national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA STATEMENT

Mineral and Petroleum Resources Royalty Bill, 3rd Draft

The National Treasury today releases the third draft of the Mineral and Petroleum Resources Royalty Bill, for a final round of public comment and parliamentary review. The Bill gives effect to the objectives of the Mineral and Petroleum Resources Development Act, 2002 (MPRDA).

The National Treasury released the first draft of Mineral and Petroleum Resource Royalty Bill in March 2003 for public comment. After extensive consultations, revisions were made to the Bill. A second revised draft Bill released on 11 October 2006 contained modifications that address most of the concerns raised during the first round of consultations. Following a second round of extensive consultations, this third (and final) draft Bill is now released for public comment and parliamentary review. This draft Bill includes further substantive changes to facilitate sustainability of the mining industry, whilst at the same time giving effect to the MPRDA.

Tax base

One of the most important aspects of any tax system is to properly define and quantify the tax base. The tax base for the mineral and petroleum resources royalty regime as defined in both the first and second draft Bills was gross sales. This third draft of the Bill confirms gross sales as the tax base, but takes into account the process of beneficiation. Though the second draft Bill attempted to take account of beneficiation activities by way of a dual rates system (differential rates for refined and unrefined minerals), this Bill takes into account comments received from the industry and shifts away from a dual rate system towards an allowance for deductions of beneficiation related expenses.

The revised tax base will thus be equal to gross sales less allowable beneficiation related expenses and transport expenses between the seller and buyer of the final product.

Given that the beneficiation related activities might differ from mineral to mineral, the Minister will by way of regulations, for the various minerals, identity what activities and related expenses will qualify as beneficiation. In general beneficiation expenses related to smelting, refining, processing and sorting (in the case of diamonds) will be deductible. **Annexure 1** provides a brief summary of the relative importance of each of these components for the main mineral types.

It should be noted that the third draft of the Bill provides for all minerals including aggregates, sand and limestone to be subject to the mineral royalties. The specific royalty rate for this latter category of minerals was initially set at zero in the previous two draft Bills.

Based on the preliminary information obtained from the industry, the qualifying deductible beneficiation and transport related expenditures expressed as a percentage of total gross revenues for the main mineral types are as follows:

Table 1: Qualifying deductible expenditure as a % of Gross Sales or Revenue

	Mineral	Deductible Expenditure: as % of Gross sales
1	**Gold**	0.4%
2	**Diamonds**	7.4%
3	**PGM**	8.0%
4	**Manganese**	19.5%
5	**Mineral Sands**	21.4%
6	**Coal**	21.6%
7	**Chrome**	23.4%
8	**Iron Ore**	27.9%

Royalty rates

In addition to a revised tax base the royalty rates have also been reviewed. Both the previous draft Bills incorporated specific, but differential royalty rates for the various the minerals. In the second draft Bill the specific royalty rates were reduced and, in addition, dual royalty rates were introduced for certain minerals (with a lower rate for refined minerals).

The new royalty rate structure will be based on a formula that takes into account the profitability of company. The royalty rate will be equal to:

$$Y (\%) = \frac{\text{EBITDA}}{(\text{Gross Sales } \underline{\text{multiplied by}}\ 12.5)} \times 100$$

For the purpose of calculating the royalty rates a negative EBITDA will be set equal to zero. Based on information received from the industry the average royalty rates for the nine main minerals, for the period 2002 to 2006, would have varied between 1.0 percent and 3.7 percent, as follows:

Table 2: Royalty Rates

Royalty rates	2nd Daft Bill – Royalty rates			3rd Draft Bill New average rates
%	Refined	Unrefined	Average	Formula
Diamonds	n/a	5	5	**3.7**
Manganese	2	4	3	**3.3**
Iron ore	2	4	3	**3.0**
Mineral Sands	2	4	3	**3.0**
PGM	3	6	4.5	**2.7**
Gold	1.5	3	2.25	**2.1**
Coal	1	3	2	**2.1**
Chrome	2	4	3	**1.0**
Base Metals	2	4	3	**1.0**

Annexure 2 is a summary of EBITDA (earnings before interest, taxation, depreciation and amortization) expressed as a percentage of gross sales / revenues for the period 2002 to 2006.

The royalty rates derived in terms of the proposed formula are lower or similar to the royalty rates structure proposed in the 2nd Draft Bill. It should also be noted that the tax base in the final draft bill is narrower, given the allowable deductions.

On average the revised royalty regime is therefore more investor friendly, and should be easier to comply with and easier to administer, while ensuring that the fiscus receives its fair share of tax revenue.

Marginal mine relief

A special relief mechanism that was included in the second draft Bill to cater for marginal mines in order to prevent their premature closure is no longer required. The formula based royalty rate structure provides automatic relief for marginal mines; it also does so in a much more elegant and simpler manner. Government will share in the down side risk of mines but also share in the benefits resulting from high commodity prices.

Small business relief

As part of Government's broader initiative to encourage and support small business development, a special relief system has been created for small miners. Small miners, with a maximum turnover of R10 million per year, will be entitled to receive a credit of up to R100 000 per year (i.e. R50 000 per assessment period of six months) as an offset against State royalties payable.

Community royalties

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

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

Comment period

The deadline for public comment is 29 February 2008. The Portfolio Committee on Finance will conduct hearings shortly thereafter before the Bill is formally tabled in Parliament.

For further comments or questions, please contact: Thoraya Pandy at: 012 315 5944 or 082 416 8416.

Annexure 1: Type and relative significance of deductible beneficiation related and transport expenses.

	5 years (2002 to 2006)	PGM	Coal	Gold	Diamonds	Iron Ore	Manganese	Chrome
	Allowable Expenses: % Distribution							
1	Smelting	50.2%		28.4%				
2	Refining	46.6%		37.7%	42.6%			
3	Transport	1.8%	38.9%	10.1%	28.6%	71.9%	82.8%	27.0%
4	Insurance	1.4%		23.8%		1.1%		
5	Processing *		41.6%					
6	Throughput **		19.5%					
7	Recovery				8.0%			
8	Sorting				10.1%			
9	Security				10.7%			
10	Primary crusher & other					27.0%		
11	Dense Medium Separator (DMS) plant, sintering						6.2%	40.4%
12	Port , shipping & insurance						11.0%	32.6%
	Total	100%	100%	100%	100%	100%	100%	100%

* Processing includes: screening, crushing and washing.
** Throughput includes: RBCT (Richard Bay Coal Terminal), loading, port and wharfage

Annexure 2: Earnings before interest taxation depreciation and amortization (EBITDA) expressed as a % of Gross Sales (a measure of company profitability)

EBITDA divided by Gross Sales (%)						
	2002	2003	2004	2005	2006	Average
Manganese	45.5	41.8	28.9	49.3	43.4	41.8
Iron Ore	37.2	27.3	23.5	46.8	53.2	37.6
PGM	40.4	26.9	28.1	29.4	45.0	34.0
Gold	46.3	32.3	15.3	4.1	33.0	26.2
Coal	32.7	20.2	26.4	27.3	23.8	26.1
Chrome	7.1	15.8	17.1	12.3	9.1	12.3

Annexure 3:

The royalty formula:

$$Y(\%) = \frac{\text{EBITDA}}{(\text{Gross Sales multiplied by } 12.5)} \times 100$$

Can also be expressed as:

Y (%) = (EBITDA divided by Gross Sales) X 100 divided by 12.5

For the purpose of calculating the royalty rates a negative EBITDA will be set equal to zero.