the same, except that Company Y and Company Z have the platinum processed (i.e. smelted and refined on their behalf). Company Y and Company Z then sell directly to unrelated parties for R90 000.

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Result. Company Y is subject to the royalty (taking into account the R90 000 sales price) because Company Y won or recovered the mineral. The fact that the platinum may have been refined does not undercut the status of the platinum as a technical mineral resource. Company X is outside the royalty regime because Company X does not have beneficial ownership of the mineral. Company Z is outside the royalty regime because the platinum is not won or recovered from a geographical ambit of the MPRDA.

Lastly, the term “transfer” of a mineral resource acts as the trigger for the royalty. The term “transfer” applies to the initial disposal of beneficial ownership (as opposed to changes in mere title) in a mineral resource. Destructions or theft also act as a transfer (but only generate aggregate gross sales if compensation results via insurance or some other means).

PART II - BASIC ROYALTY REGIME

Charging provision: Section 2

Subsection 1 (general rule and use of funds)

This subsection operates as an introduction to the core charging provision in subsection 2. Under this subsection, a royalty is imposed on every extractor. As with other nationally imposed taxes, royalty revenues will be added to the general National Revenue Fund.

Subsection 2 (basic formula)

This subsection outlines the basic formula for the ad valorem royalty charge provided by this legislation. Under the formula, the royalty imposed equals the royalty rate multiplied by the “excess” of aggregate gross sales less allowable deductions. The charge applies per assessment period (i.e. per six months).

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Royalty rate: Section 3

Subsection 1 (royalty rate formula)

The royalty rate acts as a fluctuating rate that varies from assessment period to assessment period. This fluctuating rate essentially depends on the operating profit (technically referred to “earnings before interest, taxes, depreciation and amortisation”) directly associated with mineral resources transferred. The purpose of this fluctuating rate is to allow for a limited sharing of profit and loss by Government.

On a more technical level, the formula is based on the following ratio (per assessment period):

$$\frac{\text{earnings before interest, taxes, depreciation and amortisation}}{\text{aggregate gross sales}} \times 12,5 \times 100$$

Example. Facts. Company X, a mineral resource extractor, generates R50 million of net earnings (before taking into account expenditures relating to interest, taxes, depreciation and amortisation). Aggregate gross sales amount to R150 million.

Result. The royalty rate equals 2.67 per cent (R50 million / (R150 million x 12,5) x 100).

Subsection 2 (deemed nil royalty rate)

This subsection deems the royalty rate calculation to be nil if the calculation otherwise results in a negative Royalty rate. This situation would arise when operating costs exceeds gross mineral sales revenue.

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Subsection 3 (numerator)

Earnings before interest, taxes, depreciation and amortisation form the starting point for the numerator used in the royalty rate calculation. However, these earnings are more limited, being restricted to those earnings attributable to earnings associated with mineral resources won or recovered by the extractor (or on the extractor's behalf). These earnings can be associated with any aspect of mineral resource production, including extraction, recovery and processing. All aspects of the earnings calculation are measured in accordance with the extractor's accounting records used for financial reporting.

Aggregate Gross Sales: Section 4

Subsection 1 (general rule)

This subsection sets out the total inclusions that form the base for the royalty. Aggregate gross sales encompass all receipts and accruals associated with minerals transferred during the assessment period (even if those receipts and accruals arise outside the period).

Subsection 2 (specific inclusions)

Amounts received and accrued for purposes of the aggregate gross sales calculation should be interpreted broadly. By way of illustration, amounts received or accrued cover the full range of benefits obtained for mineral resources transferred, such as debt reductions or discharge, property or service barter consideration, payments by way of insurance and option premiums.

Subsection 3 (unquantified amounts)

Unquantified amounts do not form part of aggregate gross sales until becoming quantifiable. The net effect of this provision is to defer application of the royalty until the full facts are known.

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Example. Facts. On 1 June 2010, Company X sells beneficial ownership of 100 000 ounces of gold on a forward-basis. The selling price is dependent on future commodity prices as accepted on Commodity Exchange X once the gold is physically transferred (presumably six months from the date of sale).

Result. Even though beneficial ownership to the gold is transferred on 1 June 2010, no addition to aggregate gross sales occurs on this date. Instead, aggregate gross sales are only increased on the date of physical transfer (i.e. when the amounts effectively become quantifiable).

Allowable deductions: Section 5

Subsection 1 (allowable deductions)

This section permits a limited set of offsets (i.e. deductions) against the inclusion of aggregate gross sales used for the royalty calculation. The main purpose of this section is to provide relief for mineral extractors engaged in mineral beneficiation. More specifically, these offsets cover expenditures associated with mineral resources transferred during the assessment period to the extent these expenditures relate to certain forms of beneficiation or transportation subsequent to beneficiation. Beneficiation expenditure covered by this regime entail the processing of mineral resources beyond their initial readily saleable condition subject to the type of beneficiation activities as prescribed by the Minister by way of regulation. Transport (and throughput) will also be covered when arising after the just-described level of processing.

Example. Facts. Company X has a financial year that corresponds with the calendar year, thereby resulting in a January-to-June assessment period and a July-to-December assessment period. Company X extracts and recovers gold into dowry bars in June 2011. Company X smelts and refines gold in August 2011 (beneficiation

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activities prescribed by regulation), followed by the sale of refined gold bars in January 2012.

Result. The expenditures associated with smelting and refining will generate allowable deductions. These deductions are allowed in the January-to-June 2012 assessment period (i.e. when the minerals are transferred).

Subsection 2 (non-allowable deductions)

Allowable deductions only include direct expenditures associated with beneficiation. Hence, indirect expenditures are not deductible – stewardship, management fees and management-related service fees, general overhead and administration as well as marketing. Moreover, interest, depreciation and amortisation are similarly not deductible.

Subsection 3 (unquantified amounts)

Similar to aggregate gross sales, special rules apply for expenditures that cannot be quantified. More specifically, unquantified amounts do not form part of expenditures incurred until becoming quantifiable.

Subsection 4 (processing)

For the purpose of the Act, “processing” means all forms of screening, crushing, washing, sintering, recovery, sorting, smelting, refining performed in a mill, smelter, or refining within the Republic under a mineral resource right for purposes of recovery a mineral resource from mineral bearing substances.

Deemed gross sales value and transfer: Section 6

This section contains three deeming rules. The first two rules are designed to prevent avoidance. The third is designed to assist mining stakeholders.

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Subsection 1 (premature sales)

The first rule applies to the extent that a mineral resource extractor transfers a mineral resource before that mineral reaches its initial readily saleable condition. In these circumstances, the arm's length price of the transfer is deemed to equal the arm's length value of the mineral resource at its initial readily saleable condition. This rule prevents taxpayers from understating mineral values otherwise subject to royalty charges by short-cutting the normal value-added activities associated with the mineral.

Example. Facts. Company X extracts gold ore and crushes the gold ore into concentrate. Company X sells concentrates in June 2012 when the value of the total concentrates are R80 million. Gold is normally sold in South Africa by mineral extractors only when that gold is turned into dowry bars worth R120 million.

Result. The June 2012 transfer date remains the same. However, the mineral is deemed sold at R120 million (the dowry bar state) as opposed to the actual selling price of R80 million.

Subsection 2 (deemed transfer on export")

The second anti-avoidance rule triggers a deemed transfer on export even if that export is not accompanied by a legal change in title. This rule ensures that the royalty applies before mineral resources leave the country (i.e. before those mineral resources leave South Africa's (readily) enforceable administrative control). The deemed receipt or accrual occurs at the mineral resource's arm's length value on the date of export.

Example. Facts. UK Company has a head office in London and a mine in South Africa. The South African mining operations export mineral resources won from the South African mine to the United Kingdom. The head office later sells the mineral resources. The mineral resources have an arm's length value of R20 000 on the date of export and a value of R18 000 on date of sale.

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Result. The export of the mineral resource triggers a deemed disposal (i.e. transfer) event (with a R20 000 value). The subsequent sale by the UK Company from the home office is disregarded because the royalty applies only to the initial disposal of mineral resources (stated differently, the royalty should not apply twice to the same mineral resource).

Subsection 3 (deemed transfer upon manufacture)

The final rule empowers the Minister of Finance to trigger a deemed transfer event (by way of regulation) once a mineral initially becomes subject to a manufacturing process. For instance, this situation would arise when iron ore is converted to steel. This rule ensures that the royalty is not imposed on manufacturing or similar value-added processes involving advanced stages of beneficiation.

Example. Facts. Mineral Extractor wins, recovers and processes iron ore to the value of R100 000. Mineral Extractor then applies the refined iron ore to the steel making process. The steel will be sold at R300 000.

Result. Assuming the Minister issues a regulation creating a deemed transfer event, the royalty applies to the R100 000 iron ore value immediately before manufacture with subsequent events remaining wholly outside the royalty. Otherwise, the royalty will apply to the steel when sold.

Write-off for bad debts: Section 7

Subsection 1 (general rule)

This section provides relief for bad debt write-offs. This situation arises when a mineral resource extractor is subject to the royalty upon accrual of amounts associated with the transfer of a mineral resource but ultimately writes-off all

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anticipated accruals. This section essentially allows the mineral extractor to reduce the royalty on a going forward basis to reflect the bad debt write-off.

Example. Facts. Company X has a calendar-basis financial year. Company X sells mineral resources for R1 000 000 in May 2010 to an Unrelated Party. Unrelated Party is obligated to pay this amount in July 2010. The accrual triggers a royalty of R30 000 for the July-December 2010 assessment period. However Company X never receives the R1 000 000 amount as promised, resulting in Company X writing-off the amount in August 2015.

Result. The August 2015 write-off means that the initial R30 000 royalty should never have been paid. Therefore, Company X may reduce the royalty by R30 000 in respect of the July-December 2015 period.

Subsection 2 (unused royalty reduction)

Mineral extractors entitled to a royalty reduction due to a bad debt write-off are allowed to rollover the reduction to the extent the reduction exceeds the royalty payable for the assessment period. For instance, if the royalty rate reduction from a bad debt write-off is R30 000 and only R6 000 royalty is otherwise due for the assessment period, the remaining reduction of R24 000 effectively rolls over to the next assessment period.

Subsection 3 (re-acquisitions of unpaid mineral resources)

This section applies if a mineral resource extractor reacquires mineral resources after having written off amounts due as a bad debt. In this instance, the mineral resources re-acquired are deemed never to have been initially transferred. As a result, the re-transfer of the mineral resources will trigger a royalty charge (because the royalty applies only upon “initial” transfers).

Currency translations: Section 8

This section provides rules for receipts and accruals (see section 4) and expenditures (see section 5) when these amounts arise in the form of foreign (i.e. non-Rand) currency. In these conditions, amounts are translated to the Rand at the spot rate in which amounts are received or accrued (or in which expenditures are incurred).

Part III: Reliefs

Small mining business relief: Section 9

Subsection (1) (basic conditions)

As part of a broader initiative to encourage and support small business development, small business mining relief is provided which allows for complete exemption of the royalty otherwise payable. This relief contains four basic requirements; (a) a turnover limit, (b) a royalty liability limit, (c) a residency requirement, and (d) a registration requirement. Application of these requirements is determined assessment period-by-assessment period. More specifically—

- (a) *Turnover limit:* To be eligible for small business relief for a period, the mineral extractor must not have a turnover in excess of R5 million during the assessment period. This limit operates as a hard cut-off (i.e. a turnover even slightly above R5 million prevents application of any small business relief).

- (b) *Royalty liability limit:* The small business exemption applies only if the mineral extractor does not otherwise have a royalty liability of more than R50 000. Again, this rule operates as a hard cut-off (i.e. a potential royalty liability in excess of R50 000 prevents application of any small business relief).

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- (c) *Residency requirement:* Small mining business relief is only available to mineral extractors that are South African residents throughout the relevant assessment period.
- (d) *Registration requirement:* In order to qualify for small business relief, the mineral extractor has to be properly registered with the Commissioner throughout the assessment period. This subsection prevents a mineral extractor that operates illegally from qualifying for the small business relief.

Subsection (2) (anti-income splitting)

This subsection prevents income-splitting. Notwithstanding the above, small business relief does not apply if mineral extractors are connected via a more than 50 per cent profit participation. For instance, a mineral extractor is ineligible for relief if he or she owns more than a 50 per cent profit interest in another mineral extractor, or if a more than 50 per cent profit interest is owned in the first mineral extractor. In addition, mineral extractors are ineligible for relief if a more than 50 per cent profit interest is owned in them by other parties.

Example 1. Facts. Company X owns all the ordinary shares of Company Y. Company X and Company Y each generate a R1 million turnover for the assessment period (as well as have a royalty liability of R10 000 before taking into account small business relief). Both companies are incorporated and managed in South Africa. Both companies are properly registered with the South African Revenue Service pursuant to the Mineral and Petroleum Resources (Administration) Act.

Result. Neither Company X nor Company Y are eligible for small business relief because of Company X's 100 per cent shareholding in Company Y.

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Example 2. Facts. Individual owns all the shares of Company X, Company Y and Company Z. Individual is not a mineral extractor, but all three companies mineral extractors (i.e. have been granted mineral resource rights under the MPRDA). Company X, Company Y and Company Z each generate a R1 million turnover for the assessment period (as well as have a royalty liability of R10 000 before taking into account small business relief). All three companies are incorporated and managed in South Africa. All three companies are properly registered with the South African Revenue Service pursuant to the Mineral and Petroleum Resources (Administration) Act.

Result. None of the three companies are eligible for small business relief because the same individual owns a more than 50 per cent profits interest in each of the three companies.

Exemption for sampling: Section 10

A common mining industry practice is to transfer mineral resource samples, not for monetary gain, but merely for purposes of analysis. Assuming this form of transfer is permitted pursuant to Section 20 of the Mineral and Petroleum Resource and Development Act, (Act No. 28 of 2002), no royalty charge applies to the transfer of mineral resources for sampling purposes if two criteria are satisfied. Firstly, the mineral extractor must have won or recovered the sample mineral resource at issue pursuant to a prospecting right granted under section 17(1) of the MPRDA. Secondly, the aggregate gross sales for the mineral extractor must not exceed R20 000 for the assessment period.

Part IV: Anti-avoidance rules

Section 11: Arm's length value

The need for arm's length pricing rules is well-accepted among the various South African tax acts and well-established international tax practice. The royalty differs from certain tax acts only in terms of scope. Arm's length

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pricing for the royalty is required for all transactions, not just those transactions between connected persons. This widened scope is necessary because the royalty regime only impacts a small circle of stakeholders – as opposed to other tax acts which are more far reaching.

Subsection (1) (earnings)

Under the first set of arm's length pricing rules, the Commissioner is empowered to adjust and substitute earnings that are taken into account for the section 3 EBITDA formula. This adjustment can be directed at mineral gross sales and/or associated expenditures, both of which matter for the earnings calculation.

Subsection (2) (gross sales)

Under the second set of arm's length pricing rules, the Commissioner is empowered to adjust and substitute gross sales values (i.e., sales of minerals). This rule ensures that minerals are not transferred below appropriate arm's length prices so as to artificially undermine the royalty base.

Subsection (3) (allowable deductions)

Under the third set of arm's length pricing rules, the Commissioner is empowered to adjust and substitute expenditures taken into account for deductible processing associated with beneficiation and post-processing transportation. This rule ensures that these expenditures are not incurred above appropriate arm's length prices so as to artificially undermine the royalty base.

Subsection (4) (arm's length value definition)

This section lays out the internationally accepted definition of arm's length price. Transactions should only be respected if the parties involved strive to obtain the best advantage without consideration of the royalty. Otherwise, the

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South African government reserves the right to adjust and substitute artificial prices with an arm's length price (i.e., the fair and reasonable price that two independent persons would arrive at in an open market without regard to the royalty).

Section 12: General anti-avoidance rule

The general anti-avoidance rules are consistent with other South African tax instruments. This section is modelled after the general anti-avoidance rules contained in the Securities Transfer Tax and the Value-added Tax.

Subsection 1 (general rule)

This section provides the Commissioner with the power to target transfers, schemes (etc...) that inappropriately undermine the application of the State royalty, including any specific steps thereto. Pursuant to this power, the Commissioner may recharacterise the royalty (plus penalties and interest thereon) as if the transfer, scheme (etc...) had not been entered into, carried out or in a manner that the Commissioner deems appropriate to prevent the circumvention of the royalty. However, in order for this power to be triggered, the transaction must be entered into or carried out solely or mainly for obtaining a royalty benefit, and one of two following events must occur:

- (a) *Abnormality test:* The steps entered into or carried out must not normally have been employed for bona fide business purposes (other than avoidance of a royalty benefit); or
- (b) *Arm's length test:* The rights and obligations must not normally be created between persons dealing at arm's length in a situation where the parties are solely or mainly acting to obtain a royalty benefit.

Subsection (2) (objection and appeal)

The decision of the Commissioner to invoke the anti-avoidance rule of subsection (1) is subject to objection and appeal (as described in section

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15(1)(d) of the Administration Act). Moreover, once the Commissioner proves that a transfer, scheme (etc...) results in a royalty benefit, this subsection shifts the burden of proof onto the taxpayer to prove that the taxpayer does not have sole or main intent to obtain that royalty benefit (thereby placing greater emphasis on abnormality and arm's length test).

Subsection (3) ("State royalty benefit")

This subsection provides that a royalty benefits means a reduction, avoidance, or postponement of the royalty payable.

Part V: Fiscal guarantee

Sections 13 and 14 provide mineral resource extractors with long-term stability in respect of the royalty so that investors have some certainty before committing substantial operational mining funds. Section 13 outlines how the fiscal stability protection is to be obtained and how long that fiscal stability lasts. Section 14 describes the level of protection (i.e. the nature of the guarantee).

Section 13: Duration

This section empowers the Minister to enter into fiscal stability agreements with mineral resource extractors for the duration of their mining rights. However, the agreements are limited to a specific set of mining rights – prospecting/mining rights for minerals and exploration/production rights for oil and gas. Other rights of a less permanent (e.g. reconnaissance) do not receive this protection because large initial capital outlays are lacking.

Moreover, the rights associated with these fiscal stability agreements can be assigned in the case of prospecting/exploration rights, but generally not in the case of mining/production rights (except for group of company transfers and a change of relative interests in a specific right).

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Subsection (1) (concluding the agreement)

This subsection provides that the Minister may conclude a binding fiscal stability agreement with an extractor either:

- (a) In respect of a mineral resource right currently held by that extractor; or
- (b) In anticipation of the extractor acquiring a mineral resource right.

The terms and conditions of the fiscal stability agreement last only for as long as the mineral resource extractor holds the right.

Subsection (2) (anticipated rights)

As stated above, the Minister can enter into a conditional agreement in anticipation of a mineral resource right (to be effective as at the date the right is to be granted). However, this fiscal stability agreement will be null and void if the right is not granted within twelve months after the fiscal stability agreement was concluded.

Subsection (3) (assigning fiscal stability in respect of prospecting or exploration rights)

Taxpayers holding a fiscal stability agreement in terms of a prospecting or exploration right can freely assign the fiscal stability benefits if the underlying right is transferred.

Subsection (4) (assigning fiscal stability in respect of mining or production rights)

Unlike prospecting or exploration rights, fiscal stability protection in respect of mining or production rights is assignable only in limited circumstances. More specifically, mineral resource extractors holding a fiscal stability agreement in terms of a mining or production right can assign their fiscal stability rights only

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in instances of intra-group transfers (i.e. movements within the same group of companies for tax purposes).

Subsection (5) (change in interests)

Taxpayers often change their percentage interests in a mineral resource right over time. This subsection provides that the fiscal stability clause remains in effect in respect of a single mineral resource even if the extractor's proportional interest in the right changes over time (i.e. the fiscal stability coverage includes the initial interest as well as any additions or subtractions).

Subsection (6) termination

Mineral resource extractors may unilaterally terminate their fiscal stability agreements (e.g. so as to benefit under more favourable agreements should the circumstance arise). Elective termination must not be partial. The termination must cover the entire fiscal stability agreement as the agreement relates to the underlying mineral resource right. The termination will also take effect at the beginning of the following year of assessment after notice of termination.

Subsection (7) (several mineral resource rights treated as one)

Four purposes of this section, prospecting rights, renewals thereof and the initial mining right for the same geographical area are treated as one. This unified treatment means that fiscal stability protection lasts from exploration stage through the close of the 30-year period of the mining right. The same rules apply in respect of (oil) exploration rights, renewals thereof and the initial (oil) production right. The goal here is to ensure that investors have fiscal certainty throughout the initial life of the investment.

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Subsection 8 (definitions)

This section provides two definitions that vary slightly from the rest of the Act. Firstly, retention and mining permits are excluded from fiscal stability protection because these rights are short-term in nature (and therefore do not need long-term fiscal stability protection). Secondly, the definition of Minister of Finance has been extended so that the Minister can delegate the power to conclude fiscal stability agreements.

Section 14: Terms and conditions

Subsection (1) (basic fiscal stability protection)

This subsection stabilises the substance of this Act (i.e. the royalty base and rate components (Parts I, II and III)) for holders of fiscal stability agreements. Legislative amendments will have no force and effect to the extent that any of these amendments override the base and rate so as to otherwise increase the royalty.

Subsection (2) (extended fiscal stability protection)

This subsection provides that no law may impose (directly or indirectly) another royalty charge that is substantively similar to the royalty charge on the transfer of extracted mineral resources imposed by this Act. In other words, fiscal stability protection seeks to provide investors with protection against additional indirect royalties over and above the royalty imposed by this Act (i.e. a windfall profits tax on all mineral extractions). However, Government retains the right to impose export levies that can be avoided by beneficiating mineral resources within the Republic (i.e. the Diamond Levy).

Subsection (3) (non-observance by the State)

This subsection provides an explicit protection against breaches of the fiscal stability agreement. If the fiscal stability agreement is not applied as agreed,

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the mineral resource extractor is entitled to compensation or an alternative remedy that eliminates the full impact of such failure.

Subsection (4) (Government's right to amend partially reserved)

This subsection reserves Government's right to restore the principles and intent of this Act despite the existence of a fiscal stability agreement. More specifically, Government can amend Parts I, II, II so as to prevent avoidance of the tenets of this Act.

Part VI: Miscellaneous

Section 15: Act binding on the State and application of other laws

This Act will bind the State. No provision in any other law will be construed as applying or referring to the State royalty unless the State royalty is specifically mentioned in the provision (i.e. another Act should generally have no impact on the royalty).

Section 16: Short title and commencement

This Act will be titled the Mineral and Petroleum Resources Royalty Act, 2007. This Act will come into operation for all mineral resources transferred beginning on or after 1 May 2009 (the date the MPRDA takes full effect).