The Explanatory Memorandum for the Mineral and Petroleum Resources Royalty Bill, 2008 is herby published for comment.

The National Treasury invites members of the public to submit comments on the Explanatory Memorandum by 17 October 2008 to:

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REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

FOR

THE MINERAL AND PETROLEUM RESOURCES

ROYALTY BILL, 2008

[20 August 2008]

EXPLANATORY MEMORANDUM FOR THE MINERAL AND PETROLEUM RESOURCES ROYALTY BILL, 2008

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BACKGROUND

Introduction

The Mineral and Petroleum Resources Royalty Bill gives effect to section 3(2)(b) of the Mineral and Petroleum Resources Development Act, Act No. 28 of 2002 (the MPRDA). The relevant section of the MPRDA reads: *As the custodian of the nation's mineral and petroleum resources, the State, acting through the Minister may: in consultation with the Minister of Finance, determine and levy, any fee or consideration payable in terms of any relevant Act of Parliament.*

The exploration for and extraction of mineral and petroleum resources in South Africa have been subject to various pieces of legislation over the years. These various pieces of legislation dealt with a myriad of issues, such as the ownership of mineral resources, the right to undertake exploration and mining operations, environmental and safety concerns relating to mining operations and State mining lease payments (where applicable).

The MPRDA brings South Africa's mining legislation in line with prevailing international norms. All mineral rights will henceforth vest with the State as custodian of minerals resources on behalf of South African citizens. The royalty bills which complements the MPRDA provides for the compensation to the State (as custodian) for the country's permanent loss of nonrenewable resources. Whereas consideration for the extraction of mineral and petroleum resources was previously payable to the State only in certain cases (i.e. where mining was conducted on State land), the exploitation of all minerals and petroleum

resources in South Africa will henceforth require consideration in the form of mineral and petroleum royalties payable to the State.

Alternative mineral and petroleum royalty regimes

Mineral and Petroleum royalties can be calculated based on the volume (weight) of minerals mined or on the value (*ad valorem*) of those minerals. In the case of royalties based on volume, the royalty liability is calculated by multiplying a unit of output (e.g. kg of gold mined) with a set rate per kilogram (e.g. R5.00). In this instance, if a mine extracts one hundred kilograms of gold during a specified period, the royalty liability will be R500 (100 multiplied by R5.00) for that period. It stands to reason that under a per-unit based royalty regime such as this, it will be necessary to adjust (increase) the rate (e.g. R5.00 per kg) over time. This regime appears to be relatively easy to administer. The challenge, however, is to set the rate at the correct level and to adjust this rate at regular intervals by way of an objective criteria, e.g. inflation. Very few countries with mineral and petroleum resources currently implement this form of royalty regime.

If royalties are based on value, the royalty rate is expressed as a percentage of the value of the resource (e.g. 5.0%). The royalty liability is equal to the value of the resource (the tax base) multiplied with the rate (e.g. 5.0%). In this instance, it is necessary to first determine the value of the minerals extracted / mined before the royalty liability can be calculated. If one assumes that the value of the resources extracted / mined during a given period is R10 000, the royalty liability for that period equals R500 (R10 000 multiplied by 5.0%). Assuming that the royalty rate is fixed (e.g. 5.0%) or easily determinable, the challenge is to agree on an appropriate value (tax base) for the mineral in question. As a rule, the value (tax base) is equal to gross sales (with minor adjustments) with gross sales based on arm's length prices (i.e. the quantity sold multiplied by the prevailing market price).

Proposed mineral and petroleum royalty regime for South Africa

Like most other jurisdictions, South Africa has opted for a mineral and petroleum royalty regime that is based on value (an *ad valorem* royalty regime). As explained above, this system requires two critical variables in order to calculate the royalty liability: (a) the value of the minerals (the tax base) and (b) the royalty percentage rate (e.g. 5.0%).

1. Tax base

The tax base (i.e. the value of the mineral) is generally defined as gross sales (excluding costs incurred to transport the 'final' product / mineral between the seller and the buyer). This royalty liability is often only triggered when the minerals are sold (or deemed to be sold) instead of at the time of extraction / at the mine mouth. This decision to require royalty payments only at the time when the resources are sold (or deemed to be sold) takes into account the cash-flow position of the extractor liable for the royalty payments. In most instances, it is also difficult to attach a value to a mineral at the moment when that mineral is extracted / mined.

For practical business reasons, there might be quite a time delay between when minerals are mined / extracted and when those minerals are sold. Moreover, the first saleable point / condition for most minerals only occurs after some level of (mineral) processing has occurred. For some minerals, such as gold, the first salable point / condition only occur after considerable mineral processing and refining. It, accordingly, follows that the gross sales value (i.e. the tax base) of a mineral increases the longer that mineral undergoes processing in the value-chain before being sold in its 'final' condition.

2. Royalty liability (royalty amount payable)

The royalty liability is equal to the tax base (gross sales) multiplied by the royalty percentage rate. If it were possible to value the mineral exactly when mined / extracted and Government sought to generate a predetermined royalty liability / payment, it would be necessary to set a royalty percentage rate that generates the predetermined level of revenue. For example, if the value of a mineral is equal to R5 000 immediately when extracted (i.e. at the mine mouth) and Government requires revenue of R500, the royalty rate should be set at 10% (R5 000 multiplied by 10% = R500).

On the other hand, if the same mineral has to undergo some form of processing before its value can be determined, expenses beyond the initial extraction must be incurred. If, by way of example, the value for the same mineral described above is now R8 000 after processing is undertaken to reach its first saleable point / condition, the royalty percentage rate needed to generate the same R500 of revenue now changes to a lower figure. Under this scenario, a percentage rate of only 6.25% is required to reach the R500 figure (R8 000 multiplied by 6.25% = R500). Assuming that the same mineral needs to be further refined and the value at the first saleable condition is now R10 000, a percentage rate of only 5.0% is required to reach the R500 figure (R10 000 multiplied by 5.0% = R500).

3. Royalty rates (formula based variable rates)

From the above example, it is advisable that an *ad valorem* royalty regime should utilise variable royalty rates that differs depending on the condition to which the mineral resource is processed (refined) when the royalty liability is calculated. In the above examples, if the royalty liability is calculated at the mine mouth (immediately upon extraction), the royalty percentage rate should be 10%. If the royalty liability is calculated after some level of processing, the royalty percentage rate should be 8%; and if the royalty liability is only calculated at a

later stage (after 'final' refinement), the royalty percentage rate should be set at 5%.

In view of these considerations, one of three possible avenues can be followed when setting the rate:

- Firstly, a decision must be taken at what condition (stage of processing or refinement) the royalty liability will be calculated. Will the liability be applied at the mine mouth, after some processing has taken place and or only at the 'final' refinement of the mineral in question? Once a decision in this regard has been taken, one fixed royalty percentage rate can be set for all minerals at a given condition (e.g. 8% after some processing).

- Secondly, various fixed royalty percentage rates can be set for different minerals at different conditions - stages of processing or refinement (e.g. 10% for diamonds at the mine mouth, 6% for platinum after some processing, 4% for platinum after being fully refined or 3% for gold after being fully refined).

- Thirdly, variable royalty percentage rates can be set. These variable royalty percentage rates should vary depending on the condition (stage of processing or refinement) in which the minerals are sold.

After much deliberation, it was determined to apply variable royalty percentage rates roughly at one of two conditions - after some processing (unrefined minerals) or after the 'final' refined condition (refined minerals).

The royalty percentage rates for <u>unrefined</u> minerals will be determined by the following formula:

Y(u) = 0.5 + { EBIT / (Gross sales x 9) } x100

Where:

Y(u)	=	Royalty percentage rate, unrefined;
EBIT	=	Earnings before interest and taxes (but EBIT can never go below zero).

The 0.5 amount is the minimum royalty percentage rate (5%). The constant figure, 9, was decided upon to ensure a reasonable set of royalty percentage rates for unrefined minerals that is relatively higher than for refined minerals. The maximum royalty percentage rate in the case of unrefined minerals as listed in Schedule 2 of the Bill is 7.0%

The royalty percentage rates for refined minerals will be determined by the following formula:

Y(r) = 0.5 + { EBIT / (Gross sales x 12.5) } x100

Where:

Y(r)	=	royalty percentage rate, refined;
EBIT	=	Earnings before interest and taxes (but EBIT can never go below zero).

The 0.5 amount is the minimum royalty percentage rate (5%). The constant figure 12.5 was decided upon to ensure a reasonable set of royalty percentage rates for refined minerals. The maximum royalty percentage rate in the case of refined minerals as listed in Schedule 1 of the Bill is 5.0%.

4. Summary

As discussed, the royalty percentage rates for unrefined minerals will be higher than that for refined minerals. For equity reasons, this differential is to be expected because the tax base (gross sales) for unrefined minerals is smaller given the lower level of processing / refinement compared to fully refined minerals (e.g. refined gold and refined platinum). Oil and gas are included under the "refined" royalty percentage rate formula regime in order to ensure a lower royalty percentage rate structure. This lower percentage is accepted due to the limited likelihood of finding significant oil and gas in South Africa, onshore or offshore with the resulting higher levels of exploration and production expenditures.

The variable royalty percentage rates provide automatic royalty liability relief for marginal mines. At the same time, the variable royalty percentage rates provide Government with additional income during times of high commodity prices. As a matter of fairness, Government shares in both the downside risks and upside benefits associated with mining. This sharing takes into account cyclical commodity prices and declining ore grades. Small miners are provided with special relief measures.

SECTION-BY-SECTION EXPLANATION

Definitions: Section 1

1. Background

The following definitions apply to this Act. Definitions from other Acts are referenced by incorporation into this Act.

2. Subsection (1): Definitions

"Administration Act": This definition refers to the sister act to this Act – the Mineral and Petroleum Resources Royalty (Administration) Act, 2008, which deals with administrative matters in connection with the royalty.

"earnings before interest and taxes": Earnings before interest and taxes (EBIT) is a measure of an extractor's operational profits for purposes of determining the royalty. EBIT is defined in section 5 and relates to the formulae in section 4.

"extractor": An extractor is the party (e.g. company or natural person) liable for the royalty. Other parties transferring mineral resources are not liable for the royalty.

"gross sales": Gross sales serves as the base for the royalty calculation as well as inputs for the section 4 formulae. Gross sales is a measure of the aggregate amount (value) of all mineral resources transferred by an extractor during a year of assessment. Gross sales are fully defined in section 6.

"Income Tax Act": The Income Tax Act, 1962 (Act No. 58 of 1962. EBIT (and other aspects of the royalty legislation) makes use of Income Tax Act definitions and concepts for purposes of determining the royalty percentage rate.

"Mineral and Petroleum Resources Development Act": The Mineral and Petroleum Resources Development Act (Act No.28 of 2002) (the MPRDA) is the principal legislation that regulates mining activities in South Africa and provides the basis for the royalty bills.

"mineral resource": Mineral resource means a mineral or petroleum as defined in the MPRDA with the transfer of all mineral resources being the object of this royalty legislation.

"person": This definition is used in various contexts in the legislation and follows the definition found in the Income Tax. This definition covers any type of person (including an insolvent estate or trust).

"Refined mineral resource": Refined mineral resources are mineral resources that have undergone a comprehensive level of beneficiation (e.g. smelting and refining). Schedule 1 of this legislation lists minerals in their refined condition. The distinction between refined and unrefined mineral resources is important for determining both the royalty rate and the base.

"Republic". Republic means the Republic of South Africa. This definition is most notably used in section 2 (limiting the royalty to South African boundaries).

"Royalty". Royalty means the royalty imposed by this Act.

"Transfer". The term "transfer" acts as the trigger for the imposition of the royalty. A transfer occurs when an extractor for the first time disposes of or exports without sale a mineral resource or where its mineral resources (prior to sale) is lost, stolen or destroyed.

"Unrefined mineral resource". Unrefined mineral resources are mineral resources that have undergone limited beneficiation (some processing). Schedule 2 of this legislation lists minerals in their unrefined condition.

Imposition of royalty: Section 2

1. Background

The royalty regime applies when two basic conditions are satisfied. Firstly, a person (defined as the extractor under section 1) must win or recover mineral resources from within the Republic. Secondly, the extractor must transfer the mineral resource. The "transfer" of the mineral resource operates as the actual triggering event for the royalty. Mineral royalty payments are for the benefit of the fiscus, to be collected by the South African Revenue Service and will be paid into the National Revenue Fund.

2. Extraction of mineral resources

Only persons that win or recover a mineral resource are subject to the royalty (i.e. only extractors are subject to the royalty). Other subsequent owners are outside the royalty regime. Moreover, only persons extracting and transferring a mineral resource for their own benefit are subject to the royalty. Thus, a subcontractor that extracts and transfers mineral resources "on behalf" of an extractor is outside the royalty (while the extractor (i.e. beneficial owner) falls within the royalty regime).

Mineral resources subject to the regime are defined broadly. A mineral resource is defined (as per section 1) as any mineral and petroleum as defined in the Mineral and Petroleum Resources Development Act, 2002 (MPRDA). Moreover, this definition of mineral resources includes property wholly or partly recovered, derived or consisting of minerals or petroleum as defined in the MPRDA. Stated differently, minerals or petroleum that are subsequently processed, beneficiated or otherwise transformed remain within the ambit of the royalty regime.

Mineral resources subject to the royalty are those recovered from anywhere within the territorial land or waters of South Africa (whereas foreign derived mineral resources fall outside the regime even if recovered by South African residents). As a result, the royalty applies to the winning or recovery of all

minerals pursuant to a MPRDA mining right, mining permit, prospecting right, production right, or exploration right (or a lease or sublease mentioned in section 11 of the MPRDA in respect of those rights). This form of winning or recovery is the main target of the royalty regime. In addition, other forms of recovery are also within the regime. For instance, the royalty regime applies to illegal mining operations conducted in the Republic and to parties under the coverage of an "old order" MPRDA right or permit with a pending application lodged with the Department of Minerals and Energy (the DME) for purposes of converting that "old order right" to a "new order right". Application of the royalty regime thus goes beyond the MPRDA in order to ensure that taxpayers operating outside the MPRDA's confines do not receive an unintended benefit.

3. Transfer of mineral resources

Only a "transfer" acts as the trigger for the royalty (i.e. the royalty does not apply merely upon the winning or recovery of a South African mineral resource). As defined in section 1, a transfer arises upon the occurrence of one of three events, as follows:

(1) *Disposal:* Under paragraph (a) of the definition, a "transfer" arises upon an actual disposal a mineral resource. This disposal is intended to cover any change of beneficial ownership, such as a sale.

(2) *Exports:* Under paragraph (b) of the definition, a "transfer" arises upon export. This trigger exists because enforcement of a royalty becomes extremely difficult after mineral resources have left the country. The export point essentially becomes the last practical trigger point.

(3) *Theft, loss or destruction:* Under paragraph (c) of the definition, a "transfer" arises upon the theft, loss or destruction of a mineral resource. In essence, Government (as custodian of South Africa's non-renewable

resources) is entitled to full compensation for the permanent loss of its mineral resources even if those mineral resources are involuntarily removed. This trigger also acts as an administrative backstop to prevent evasion (i.e. arguments that the royalty should not apply to the ongoing removal of mineral resources on the basis that the mineral resources were allegedly stolen). However, as an exception to this trigger, the involuntary release of gas into the air (flaring) during mining is not viewed as a transfer (because in some instances mining technology does not exist to capture this release for economic gain).

A "transfer" arises only upon the initial disposal of beneficial ownership. Thus, mineral resources previously disposed of by way of a transfer are not subject to royalty a second time. For instance, assume a mineral resource is exported to the United Kingdom and subsequently re-imported. Under this circumstance, a subsequent sale of that mineral resource will not trigger a royalty because the mineral resource was already subject to a royalty upon the initial export.

Determination of royalty: Section 3

1. Refined versus unrefined minerals

Mineral resources subject to the royalty are transferred in one of two physical conditions – refined or unrefined. Mineral resources within the refined paradigm are listed in Schedule 1; whereas mineral resources within the unrefined paradigm are listed in Schedule 2. In essence, Schedule 1 views a mineral resource as refined if that mineral resource is beneficiated into its purest form – metal slabs, ingots, bars, billets, plates consisting mostly of one mineral resource (i.e. copper is refined once processed into copper metal slabs consisting of 99 per cent copper purity).

In some cases, a mineral resource is listed under both schedules. In these instances, the dual listed mineral resource will be viewed as "refined" only if refined to or beyond the condition specified in Schedule 1 for those mineral resources. Dual listed mineral resources that fail to reach the Schedule 1 condition will be viewed as unrefined.

2. Royalty liability (royalty amount payable)

The royalty liability determination requires two elements – a base multiplied by a percentage rate. The base is set in section 6, and the rate is set in section 4. Refined and unrefined minerals are separately aggregated for purposes of these elements as described below.

3. Subsection (1): Royalty percentage rate determination for refined mineral resources

The royalty imposed upon refined (i.e. Schedule 1) mineral resources transferred by an extractor equals: **(1)** gross sales under section 6(1) for transferred refined mineral resources, **multiplied by (2)** the percentage rate determined under section 4(1). This calculation is made by aggregating all refined mineral resources transferred by an extractor (i.e. the calculation is not performed mineral-by-mineral or category-by-category).

4. Subsection (2): Basic royalty determination for unrefined mineral resources

The royalty imposed upon unrefined (i.e. Schedule 2) mineral resources transferred by an extractor equals: **(1)** gross sales under section 6(2) for transferred unrefined mineral resources, **multiplied by (2)** the percentage rate determined under section 4(2). This calculation is made by aggregating all

unrefined mineral resources transferred by an extractor (i.e. the calculation is not performed mineral-by-mineral or category-by-category).

Royalty formulae: Section 4

1. Background

As mentioned in Section 3, transferred mineral resources are subject to one of two royalty rates (formulae). One formula applies to all "refined" (beneficiated) mineral resources and the other to all "unrefined" (concentrate or bulk) mineral resources. A formula approach was used for setting these rates as opposed to utilising flat rates (e.g. a flat 3 per cent), thereby making these rates adjustable in light of business conditions. In essence, the formulae provide equitable relief for mines during marginality (e.g. during start-up operations, when a mine is at the end of its life span or during times of low commodity prices) while at the same time providing the fiscus with higher revenue potential when more favourable economic conditions exist (e.g. commodity booms and high grade mines). The variable percentage rate regime takes into account the profitability of a mine without compromising the gross sales (with minor adjustments) as the tax base (as described in section 6).

2. Subsection (1): Royalty formula for refined mineral resources

The royalty rate percentage for the aggregate amount of gross sales for transferred refined mineral resources is—

0.5 + [earnings before interest and taxes/(gross sales in respect of refined mineral resources x 12.5)] × 100.

3. Subsection (2): Royalty formula for unrefined mineral resources

The royalty rate percentage for the aggregate amount of gross sales for transferred unrefined mineral resources is—

0.5 + [earnings before interest and taxes/(gross sales in respect of unrefined mineral resources x 9)] × 100.

4. Formula parameters

Each formula contains four parameters: (1) an intercept term, 0.5 (%), (2) earnings before interest and taxes, (3) gross sales and (4) 9 or 12.5 as constants. The 0.5 (%) essentially acts as a minimum charge in order to ensure that Government (as custodian) always receives some level of royalty payments for the permanent loss of non-renewable resources. "Earnings before interest and taxes" and "gross sales" are discussed in sections 5 and 6. These parameters ensure that the royalty percentage rate varies according to the profitability of a mine.

The key difference between both the refined versus the unrefined formulae lies in the 9 versus 12.5 constants. The two constants effectively seek to neutralise some of the difference between the different refined versus unrefined mineral bases. Refined mineral resources have higher gross sales (tax base) than unrefined minerals because more value addition occurs as minerals are refined. The higher 12,5 constant seeks to offset this higher refined base.

5. Subsection (3): Percentage royalty rate ceilings

The variable percentage royalty rates are subject to specified maximum rates. Refined minerals have a rate ceiling of 5 per cent and unrefined minerals have a rate ceiling of 7 per cent. These ceilings apply on an aggregate level for all refined (and unrefined) minerals transferred by an extractor.

Earnings before interest and taxes: Section 5

1. Background

Earnings before interest and taxes (EBIT) is a key component to the "rate" formulae (mentioned under Section 4). More specifically, EBIT is the numerator. EBIT essentially measures an extractor's net operating mining profits in relation to won or recovered mineral resources to be eventually transferred. Taxes and other Government charges, such as the royalty, are excluded because EBIT is part of the royalty determination. The exclusion of interest effectively neutralises how key methods of financing (i.e. debt or equity) mineral operations are undertaken.

2. Subsections (1) & (2): EBIT for formulae

EBIT for mineral resources transferred is conceptually viewed as the aggregate amount of:

(1) Gross sales for all transferred mineral resources;
PLUS
(2) Recoupments in respect of the disposal of assets used to develop mineral resources to the extent the depreciation on those assets offset EBIT;
LESS
(3) Operating expenditure incurred (and depreciation allowances applicable to capital expenditure) relating to the extraction and development of mineral resources to the extent those expenditures are both: (i) deductible under the Income Tax Act, and (ii) bring those minerals to a Schedule 1 or Schedule 2 condition (as applicable).

Refined and unrefined minerals are separately aggregated for purposes of the EBIT calculation described above. This calculation is made by aggregating all

items described in (1) through (3) above relating to all refined mineral resources (or unrefined as the case may be); the calculation is not performed mineral-by-mineral or category-by-category.

3. EBIT components

As shown above, the EBIT calculation contains three elements: (1) gross sales, (2) recoupments and (3) deductions (expenses). ”Gross sales” is addressed in section 6 (being an aggregate of gross sales relating to refined or unrefined minerals). Recoupments relates to the recoupment of allowances stemming from assets used to generate deductions from EBIT (and therefore can only be understood once permissible deductions are understood). “Deductions” relates to costs associated with the winning or recovering of mineral resources as well as expenses occurring before those minerals reach a specified (i.e. refined orunrefined) condition.

In terms of deductions, both operating expenditures and capital expenditures are to be taken into account with Income Tax principles applying as a starting point. All of these expenditures are potentially deductible in the year incurred notwithstanding the fact that gross sales in respect of mineral resources may only be received or accrued in a subsequent year. Permissible operating and capital expenditures include both direct and indirect costs. However, deductions are permitted only to the extent those deductions contribute toward bringing mineral resources to their applicable Schedule 1 or Schedule 2 condition (for example, if a mineral resource is using a Schedule 1 based formula, only deductions relating to the cost incurred for preparing the mineral resource to reach its Schedule 1 condition are deductible). All deductions are limited solely to deductions incurred on or after the 1 May 2009 implementation date.

Applicable capital expenditures within the scope of EBIT largely include depreciation allowances described under sections 36 (e.g. fixed mining capital

expenditure) as well as the Tenth Schedule (e.g. fixed oil and gas capital expenditure) and to a lesser extent sections 11(e) and 12C (general equipment, plant and machinery). Only allowances associated with the post-1 May 2009 implementation date period will be taken into account.

Returning to the recoupment factor, the above described depreciation allowances relating to mineral resource capital expenditure can give rise to recoupment under section 8(4). Hence, gains reflecting depreciation allowances that previously reduced post-1 May 2009 EBIT are fully added back to the EBIT calculation during the year of recoupment (whereas, pre-1 May 2009 depreciation should not give rise to any recoupment because no previous subtraction occurred under the EBIT formula).

The EBIT rules contain special recoupment considerations relating to section 36 capital expenditure in order to effectively bring this form of recoupment back in line with the section 8(4) recoupment regime. Under paragraph (j) of the "gross income" of the section 1 Income Tax definition, section 36 capital expenditure gives rise to gross income for all profit upon disposal for purposes of the Income Tax Act (not just to the recoupment of prior unredeemed capital expenditure).

The EBIT rules effectively disregard the paragraph (j) "gross income" element and trigger recoupment only to the section 8(4) level. Also at issue is the "capital expenditure incurred" definition of section 36(11). Under this definition, section 36 capital expenditure is reduced for amounts received or accrued upon disposal. Hence, section 8(4) recoupment does not apply in the context of the royalty regime to the extent section 36(11) capital expenditure has already been reduced (thereby eliminating the potential for a double impact on the same amount).

> *Example. Facts.* In 2020, Company X pays R25 million for a shaft sinking and mine equipment relating to Mine X. For purposes of Income Tax,

Company X deducts the full R25 million in the year against Mine X related taxable income of R40 million (i.e. the R25 million amount is within the ring-fencing rules). In 2025, Company X sells the Mine X related shaft sinking and mine equipment for R28 (as well as Mine X for another specified sum). Assume no other mining capital expenditures.

Result. For purposes of the Income Tax Act, the 2025 sale of shaft sinking and mine equipment gives rise to R28 million of ordinary revenue (the full sale price) by virtue of (j) of the gross income definition. However, the royalty only requires recoupment as determined under section 8(4). Under this recoupment, only R25 million is added to EBIT (i.e. recoupment of the prior R25 million of deductions).

4. Subsection (3): EBIT adjustments

The EBIT calculation described in subsections (1) and (2) contains a number of special adjustments in relation to deductions normally taken under the Income Tax Act. These adjustments are covered below

a. Financial instruments

The EBIT calculation does not taken into account any deduction in respect of a financial instrument as defined in section 1 of the Income Tax Act. Hence, interest deductions from debt (i.e. one form of financing) and the cost of carrying derivatives is not deductible. This exclusion is implicitly matched on the gross income side because gross income is largely limited to gross revenues from mineral resources (income from financial instruments associated with working capital is disregarded).

However, costs arising from mineral resource hedges (e.g. forward contracts) are deductible because these hedges act as an economic offset against mineral

resource gross sales. For instance, a hedge against gold produced by an extractor is deductible from EBIT. The proceeds of such hedging are included in gross sales. Hedges for related items associated with the trade of mineral resource extraction are not deductible from EBIT (such as a dollar currency hedge even if the underlying mineral produced is priced in that currency).

b. Royalty payable

The royalty liability due under this Act is deductible under section 11(a) of the Income Tax Act. However, this royalty liability is not deductible from EBIT because a deduction in respect of the royalty would lead to a circular calculation.

c. Transportation costs

The EBIT deduction cut-off to a specified condition is clarified in respect of transportation, insurance and handling. Costs of this kind after the applicable condition are not deductible. Therefore, deductions to calculate EBIT in the case of refined mineral resources are limited to the costs to reach the refined condition (including transport, etc.); costs beyond the refined condition (including transport, etc.) are not deductible. Similar principles apply to unrefined mineral resources.

In no event are transport, insurance or handling costs deductible to effect the disposal of mineral resources. This exclusion matches the exclusion of these items from the gross sales calculation (see section 6(3)).

d. Balance of assessed losses

The EBIT calculation does not take into account the balance of assessed losses mentioned in section 20(1)(a) of the Income Tax Act. In other words, excess losses cannot be generally carried over to offset EBIT in a later period. This rule

has no effect, however, in terms of unredeemed section 36 capital expenditure because this unredeemed expenditure is not technically a balance of assessed loss.

The net effect of this regime is to prevent the carryover of excess operating losses while allowing for a carryover of mining capital expenditure (i.e. long-term mining investment expenditure). The exclusion of excess operating losses prevents a negative loss year to undermine the rate formula in a later year. The carryover of excess capital losses acts as a stimulus for mining investment (especially during the start-up phase).

Special rules exist for oil and gas expenditure because this form of expenditure is addressed via the Tenth Schedule as opposed to section 36. Because the Tenth Schedule lacks the concept of unredeemed capital expenditure, excess oil and gas expenditure gives rise to a section 20(1)(a) balance of assessed loss. The EBIT calculation accordingly allows oil and gas capital expenditure to fall with the assessed loss balance section concept of 20(1)(a) (i.e. by excluding oil and gas expenditure from the section 20(1)(a) prohibition). This EBIT calculation escape places oil and gas capital expenditure on par with section 36 unredeemed capital expenditure.

e. Foreign currency losses

EBIT does not allow for currency deductions in terms of section 24I of the Income Tax Act. This rule matches the gross sales calculations, which implicitly exclude currency gains.

f. General anti-avoidance rule

The EBIT calculation does not take into account the General Anti-Avoidance Rule as utilised under Part IIA of the Income Tax Act. The royalty regime has its own General Anti-Avoidance Rule (section 12 of the Money Bill).

g. Additional oil and gas allowances

Paragraph 5(2) of the Tenth Schedule of the Income Tax provides additional deductions for oil and gas exploration (an additional 100 per cent) and for oil and gas production (an additional 50 per cent). EBIT excludes these additional deductions in order to create parity between the oil and gas versus mineral sector.

5. Subsection (4): Composite mineral resources

Mineral ores often times represent a composite of minerals with a main mineral along with by-products (e.g. gold with uranium or silver as by-products; platinum with nickel as by products). EBIT issues arise when some mineral resources within an single ore fall within Schedule 1 while others fall within Schedule 2 (because different schedule minerals require separate calculations.

As a general matter, an extractor must allocate between the refined versus unrefined minerals according to a reasonable method of apportionment consistently applied. However, special rules exist to simplify the allocation where a *de minimis* level of mineral resources resides in a separate schedule. More specifically, the value of by-products of a mineral resource (refined or unrefined) within one schedule may be aggregated into the other schedule for EBIT purposes as long as these by-products do not exceed 10 per cent of the total.

6. Subsection (5): Negative EBIT

This subsection deems EBIT to be nil if the EBIT calculation otherwise results in a negative number, ensuring that the EBIT / (Gross sales) ratio can never be negative. This provision ensures that the minimum royalty percentage rate will always be equal to 0.5 per cent.

Gross sales: Section 6

1. Background

"Gross sales" plays a triple role. In terms of royalty percentage rates, gross sales play a role in the section 4 formulae by acting as the denominator. Gross sales also play a role in the EBIT factor within these formulae. Lastly, gross sales is the royalty tax base (i.e. the rates as per the formulae are multiplied by gross sales (with minor adjustments) to determine the royalty liability (see section 3)).

Separate gross sales calculations are required for Schedule 1 (refined) mineral resources and for all Schedule 2 (unrefined) mineral resources. These calculations are made by aggregating all refined (and unrefined) mineral resources transferred by an extractor (i.e. the calculation is not performed mineral-by-mineral or category-by-category).

Gross sales fall into three categories: (i) transfers arising from disposals at the specified Schedule 1 or 2 (refined/unrefined) condition, (ii) transfers arising from disposals at a condition other than the specified Schedule 1 condition, and (iii) transfers arising from exports or transfers arising from consumption, theft, destruction or loss. Though calculated separately, the rules for calculating Schedule 1 and Schedule 2 mineral resource gross sales mirror one another.

2. Subsections (1)(a) & (2)(a): Transfers arising from disposals at the specified condition

Disposals (i.e. sales and other disposals of beneficial interests) occurring at the specified condition give rise to gross sales equal to amounts received or accrued (matching Income Tax concepts). For instance, this rule will apply to gold (a Schedule 1 mineral resource) if sold at 99,5% purity, and to antimony (a Schedule 2 mineral) if sold at a 65% Sb content. It should be noted that these sales may be subject to arm's length pricing adjustments if required (see section 11(2)).

3. Subsections (1)(b) & (2)(b): Transfers arising from disposals outside the specified condition

Disposals (i.e. sales and other disposals of beneficial interests) occurring at a condition that differs from the specified condition gives rise to gross sales that requires some adjustments. In these situations, receipts and actual accruals could either: (a) be adjusted by way of a specified procedure or (b) be ignored and an arm's length price at the specified condition is used. For instance, in the case of option (a) if gold is disposed of at a 98 per cent purity level, the receipts or accruals rule (of section 6(1)(a)) must be adjusted. The gross sales amount will be adjusted (increased) by a factor equal to 1.015306 (99.5/98) to arrive at the estimated value of sales as if the gold were disposed of at the 99.5 per cent purity level (i.e. the Schedule 1 condition) on the same date.

Table 1: Indicative adjustments to gross sales

Mineral	Specified range		Unit	Sold at	Ratio
Chrome Ore	37%	46%	Cr_2O_3	34%	108.8%
Manganese	37%	48%	Mn	35%	105.7%
Iron Ore	61	64	Fe	59	103.4%

Mineral	Specified range		Unit	Sold at	Ratio
Chrome Ore	37%	46%	Cr_2O_3	48%	95.8%
Manganese	37%	48%	Mn	50%	96.0%
Iron Ore	61	64	Fe	66	97.0%

In the case of option (b) above the arm's length price will be the (hypothetical) price that would have been obtained if the mineral resource had been disposed of in the specified condition. For instance, if gold is disposed of at a 98 per cent purity level, the receipts or accruals rule (of section 6(1)(a)) would not apply. The gross sales amount would instead be determined using an arm's length price as if the gold were disposed of at the 99.5 per cent purity level (i.e. the Schedule 1 condition) on the same date.

The purpose of these alternative deviations is two-fold. Firstly, the Schedule 1and 2 conditions are intended to act as minimum bases. This minimum bases ensures that extractors do not structure their affairs so as to undermine the royalty (i.e. by adding little or value to the mineral from its mine mouth condition so as to artificially reduce the gross sales value below general industry practices).

Secondly, it also prevents the royalty from acting as a hidden penalty for beneficiating mineral resources. The Schedule 1 and 2 conditions effectively acts as maximum bases upon which the royalty can be applied (so that additional addition be way of further beneficiation does not increase the gross sales base for the royalty).

4. *Subsections (1)(c) & (2)(c): Transfers arising from exports or consumption, theft, destruction or loss*

Transfers arising from exports or consumption, theft, destruction or loss require a hypothetical arm's length price determination. This arm's length price will be the

hypothetical price that would have been obtained if the mineral resource had been disposed of in the specified condition. For instance, if lead is destroyed, the gross sales amount would be determined using an arm's length price as if the lead were disposed of at a 50 per cent purity Pb concentrate level (i.e. the Schedule 2 condition) on the date of the destruction.

5. Subsection (3): Exclusion of transportation, insurance and handling costs

The determination of both gross sales and EBIT excludes transportation, insurance and handling charges. This exclusion is necessary so as not to penalize minerals that are located far from markets or an export port.

Transport, insurance and handling charges for the transportation of minerals, in the conditions as per Schedules 1 and 2, between buyer and seller are excluded.

6. Subsection (4): Unquantifiable amounts of gross sales

In exceptional circumstances, gross sales derived from the transfer of mineral resources may receive or accrue in respect of an uncertain amount. For instance, an extractor could conceivably transfer a mineral resource to a transferee with the price conditional on a price obtained by the transferee when the transferee makes a subsequent transfer. In these circumstances, gross sales are based on arm's length value (without any deferral for the conditional price arrangement). This rule overrides the receipt or accrual rule of subsections 1(a) and 2(a) (i.e. transfers arising from disposals at condition). This rule has no bearing on the other triggers relating to gross sales under section 6 because these other triggers already apply an arm's length price as the starting point.

Small business exemption: Section 7

1. Subsection (1): Basic conditions

As part of a broader initiative to encourage and support small business development, this Act provides relief for small mining operations that allows for complete exemption of the royalty otherwise payable. This exemption is subject to four requirements: (1) a gross sales (turnover) limit; (2) a royalty liability limit; (3) a residency requirement; and (4) a registration requirement. Application of these requirements is determined on a year-by-year basis. More specifically,

(a) *Gross sales limit:* To be eligible for small business mining relief during a year of assessment, an extractor's gross sales for that year must not exceed R10 million. This limit operates as a hard cut-off, as gross sales even slightly above R10 million prevent the application of any small business mining relief. As in other tax provisions in this Act, this hard cut-off rule exists as a matter of administrative simplicity.

(b) *Royalty liability limit:* Small business mining relief applies only if an extractor is otherwise subject to a royalty liability during a year of assessment that does not exceed R100 000. Similar to the gross sales limit, this rule operates as a hard cut-off. This rule ensures that certain high-profit mineral resources do not receive an unfair advantage over low-profit mineral resources.

(c) *Residency requirement:* Small business mining relief applies only to extractors that are South African residents (as defined in section 1 of the Income Tax Act) throughout the entire year of assessment. Foreign residents are excluded because a foreign owned operation may be small in South Africa but fairly significant elsewhere.

(d) *Registration requirement:* To qualify for small business mining relief, an extractor must be registered with the Commissioner in terms of section 2

of the Royalty Administration Act throughout the entire year of assessment. In effect, a taxpayer must be a compliant party. Operating illegally and then applying for this exemption is not permissible.

2. Subsection (2): Anti-splitting rules

The small business mining exemption described in subsection (1) is intended for small stand-alone operations. A taxpayer should not be able to split a large operation into smaller parts so as to artificially obtain the exemption for each smaller part if no exemption would apply once those parts are viewed as a whole. The splitting of business operations usually can occur by housing each part in a separate company.

In terms of the technical remedy to prevent this splitting concern, small business mining relief does not apply if any one of following three conditions are satisfied.

Requirement #1: Prohibition against controlling interests in another extractor: The exemption does not apply if the extractor holds more than 50 per cent of the equity or voting rights in another extractor. Therefore, an extractor cannot qualify for small business relief if that extractor has a controlling share / interest in another extractor (company).

Requirement #2: Prohibition against being controlled by another extractor: The exemption does not apply if more than 50 per cent of the equity or voting rights of the extractor are held by another extractor. Therefore, an extractor cannot qualify for small business relief if another extractor has a controlling share / interest in the extractor (company).

Requirement #3: Prohibition against parties controlled more than one extractor: The exemption does not apply if a person (other than an extractor) holds more than 50 per cent of the equity or voting rights of two or more extractors. Therefore, if a holding company holds all the shares of two extractors (companies), both extractors (companies) are disqualified from the small business relief.

Exemption for sampling: Section 8

1. Background

Extractors often transfer mineral resource samples for purposes of analysis and testing as part of the prospecting and exploration process. In the interest of encouraging South African prospecting and exploration, an exemption exists for analysis and testing.

2. Requirements for exemption

Complete exemption from the royalty otherwise payable exists for the transfer of mineral resource samples pursuant to prospecting/exploration. More specifically, this relief contains three basic requirements. Firstly, the mineral resource must have been won or recovered for testing, identification, analysis and sampling pursuant to section 20 of the MPRDA. Secondly, the mineral resource (sample) must have been extracted pursuant to a MPRDA prospecting right (mining) or exploration right (oil and gas). Thirdly, the gross sales value of those ('sample") mineral resources must not exceed R100 000 per annum.

Rollover relief for disposals involving going concerns: Section 9

1. Background

When a mining operation is sold, royalty implications arise if the operation includes (previously unsold) mineral resources. This situation typically involves mineral resources held as inventory. In essence, the sale of the mining operation triggers a disposal of all mining operations including the mineral resources on hand, thereby implicating a royalty "transfer." This section provides relief in order to ensure that the royalty does not inadvertently hinder business restructurings.

2. Subsection (1): Disposal relief

This subsection provides relief when mineral resources are sold or otherwise disposed of along with a going concern, or along with part of a going concern capable of separate operation (e.g. a separate division). The sale/disposal must also be from an extractor to another extractor. This going concern concept is loosely modeled after section 11(1)(e) of the Value-added Tax. In these circumstances, relief is provided by treating the transaction as a non-event (i.e. deeming a non-disposal) and thereby turning off an otherwise existing royalty liability.

3. Subsection (2): Purchasing extractor liability

The relief provided by this section does not act as an outright exemption but rather as a deferral event. Therefore, the liability relief provided by the transferor-extractor is offset by the assumption of the royalty liability by the transferee-extractor. This rollover is accomplished by deeming the purchasing extractor to be the party that won or recovered the mineral resources transferred. This deemed winning or recovery means that the transferee extractor will be subject to the royalty on subsequent transfer. (Note: The exclusion of mineral resources involved in previous disposals from the transfer definition also does not apply because the going concern sale in subsection 1 technically never gave rise to a disposal.)

Transfer involving body of unincorporated persons: Section 10

1. Background

Multiple parties sometimes jointly hold various fractional percentage interests in one or more mineral rights. This joint holding can be in the form of a partnership, a pooling arrangement, a joint venture or some other unincorporated body. Without special relief measures, these arrangements can frequently give rise to inadvertent transfers that trigger a royalty liability. The mere allocation of mineral resources to a partner could easily trigger a royalty. For instance, assume a partnership has three partners and mineral resources are found by the partnership. Upon extraction, each party has a ⅓ interest in each mineral resource. Therefore, allocation of that mineral resource to one partner from the other two partners triggers a ⅔ part disposal.

2. Subsection (1): Unincorporated bodies as a deemed extractor

In order to overcome the inadvertent triggering of royalties, partnerships, pooling arrangements, joint ventures and other unincorporated bodies are allowed to be treated as a single extractor. This result is achieved simply by registering as a single extractor under section 4 of the Mineral and Petroleum Resources Royalty (Administration) Act. With this registration, the royalty for the unincorporated body (etc…) is determined independently from the body for all purposes of the Act (e.g. the rate and the EBIT calculation).

3. Subsection (2): Non-member capacity

This provision is a corollary to the main rule that deems the unincorporated body as a separate extractor for royalty purposes. In essence, the members of that body are also treated as separate from the unincorporated body (with the exclusion of unincorporated body assets).

4. Subsection (3): Impact of initial election

The initial election creates a deemed transfer of mineral resources by the extractor member to the unincorporated body. Therefore, this deemed transfer will potentially trigger a royalty liability for the member.

5. Subsection (4): Impact of terminating election

Like the initial election, the terminating election also creates a deemed transfer of mineral resources. However, this deemed transfer triggers a royalty for the partnership (as opposed to the partners).

6. Actual disposals between unincorporated bodies and their members

Given that unincorporated bodies are viewed as separate from the member once a separate registration is made, the royalty can also implicitly arise when an unincorporated body deals with its members. Disposals by a member to an unincorporated body or by an unincorporated body to a member also operate as a transfer event that triggers a royalty liability.

Arm's length transactions: Section 11

1. Background

Arm's length pricing rules are well established international tax practices and integrated within most South African tax acts (especially the Income Tax Act). For purposes of the royalty, the scope of the arm's length pricing rules extends to all transactions – including transactions between connected and unconnected 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.

2. Subsection (1): Earnings before interest and taxes ("EBIT")

Under this arm's length pricing rule, the Commissioner is empowered to adjust and substitute net earnings that are otherwise taken into account for EBIT. This adjustment may be directed at any factor of net earnings (i.e. gross sales, recoupments and deductible expenditures). For instance, this rule ensures that net earnings in respect of mineral resources sold (and in respect of mining assets used to sell those mineral resources) are derived at by using appropriate arm's length prices so as not to undermine the royalty.

3. Subsection (2): Gross sales

Under this arm's length pricing rule, the Commissioner is empowered to substitute actual gross sales transfer values (amounts received or accrued from the disposal of mineral resources at their Schedule 1 and 2 conditions as per sections 6(1)(a) and 6(2)(a)). This rule ensures that mineral resources are not artificially sold below appropriate arm's length prices, thereby undermining the royalty base (gross sales). This rule does not apply to other gross sales transfers – hypothetical disposals under sections 6(1)(b) - (c) and 6(2)(b) - (c), as these disposals are already subject arm's length pricing as a starting point.

General anti-avoidance rule: Section 12

1. Background

General anti-avoidance rules (GAAR) are found in most tax acts. The GAAR contained in this section is modeled on the historical model as opposed to the more recent GAAR currently contained in the Income Tax Act. The current Income Tax GAAR is not utilised here because the current GAAR is too specific

to that Act. The purpose of the GAAR is to act as a general anti-avoidance backstop to deter royalty schemes (in addition to common law rules against synthetic transactions and shams).

2. Subsection (2): Anti-avoidance rule

The GAAR applies based on a three-part test. Under this three-part test, a disposal, transfer, operation, scheme or understanding involving a mineral resource is subject to GAAR if that disposal (etc…): (i) has the effect of avoiding, postponing or reducing the royalty, (ii) is carried out in an abnormal manner or has created abnormal rights/obligations, and (iii) is driven solely or mainly to obtain a royalty benefit. To the extent the GAAR applies, SARS may re-characterise the transaction as if that transaction were never carried out or to eliminate any royalty benefit.

3. Subsection (2): Appeals and presumptions

This subsection clarifies that any assertion of GAAR by SARS is subject to objection and appeal. In addition, this subsection contains a presumption that the disposal (etc.) has a royalty avoidance purpose of the disposal (etc.) that results in a royalty benefit (but for the application of GAAR).

4. Section (3): Royalty benefit

A royalty benefit means a reduction, avoidance or postponement of a royalty liability.

Conclusion of fiscal stability agreements: Section 13

1. Background

Sections 13 and 14 provide an extractor with an option to obtain a long-term fiscal stability in respect of the extractor's royalty liability calculations. In general, the purpose of a fiscal stability agreement is to ensure that an extractor's investors have certainty with respect to the royalty regime (i.e. law) given the substantial investments and long-lead times to production required for most mining operations. Section 13 outlines the manner in which fiscal stability protection is to be obtained and the duration of this stability. Section 14 outlines the level of protection (i.e. guarantees) afforded by the fiscal stability agreement.

2. Subsection (1): Ministerial power to conclude and general duration

This subsection empowers the Minister of Finance to enter into fiscal stability agreements with extractors for the duration of their MPRDA mining rights. However, fiscal stability agreements are limited to a specific set of MPRDA mining rights – prospecting/mining rights for minerals and exploration/production for petroleum (see Subsection 8: Definitions). Other MPRDA rights – mining or reconnaissance permits – are not eligible for fiscal stability protections as such permits do not envisage large initial capital outlays given their short-term nature.

The Minister of Finance may conclude a binding fiscal stability agreement with an extractor either:

(a) for an MPRDA mining right currently held by that extractor; or

(b) in anticipation of that extractor acquiring an MPRDA mining right.

The terms and conditions of a fiscal stability agreement apply to an MPRDA right for as long an extractor holds that right. In addition, the MPRDA right includes any participation interests subsequently held by that extractor in that right). Thus, a fiscal stability agreement remains in effect in respect of a mineral resource right even if an extractor's ownership interest in that right changes over

time (the fiscal stability agreement includes the initial ownership interest and any other additions or subtractions to that interest).

3. Subsection (2): Anticipated mining rights

As stated in subsection (1), the Minister can enter into a conditional fiscal stability agreement in anticipation of an extractor's receipt of an MPRDA mining right (effective from the date the DME Minister grants the right). However, this fiscal stability agreement is null and void if the anticipated MPRDA mining right is not eventually granted within 12 months after conclusion thereof.

4. Subsection (3): Assigning prospecting/exploration fiscal stability

The ability to assign prospecting or exploration rights is open-ended. Extractors holding a fiscal stability agreement in terms of an MPRDA prospecting or exploration right can freely assign their fiscal stability protections to another person upon the disposal of the underlying right.

5. Subsection (4): Assigning mining/production fiscal stability

Unlike prospecting or exploration rights, fiscal stability protection for MPRDA mining or production rights is assignable only in limited circumstances. In the case of mining or production right transfers, fiscal stability benefits in respect of such rights are assignable only in instances of intra-group transfers as contemplated in the Income Tax Act (i.e. movement of assets within the same group of companies as defined in section 1 of the Income Tax Act).

6. Subsection (5): Unilateral extractor termination

Extractors may unilaterally terminate their fiscal stability agreements (e.g. so as to enter into a potentially more beneficial agreement). 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. This termination takes effect at the beginning of the year of assessment following year of assessment in which notice is given.

7. Subsection (6): Multiple resource rights treated as one

Prospecting rights, renewals thereof and the initial mining right converted from that prospecting right for the same geographical area are treated as one. This unified treatment means that fiscal stability protection lasts from the exploration stage through the close of the initial 30-year mining right period.

8. Subsection (7) (delegation of powers)

The Minister may delegate the authority to conclude binding fiscal stability agreements to the Director-General of the National Treasury. The Director-General may in turn delegate this authority to another person under the Director-General's control, direction or supervision.

Subsection (8): Definitions

For purposes of section 13, MPRDA rights cover all rights listed under this Act, except for mining permits and reconnaissance permits. These permits are excluded from fiscal stability protection as these rights are short-term in nature (i.e. do not need long-term fiscal stability protection).

Terms and conditions of fiscal stability agreements: Section 14

1. Subsection (1): Fiscal stability rate protection

This subsection stabilises the rate formulae described in section 4 for holders of fiscal stability agreements. Legislative amendments will have no force and effect to the extent that any of these amendments override the fiscally stabilised rate formulae so as to otherwise increase the royalty.

2. Subsection (2): Non-observance by the State

This subsection provides explicit protection against breaches of the fiscal stability agreement. If the fiscal stability agreement is not applied by the State as agreed, the mineral resource extractor is entitled to compensation or an alternative remedy that eliminates the full impact of the failure.

Foreign currency: Section 15

This section contains currency conversion rules for amounts received, accrued or expenditures incurred if these amounts arise in foreign currency. This situation is common for certain minerals which are often traded in dollar, pound or euro denominations. Under these circumstances, these foreign currency amounts are translated to the Rand at the spot rate in which the amounts are received, accrued or incurred. These currency translation rules apply for all royalty determination purposes.

Transitional Credits: Section 16

1. Background

While the MPRDA will imposes a universal State royalty from the 1 May 2009 effective date, the State currently receive some lease payments for the mining of certain minerals. These lease payments or similar charges owed to the State are

typically required by the Minerals Act, 1991 (Act No. 50 of 1991). However, other acts (such as the Precious Stones Act) may also apply. The transition from the old system to the new system should largely be seamless, but legislation is required to correct technical overlap and to differentiate pre-1 May 2009 lease payments from post 1 May 2008 mineral royalty payments.

2. *Subsection (2): No double State royalty*

Most contracts and legislation arising in respect of State leases and similar mineral resource payments to the State will fall away as of 1 May 2009. However, it may be that differences in the old system versus the new could trigger a double charge. This situation arise if the pre-1 May 2009 State lease or similar payment is required upon the winning or recovery of a mineral resource (an event arising before the transfer of the mineral resource). In this circumstance, the extractor would be subject to a charge upon mineral extraction via the old lease arrangements with an additional royalty charge arising to the extent the mineral resource is transferred from 1 May 2009 onward.

In order to remedy this potential double charge, the pre-1 May 2009 lease or similar State payments in respect of a mineral resource can act as a credit against the royalty chargeable on transfer pursuant to this legislation. This rule applies only if the old regime imposes a charge for the pre-1 May 2009 winning or recovery of a mineral resource and the new legislation imposes a charge by virtue of a transfer occurring from 1 May 2009. It should be noted that these offsets (credits) do no apply in the case of community royalties.

3. Subsection (2): No credits for profit-sharing agreements)

Credits granted under subsection (1) do not apply to payments made to the State in respect of leases contemplated in item 9(7) of Schedule II to the MPRDA (i.e. relating to precious stones). These lease payments are more akin to a profit

sharing arrangement between the State and the private sector. Both the State and private party in these circumstances should be held accountable to their allocable share of the royalty.

4. Subsection (3): Credit ceiling

This subsection limits the credits described in subsection (1). An amount of (old) lease payments to the State in respect of a mineral resource may only set-off the (new) royalty payable for that mineral resource under this legislation to the extent of the royalty payable under this legislation. For instance, assume an ounce of gold is subject to a lease charge of R100 that was paid to the State for the pre-1 May 2009 winning or recovery of the mineral resource. Also assume that the same ounce of gold was subject to a new mineral royalty charge of R60 under the legislation when that ounce is transferred post 1 May 2009. Under these circumstances, the R100 pre-1 May 2009 payment eliminates the new royalty charge. However, the credit is limited to R60 with no carryover of the remaining R40. The obligation will be on the taxpayer to provide proof of the payment of the (old) lease charges (if any) on the same minerals that are transferred post 1 May 2009.

Act binding on State and application of other laws: Section 17

The State is legally bound by the provisions contained in this Act. No other law should impact the royalty unless the royalty is specifically mentioned in that law. The purpose of this provision is to prevent this legislation from becoming subject to a myriad of overrides in other (non-amending money Bill) legislation.

Short title and commencement: Section 18

This Act is titled the Mineral and Petroleum Resources Royalty Act, 2008. This Act comes into operation for all mineral resources transferred beginning on or after 1 May 2009.