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The realities of royalties in South African Mineral and Petroleum Royalty Bill

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"The nature of the challenge is clear. It is to create a situation in which the countries, regions and localities where mining activity takes place have a direct share in the wealth produced by exploitation of their mineral riches in a way that translates into an improvement in their inhabitants quality of life and a level of well being. This is an appropriate reciprocity for the reduction in natural capital resulting from the exploitation of non-renewable resources, an exploitation that can generate significant negative impacts."[1]

1. Introduction

Everything about the Republic of South Africa is said to be entering exciting times and facing new challenges. This is usually said within the context and against the backdrop of a changing face of South African political and economic landscapes from the past history of exclusion, deprivation, segregation and prejudice to the future of inclusion, tolerance, equal distribution and social harmony. The economic equal distributive idea is likened to the socio-democratic ideals of social justice, which advocates equal distribution of wealth to all citizens of the country. The South African idea is that South Africans are now in the new social era and the social transformation, on all fronts and most particularly the economic front, must move with the times and reflect the times that all its citizens find themselves in.

On the political front, the year 1994 ushered in a new face of South Africa with the first democratic elections which, for the first time in hundreds of years, saw the inclusion and participation of the African majority of its citizens. These changes were soon entrenched by the adoption of the new South African Constitution[2]**,** which espouses noble ideas of respect, equality, tolerance, economic development, distribution and access to country's wealth in a fair and equitable manner.

The Constitution forces its citizens and the government to seek to redress the past imbalances particularly in the economic front and proactively take measures to see to this equilibrium of South Africa's wealth. Legislature, various political fronts and various economic fronts rallied around these principles and began talking the concept of Broad-Based Black Economic Empowerment[3]. This concept has one central theme, which is to

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[1] Patricia Gonzales (MPRI/IDRC) see infra for full and further particulars
[2] Act 108 of 1996
[3] Act 53 of 2003

advance the economic participation of the previously (and in many respects the current) disadvantaged individuals into the mainstream economic activities of the country. It further aims to fast track their access to economic wealth and sharing of the fruit of common market and to seek to even out the economic disparities in many sectors of the society. As to how this empowerment process is being implemented and achieved, this paper will not even begin to traverse the diverse proposals and ideas of its implementation and realisations.

Various economic sectors produced sector-specific economic empowerment charters in an attempt to lay the road maps on how to achieve this equilibrium of wealth distribution into the African hands. Virtually all-economic sectors are being active in that front including the mining sector. The Mineral and Petroleum Charter[4] was among the first industry-specific charter to be produced after much publicised debates as to the best frame within which to approach and implement this concept.

After that charter has been adopted and its implementation being realised, the South African government seeks now to introduces the Mineral and Petroleum Royalty Bill[5], which aims to collect monies from the mining houses that conduct mining activities in many areas. The move has caused many heated debates within the industry[6] with the government forging ahead with its proposal subject to various consultative processes, while the business is also forging ahead with its attempts to halt this move right in its drafting stages.

The purpose of this essay will be to look at the concept of the royalties, what they are, why is the South African government keen to introduce this Bill, why is business against them, why do we have them over and beyond the normal mining tax systems and the requirements of Black Economic Empowerment programs. In doing so, the article will also shed some light on their (royalties) nature and make necessary proposals in the process which, it is hoped, would in the main assist government and the Department of Minerals and Energy (DME) to implement, modify and manage royalty regime(s) in the mining and the petroleum industries.

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[4] See an annexure to the Minerals and Petroleum Development Act.
[5] Bill of 2002 introduced in Parliament on the 10th March 2003
[6] See the debates herein infra under the heading of 'South African position on the Royalty Bill'

The essay will, to the extent that it can, rely on case law but the topic is mostly theoretical in South Africa and very few case law authority exist to clarify and provide thoroughly researched and considered legal analysis of the topic. The theoretical research of this article will take the reader to various countries that are in more or less the same boat as South Africa in terms of their relative reliance and dependence on mining industry and mining products for economic survival and activities. Similarities also extend to the relative sizes of these countries, similar perceptions of economic participation or lack thereof by mining houses vis-à-vis paying taxes that are congruent with their incomes, non-existing developmental corporate social responsibilities, no or less royalty payments and generally prevailing negative social-environmental impact of mines and mining houses on immediate communities within which they function and carry on their businesses.[7]

It is the writer's opinion that the political backgrounds of these countries, as compared with South Africa, also have huge impact and influence on how the concept of royalties can be understood locally. A comparative analysis of their *modus operandi* will be undertaken to see if the legislative attempts by South Africa is in or out of order in seeking to introduce royalties and whether its reasons are in or out of tune with sound local or international economic principles. Immediate economic concerns surrounding royalties are that royalties have the potential to attract or dismiss much needed investments, be it direct or indirect investment. Their effect on shareholders' dividends, growing local mining costs/ business and their general impact on financial upkeep of mining operations in South Africa will also be researched in this essay.

The essay will therefore assume this outline of topics, definition and origin of the concept; international comparative analysis; the South African past mining regimes *vis-à-vis royalties*; the current South African Royalty Bill; critics of the South African royalty Bill; the defenders of the Bill; some proposals; way forward; and conclusion.

2. Definitions and origin of the concept of royalties:

The main question that needs to be answered before a meaningful understanding of royalties can be made is, what kind of a financial species one is dealing with? Is it some

[7] In researching for this paper, the writer discussed this paper with Financial Tax Officer of a mining company in Johannesburg. This officer argues that South African model of royalties is more like that of

kind of a tax or not? What is this concept, when and why is it levied or charged?

It then becomes important to understand the concept of tax, whether as a definition or as a concept used in legal sense. The Organisation for Economic Cooperation and Development ("OECD") is said to define tax "as compulsory, unrequited payments to the general government".[8] Manuel Calzada begins his research into the difference or similarities of these two levies (*viz*. royalties and a normal tax) by pointing out that "a payment is said to be requited where it directly secures some advantage; for example, where it secures goods and services or access to particular resources that the legal definition of taxation also recognises that a payment is not a tax to the extent that it is requited. Thus, royalties paid to the State government for the extraction of minerals and timber are not taxes."[9]

This extrapolation of principles indicates to the reader that there are different types of taxes that are levied in accordance with the said OECD definition, the normal tax (including the duties of excise) and royalties to the extent that they are unrequited. In any case, Calzada argues that certain royalties could be deemed duties of excise on the strength of certain authoritative decisions such as those in Dennis Hotels, Bolton, Parton and Matthews cases.[10] It must therefore be understandable when investors and businessmen alike often confuse royalties with taxes and vice versa.

Duties of excise to the extent that it is relevant and helpful in distinguishing royalties and tax definitions, is defined herein as "a tax on a step of production". The author argues that this crisp definition found judicial support in the case of Phillip Morris[11], wherein Brennan CJ held that "[I]f there be any rock in the sea of uncertain principle, it is that a tax on a step of production or distribution of goods to the point of receipt by the consumer is a duty of excise." The work of Calzada is important in that his research sought to point out that flowing from the definition of OECD, certain levies, particularly the royalties, could be swallowed by the definition of duties of excise and that would in all probabilities render them invalid as a different charge and would put them beyond the powers of government to impose them as royalties.

Australia. The writer's view however, is that for the purposes of analysis of desirability or otherwise of royalties, SA's socio-economic outlook on royalties is based on similar perceptions alluded herein.

[8] Calzada, M. "State Government Mining Royalties: Requited Taxes or Duties of Excise?" http://www.murdoch.edu.au/elaw/issues/v7n3/calzada73_text.html

[9] Ibid at page 2 of 6

[10] Ibid

[11] Phillip Morris Ltd v Commissioner of Business Franchise (Vic) 1989 167 CLR 399

It is therefore correct, with respect, to find that the character of tax required a consideration of the substantive operation as well as the text of the statute that imposes it.[12] In other words, it becomes crucial to be clear on the character of the tax, what it substantially intends to do. The language used in tax statutes has to be clear on what exactly is it imposing onto its public. Failure to do so and /or uncertainty could spell disaster for governments as their work could be undone within few seconds if it is found that what is proposed to be a royalty is in fact duties of excise.

Key word is '*requited*', in that if payment is *requited*, it is not a tax and it is *not requited* if it secures, access to a particular resource. If payment is *unrequited*, then it is a tax. Calzada then argues that "mining royalties paid to State government are requited given that they provide access to a particular resource there is a direct correspondence between the size of the payment and the share of the assets extracted given that payments are calculated as a proportion of the realised value from the source extracted."[13] He is doubtful that, given the OECD definition, it could conclusively be said that royalties are to be excluded from duties of excise. This is because of the long-standing principled definition which provides that a tax or charge on a step of production is a duty of excise, and secondly because the structure of minerals royalties, invariably, tax most minerals - though not all - at a step of production beyond that of extraction. Therefore to the extent that payment of a tax is a step in the production of a final product from raw minerals, it could be argued that such payment constitutes a duty of excise and not royalty.

The fundamental character of the term 'excise' is that of a tax on articles produced or manufactured in a country. Dixon J[14] correctly pointed out that "the basal conception of an excise in the primary sense which the framers of the Constitution are regarded as having adopted is a tax directly affecting commodities ... To be an excise the tax must be levied 'upon goods' ... The tax must bear a close relation to the production or manufacture of goods, the sale or the consumption of the goods and must be of such nature as to affect them as the subjects of manufacture or production or as article of commerce."[15]

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[12] Calzada, op. cit at page 2 of 6
[13] Ibid
[14] See *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263 at 299

It is submitted that on the strength of this finding one can conclusively argue that royalties do not relate to the production or manufacture of any commodity, at best, it guarantees access to such a commodity. On that basis it therefore does come close to excise but it is not quiet the same. The levels of production for some strange reasons become vital in differentiating tax excise and royalty. It is submitted that this might be a superfluous and simplistic substantive argument in seeking to differentiate the two levies, hence a more comprehensive conceptional basis for defining and determining royalties has to move away from the temptation of being swallowed into and / or be classified as a charge on the (first step) of production or manufacturing.

Royalties, although allow access to a product, are to be applicable only at the level of extraction and are payable to the holder or owner of a land or of mineral rights and in many of these countries researched, that owner or holder is the State. Calzada points out that the Mining Act 1978 of the Western Australia provides at Section 9 (1)(a) that "all gold, silver, and any other precious metal existing in its natural condition on or below the surface of any land in the State ... is the property of the Crown." Section 108 thereof provides that "[I]n respect of each mining tenement there shall be payable by the holder at the times respectively prescribed, such rent as may be respectively prescribed". Section 109 (1)(a) “empowers the Governor to make regulations under section 162 to prescribe how, by whom and what rate ... royalties shall be paid in respect of minerals, and under section 109 (1)(b) to exempt ... any persons ... from payment of royalty."[16]

In Queensland, Australia, mining royalty is viewed as something that "represents a payment to the State for the right of use of state's mineral resources."[17] The same governmental source goes further to state that "[G]enerally royalty is payable when mineral is sold, disposed of or used." In expantiating the concept, the source states "the Mining and petroleum royalties represent a payment to the owners of a resource for the right to extract it. As the State owns all petroleum and gold and most minerals, royalties on these commodities are normally paid to the State Government *via* the Department of Natural Resources and Mines."

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[15] See also Calzada, op. cit at 3 of 6
[16] Ibid
[17] http://www.nrm.qld.gov.au/mines/royalties/mining_royalties.html

The Australian's Northern Territory Government[18] also imposes mining and petroleum royalties. It views royalties as not taxes but as "a charge for resources payable by the holder of a mining tenement to the Government as owner of mineral rights over the site. The Territory Government has for that purposes enacted a Mineral Royal Act that "levies a royalty on the recovery of mineral commodities tenement in the Northern Territory." What is noteworthy from this Australian governmental website information is that royalties are classified under rents or as charges payable to government by mining houses and the reason for such payment is embedded in the description of the concept. The Mineral Royalty Act actually states that the overall objective of the Act is to maximise contribution of the mining industry to the long-term welfare of the Northern Territory.

The New South Wales Department of Primary Industries[19] also imposes royalties on minerals. Its research article titled "Mineral Royalties in New South Wales" shows that "[T]he Crown, or in other words the people, of New South Wales owns the majority of mineral assets in New South Wales. A mineral royalty is the price charged by the Crown for the transfer of the right to extract a mineral resource." The Peruvian government also imposes a royalty on its non-renewable resources. The thinking is that "as the State is the owner of resources on the ground, the concessionaire (*i.e.* the mining companies) uses them in lieu of the State. So the State, as the owner, has the right to a payment called royalty, usufruct or rent, which must be paid by the concessionaire."[20]

The emerging idea herein is that royalties are charged by the owner and/ or holder of the land and / or of mineral rights and are payable by the licensee or lessee for extracting minerals from the owner' or holder's land. It is apparent that the owner who may or may not be the State is entitled to such charges for allowing another person to use and benefit from the land and / or minerals from his land. If State is the holder of minerals or land from which minerals are extracted, then it *mutates mutandis*, invariably must collect such payments for and on behalf of its citizens and more particularly those communities that are within the immediate areas affected by extractions of minerals. There seems to be an overall realisation that mining activities leave permanent damages to affected landscapes and communities. As such, communities affected by such mining activities aim to benefit from State's levy resulting from their damaged lands. This expectation is

[18] http://nt.gov.au/ntt/revenue/formmra.shtml
[19] http://203.202.139.161/invest/royalty
[20] Consaglieri, op. cit at 4 infra

fuelled by the fact and perception that mining houses will, in the process of land and environmental degradation, be making meaningful profits. It therefore is important that the analysis of South African mining taxation and royalty schemes take into account, as a point of departure, the transformation and/ or changing face of mining ownership jurisprudence and policies.[21]

There are various ways of levying a royalty and also that depends on the owner's preferred tax and mining rent systems. Royalties may be levied on the overall turnover, on gross sales, on revenue, on profit, *ad valorem* and for quantum.[22] It stands to reason that each of the type of royalty charged has its own flaws or loopholes, which astute lawyers and accountants would be able to manipulate.

In following Calzada's concise distinction between the duty of excise and royalty, it then becomes important to correctly levy a royalty that would not conflate the two concepts into one. He uses an apt example, which relates to imposition of royalty on gold by the Western Australian government. "Gold, which was previously exempted from royalties, became liable for royalties from 1 July 1998 although the Regulations provide special provisions which include certain exemptions for smaller producers, lower royalty rates than most other minerals and transitional arrangements that were aimed to placate the complaints and concerns of the gold mining sector regarding the potential uneconomic nature of many producers if they became subject to royalty payments."[23] The problem herein is the formula with which gold is levied for the purposes of recovering royalties.

Regulations in respect of gold, in the Western Australia, states that gold royalties are based on Gold produced gold bearing material. Regulations 86AA (1) is quoted as stating that “[W]hen gold metal is produced from gold bearing or obtained from a mining tenement, royalties shall be paid by the holder of, or applicant, for the mining tenement". Calzada observes that the word ‘produced’ is “generously” used throughout the said regulation. He correctly finds in his interpretation that the section or provision of a regulation taxes a product already produced. Every calculation is made in terms of the value of the final product, rather than on the value of the mineral units’ natural state, the substance over which the Crown has ownership rights.

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[21] See the analysis hereinbelow under the comparative South African analysis
[22] New South Wales website, op cit at fn 18
[23] Calzada, op. cit at 4 of 6

This, with respect, must be a correct interpretation of the section and the formula, and as such it becomes possible that mining royalty of the kind levied on the processed minerals could then fall within the definition of duties of excise. This then becomes a lesson, as indicated hereiabove, to other countries that seek to introduce formulae to levy royalties on variety of minerals to guard against having their royalty formulae not being reclassified as a tax in the form of duties of excise.

3. Flaws in some types of royalty formulae

Royalties can in the main be imposed based on gross revenue or sales of the mineral, per a measured weight of a mineral or based on the value of the mineral. One main flaw of gross revenue based royalty, which is mainly preferred by the land / mineral owner or holder and detested by mining companies, is that in a country dependent on mining activities, such a levy ignores the company's ability to pay and cover its costs. The unintended consequence is that operational costs are raised, cash flow is reduced, marginal mines are forced out of competition and business and the mine life is shortened. It further prejudices investment, and reduces and in some instances completely wipes out employment potential of mining companies. This levy may discourage smaller mines from emerging, as they would be choked by these royalty charges. The position, particularly in South Africa, is worsened by international market exchanges and negative fluctuation of international commodity prices and/ or unstable financial sectors, particularly the currency exchanges. If the ZAR rand-dollar exchanges favours or result in the rand strengthening, then mining houses are negatively affected as it is now eating away at profits. The discussions on introduction of royalties by SA government must respectfully take such effects into account.

Revenue or turnover based royalty formula is usually viewed with scepticism by land or mineral rights owners, and obviously preferred by mining companies. Holders or owners of minerals rights prefer royalties that are based on an agreed measured production of minerals. This formula gives them certainty of easily ascertaining production and royalty payments when calculations have to be made. The process, in their mind, is impartial and reliable. They, likewise, do not like revenue-based formula because the entire assessment and determination of an amount payable, is in the hands of the person that is liable to make those payments. The natural instinct of business for maximisation of profits often result in hiding profits and/ or masking them in such a way that accounting books of mining company reflect losses instead of profits thus disentitling mining houses

from paying any royalty.[24] Miners on the hand prefer royalties which are based on profit simply because when a loss is made, hardly any royalty would be payable. This it is not suggested that it normally takes place. The reality is that large companies are able to structure their affairs in such a way that, amongst others, minimum tax is paid. This is in accordance with the trite common law position profoundly captured in *Commissioner of Inland Revenue v The Duke of Westminster.*[25] Given the above problems from different perspectives of owners and miners and this legal position, the only question that one may raise, is whether this conduct (tax or financial avoidance) is evil and immoral.

One will find that the two abovementioned modes of levying royalties, *i.e*. on revenue or on an agreed measurement based formula are forever bones of contention between the imposer who is the owner or holder of mineral ores in that the owner would not want to leave the royalty assessment in the hands of the mining company for fear of never receiving any royalty payments as these companies may continuously register losses, while on the other hand miners, as the leasing companies that ultimately have to pay royalties would prefer to be charged based on turnover or gross sales so that the royalty payable can reflect the profit or loss made on the market. According to the profit based theory, during hard times, it would be easy to ascertain whether mining houses have or have not suffered any losses, thus necessitating any need for payment or non-payment of royalties.

It becomes necessary then to balance the needs of those involved in the mining industry by extensively researching on interactions and deliberations about royalties to see what could be an appropriate formula for imposing royalties and also the substantive reasons therefor. The essay will expose the weaknesses of royalties charged on sales/ turnover and those charged on revenue.

4. International comparative analysis of royalties

The aim of this section is to find out what other countries think of royalties and how they manage and administer their regimes. It also seeks to find out the socio-economic and political events that mostly lead to the introduction of royalty regimes. The first country to

[24] See the analysis under the 'International Comparative Literature' hereinbelow, particularly the views of Joan Kuyek.
[25] 1936 AC 1 (HL) at 8 Lord Atkin said that "… it has to be recognized that subject, whether poor and humble or wealthy and noble, has the right so to dispose of his capital and income so as to attract upon himself the least amount of tax."

be examined regarding royalties is Brazil wherein a research study was commissioned on the royalties. The Mining Policy Research Initiative (MPRI) and the International Development Research Centre compiled specific research articles under a title "Mining and Sustainable Developments Series No 2: Mining Royalties"[26] (hereinafter to be referred to as “the Series”).

Gonzales, P[27] approaches this topic somewhat socio-politically and with a redistributive angle and asks, *"Who benefits from mining?"*[28] She observes that this question is increasingly being raised particularly in Latin America where exploitation of minerals resources constitutes a significant element in many national economies. According to her analysis, which is correct, the idea behind the challenges to the mining houses and governments is to create a situation in which countries, regions and localities where mining activity takes place have a direct share in the wealth produced by the exploitation of their mineral riches in a way that translates into an improvement in their inhabitants' quality of lives and level of well being. She is of the view that "[T]his is an appropriate reciprocity for the reduction in natural capital resulting from the exploitation of the non-renewable resources, an exploitation that can generate significant negative impacts."[29]

She notes correctly so that, in the questioning of how the wealth is to be shared and distributed, heated debates have arisen in the main mining countries which debates have mostly focussed on benefits, limitation of tax and royalty systems applicable to mining. Despite the debates both for and against the imposition of these royalties, Gonzales finds as undisputable the principle that it is just, fair and necessary that for the State, "as the owner of the minerals, to impose a charge or compensatory fees for the exploitation of these non-renewable and scarce resources".[30] She identifies two countries wherein the move to introduce royalties is still in the infantry stages *viz*. Peru and Chile.

She advises that "the debate in Peru led to an approval in June 2004 of new legislation providing for royalties" whereas Chilean government still has to find the necessary parliamentary majority support to enact these measures on its mining industry. She is of the firm view, correctly so it is argued, that countries that do not have these royalty

[26] Published by International Development Research Centre (IDRC) 2004
[27] "Distributing Mining Wealth through Royalties"
[28] Gonzales, at page 3 of the Series titled "Presentation"
[29] Ibid
[30] Ibid

schemes must urgently seek to proactively address this '*deficiency*' as lack of such a corrective measure perpetuate distortions and inequalities.

The reason, she opines, that this deficiency has to be urgently corrected is that she feels, correctly so it is submitted, that mining industry has to contribute to the local communities "and the implementation of mining royalty system that provides for an equitable distribution of resultant revenue between the national level and mining regions and localities can be an effective tool in overcoming the paradox of wealth producing mineral exploitation living side by side with extreme poverty and social inequity, a state of affairs evident today in many different zones where the economy depends on extractive industries such as mining and hydrocarbons."[31]

It is argued that the origin of these royalty schemes entrenches the finding of many commentators who do not view the scheme as another tax system but as a charge or a rent of compensatory nature that is particularly necessary in localities wherein the extraction process leaves significant damage to the landscape. The South African government has to this effect enacted the Environmental Act[32] with a specific objective, *inter alia*, to deal with the conduct and operations of the mining houses. It will be researched as to how the two would be able to co-exist without unreasonably and unduly imposing plethora of taxes and levies on the mining and petroleum companies which levies may in fact be duplicatory and cumbersome and most probably self defeating.

Consaglieri, Jaime F.[33] on page 4 of the Series researching the Peruvian royalty is also of the view that some levy representing compensation must be charged by the owner of minerals. To the author, royalty applied to the mining activity is the charge incurred by companies for exploiting a resource that is the State's property. She finds that the Peruvian Constitution in article 66 and various resolutions and reports of organisations such as the United Nations and the World Bank supports the levying of this charge.[34] Flowing from the negative impact that a mining activity has on the immediate localities, Consaglieri points out that another human disaster could result from a failing mining activity.

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[31] Gonzales, supra
[32] National Environmental Management Act 107 of 1998
[33] "Mining Royalty as Compensation Not Tax"

She observes that taking into account current technological advances in the mining industry, it is probable that in less than 15 years mineral ore reserves currently being exploited will be almost exhausted and what remains will have a lower mineral content, which in view of high production costs will make extraction uncompetitive or unprofitable. When a mine closes, in addition to the environmental impacts, another direct consequences for the population of the area is the substantial loss of income and indirect service due principally to the fact that mining does not generate other enduring local activities or initiatives.

It is evident from these observation that the government of Peru was moved as recently as 2004 to start deliberations which would lead to the enactment of a Royalty Act.[35] The main objective thereof is the protection of its human capital in areas surrounding the mining activities over and beyond the environmental preservation. Consaglieri, noted "the proposed legislation for the application of mining royalties stipulates that revenue generated will be allocated to the "financing or co-financing of investment in the production projects that articulate mining with the economic development of each region in order to ensure sustainable development of urban and rural areas."[36]

In proposing the percentage to be charged as royalties on the minerals extracted, the legislation further provides that the revenue raised will be distributed among regions and municipalities exclusively for the purposes of financing investment projects. The early stages of this legislation are admirably an effort of the stakeholders in the form of communities wherein the mining activities are taking place, the government and the mining companies. She however notes that such a joint effort has its disadvantages in that it would lead to delays and ultimately stagnation of progress due to seriously differing interests in the topic.

Kuyek, Joan[37], at page 5 of the Series, notes that mining in Canada enjoys power far well in excess of its economic contribution. In other words the author is one of those researchers who found that mining companies do not make just and equitable economic contribution to the national revenue, despite the power they command in the economic circles. It is to be conceded at the outset that economic power does not necessarily equate with economic excellence and wealth accumulation.

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[34] Consaglieri, op. cit at page 4 of the Series
[35] Mining Royalty Law particularly article 9 of the Bill passed in session on the 03rd June 2004
[36] Consaglieri, supra at page 4 of the Series

She finds however that "the Canadian tax system has evolved over time in response to the demands of industry lobbies, so that despite millions in perverse subsidies, mining companies pay almost nothing in taxes. They manage to achieve this through tax planning techniques and deductions that result in accounting losses even in years where when commodity prices are high, and through ensuring that most taxes are based on '*net profits*' rather than on sales."[38] She further illustrates using economic figures that indicate that the four big mining companies[39] in Canada have, despite substantial sales recorded during the year 2003, paid far less taxes or were in effect being owed by government for tax losses.

The direct consequences of this trend as the learned author correctly observed is that even in Canada, the return on investment from the mining industry to the federal and provincial government is shrinking in terms of cash revenues, contribution to the GDP and employment, while the environmental and social costs are rising. At the same time the ore reserves are undoubtedly being depleted.[40] This preference on levying the royalty on profits propels governments, environmental lobbyists and local communities to be actively involved in the determination of what royalties to be levied.

The realisation comes, *inter alia*, from a trite legal principle that tax avoidance is legal and as such astute accountants and lawyers that these mining houses keep in-house, are able to plan their tax books in such a way that they pay little or no tax at all. This realty, the paper will show, runs deep within anyone who insists on levying royalties on revenue instead of on profit basis. It becomes an unfortunate turn of events when the stakeholders fail to see a line of compromise and dig deep on their positions because the possible reality is that, even where an honest research shows that a royalty regime based on sales will be detrimental to the national mining industry,[41] such gesture might be rejected by government which does not differentiate between small marginal miners and well off mining company like De Beers of South Africa.

This realisation which unfortunately exists in mining companies' accounting books, would also force government to differentiate imposition of a royalty, which is introduced as an alternative levy on the concessionaires and miners to avoid these kind of legal evasions.

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[37] "Myth and Realty: Understanding Mining Taxation in Canada"
[38] Kuyek, op. cit at 5 of the Series
[39] Barrick Gold, Placer Dome, Inco and Noranda
[40] Kuyek, supra at 5

"In Chile a pivotal public debate has developed over the last year concerning the mining sector's tax contribution and especially the application of royalty to copper exploitation. Chile is the world's principal copper producer and its export constitutes almost 40% of global copper supply. For many, however, the sector's contribution is too low."[42] The author furthers the similar threats in mining tax schemes, which are harmful to the national treasury and national revenues. He specifically observed that in the fiscal period from 1990 to 2001, a state owned mining company called Codelco paid to the Chilean treasury about 10, 659 million US dollars, while private mining companies only contributed 1, 638 million US dollars, in spite of their production being 25% greater. In addition, taxes paid by Codelco per metric ton of copper produced represented 28% of the final price while taxes paid by private mining amounted to only 5.3%"[43]

It is therefore not surprising, when the author points out that the estimated loss in total revenue to the Chilean government over the past decade runs to 10 000 million US dollars. To add insult, Pizarro found, from his work on miners' contributions to national revenue, that multinationals leave much to be desired. He says "[T]he state of private mining company tax contribution was pathetically demonstrated in 2002 by the sale of Disputada de Las Condes, a mining company belonging to the multinational Exxon. For 22 years the company paid no tax at all to the Chilean state, declaring losses every year."[44] To further rub insult on to Chileans' faces, the explanation given by the multinational in question was to the effect that multinational companies use any legal subterfuge to avoid paying taxes. This argument is true of many advanced tax systems in the world but the effect thereof is that countries such as Chile, Latin America and African countries who are being deprived of these revenues will forever lack any meaningful economic development while at the same time their mineral / ore reserves are being depleted. This unfortunate consequence perpetuates the disparities and inequalities that Gonzales referred to.[45] It is such perception that supports an argument that royalties must be levied as separate and non-tax related levies so that in some instances their revenue derived therefrom could serve a specific purpose.[46]

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[41] This view is also raised by the South African Competition Commission in criticizing the government's attempt to introduce the Mineral and Petroleum Royalty Bill of 2003 and is discussed hereinbelow

[42] Rodrigo Pizarro "The Establishment of Royalty in Chile" at 7 of the Series

[43] Ibid

[44] Ibid

[45] Gonzales, op. cit at 3 of the Series

[46] These authors suggest that it is immoral for miners to avoid liability in the face of land degradation, inequality of wealth, abuse of various rights and poverty. Given these circumstances such conducts defy any moral expectations one would have of companies that destroy landscapes. The same position must by necessary and logical extension apply equally to the two economies found in South African economy.

Pizarro argues that mining uses non-renewable resources, meaning that there is an economic rent, that belongs to all the Chileans and which at present is appropriated by the industry. The author notes that in the beginning, government and mining companies, as allies, had deliberately ignored and isolated discussions on the need to introduce and administer mining royalties. The prevalent reasoning for discouraging these debates was that royalties "put a brake on investment. But the evident injustice of the mining sector's level of contribution, and above all common sense, inspired many citizens to organise around this demand."[47] The government of Chile eventually listened and promulgated a legislation that imposes royalties on mining and finally acknowledging the Chileans' rights to those royalties.

This apparent victory for the Chilean is given two reasons by the author; *viz.* that the first reason is that by enacting this legislation the government marked the beginning of the end of a mining tax regulatory and framework that benefits large scale mining to the detriment of the country; and secondly, the enactment of royalty law showed that the masses of Chile were able to impose their views on the political class that is increasingly becoming "distant from the concept of great politics in which the public task involves strategic vision."[48] Although the government is beginning to take measures which would restore to the Chileans economic benefits from the sector so closely and intrinsically linked to its economy, Pizarro notes that this unfortunately occurred at the cost of ceding to the multinationals practically all of the income that belongs to the country".[49]

Fortunately for other countries, national constitutions had foresight to foresee the devastating roles that foreigners, with no political and sentimental loyalties to the government and people of the host mining country may have on their development. The constitution therefore would have clauses that are as specific as those of Colombia, which provides, in Article 360, for "economic compensation by way of royalty for the exploitation of a non-renewable resources. It also establishes the right to a share in these royalties for the departments and municipalities where the exploitation takes place, as well as for the ports through which the resource, or products derived from it, are transported."[50]

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[47] Pizarro, supra
[48] Ibid
[49] Ibid

Arbelaez, referred to hereinfra, notes that in the past mining industry was exempted from the payment of Royalties and this was a result of the old Spanish Roman legislations. Those that were exempted from royalties could pay certain specific taxes. Recently and for private mining company's perspective, royalties represents an unavoidable fiscal levy arising from the inherent nature of their industrial activities. The Colombian law seems to have covered the loopholes in that local and regional governments are authorised and obliged "to use the revenue from royalties for investment programs and regular ongoing programs in accordance with the priorities and development plans of each territorial entity".

The central distribution of royalties must follow criteria of social justice on a national scale, with particular focus on electrification and road network projects."[51] Colombian Royalties are also administered through a legislative created body called the National Royalty Fund, a project that this essay will propose that it be adopted and implemented in the South African Mineral and Petroleum Royalty Bill.

Queensland and Western Australia are dependent on the mining industry and have legislations that empower government to impose royalties on most of its mineral ores. The Minister and/or governors of Australian provinces also regulate the formula.

5. Summary of international comparative literature

A definite picture seems to suggest that countries wherein mining has meaningful contribution to national economies have introduced royalty levies for the exploitation of their country's or national non-renewal minerals. These royalty charges are imposed in addition to tax regimes that exist and in effect, the two seem to be serving the same purpose, *viz*. to generate revenue for the national treasuries, albeit in different ways. It becomes apparent that the introduction of, or debates surrounding, royalties are more socio-politically driven in that local politicians and scholars thereof perceive the refusal or non-payments of royalties, as tantamount to abuse of the national treasures without any compensation therefor. Another author fell short of calling this royalty non-payment by these big mining houses, theft.

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[50] An extract from an article by Mario J. Arbelaez "Mining Royalties in Colombia" at 9 of the Series
[51] Ibid

This feeling of 'illegal' deprivation rightly or wrongly is fuelled, it is humbly submitted, by mining houses themselves with their emphasis of insatiable need to maximise more profits. This need coupled with optimal exploitation of those lands and minerals carry with it the ultimate destruction they leave behind each and every used mine, land and mine dumps. In many instances there is little or no financial corresponding gain by the locals. In other cases, one often read news reports where oil and mining companies, particularly diamond producing companies are being implicated in either corrupting local authorities, and in some cases supporting and encouraging tribal and sometimes civil conflicts. These incidences occur mostly in growing countries and multinationals become beneficiaries from such conflict and corruption ridden countries.

This, it is noted, is a socio-political perception that is fuelled further by the inequitable compensation of even their labour component and the financial arrogant image that miners / employers and multinational parent companies display. It is a known fact that mines thrive on migrant labour system and as such they consume many husbands and fathers who are forced at the pain of fending for their families and societies to live in sub-human single compounds or hostels in the city centres or near mines and never to be seen while their rural families and the much cherished social fabrics and family units are broken. Socially, people are dislocated, as the mining wheels of production grind on irrespective of the harm and damage it leaves and all in the name of production and profit.

These multinationals frequently speak of multi-millions US dollars in profits and millions of tonnage of minerals to be produced each year and huge reserves, which extends the life of a mine to decades and generations of local inhabitants to come. The locals have no congruent gain to show for the environmental, social, economic sufferings that their communities suffer at the hands of these mining houses that seem to be raking unimaginable financial figures in the entire process. These are some of the negative sentiments and observations that propels the authors of the series considered in the definition and paragraphs referred to hereinabove to urge other countries to ensure that this gross abuse and destruction of lives, land and societies does not take place without any prospect of gaining any tangible compensation for their destroyed lives.

In cases where the debates are fresh as in Peru and Chile, the heated debates that take place between mine houses, governments and civil organisations centre on percentage and formulae to levy on the proposed royalties. It is evident that mining houses prefer

low royalty percentages chargeable and that government must impose royalties either on profits or when the mining companies are '*in accounting'*. This proposal, as was argued hereinabove, creates uncertainties for the State and civil society leaders given the possibility and abilities of mining houses to 'create' scenarios that could for many years in succession, evidence accounting losses, which would in effect excuse them from paying any royalty to the State.

Whereas it is not illegal for any company and individual to avoid paying taxes, many countries have no corresponding legislation to deal with creative attempts to avoid paying rents and royalties. It therefore is risky for the public sector to trust that business will live up to its obligation to pay royalties hence one finds the disturbing studies conducted by the Latin American authors considered hereinabove concerning the actual profit made by mine houses and what they actually paid into the national treasuries as royalties.

On the other hand government and its supporters prefer higher royalty rates and that the royalty formula be revenue instead of profit based. The idea from the Latin American authors is that it is easier to detect the revenue generated by mining companies without entering deeper into their accounting books. Figures of trades are easy to access and are not as intrusive as any attempt to search for the losses and/ or profits. The debates inevitably take place amid the inherent differing interests of government and business as the two are incapable of agreeing on what seems to be making business sense. It would therefore make sense that in the midst of this inherent mistrust between public and private sectors, government would take the matter into its hands and be assured that despite any possibility of creative accounting, certainty in the form of revenue based royalty scheme would at least yield some meaningful compensation into the national revenue funds.

It would be evident that even in South Africa, the issues are still the same as those already considered at an international level. Government and business, expectedly approach royalty issues differently. Each sector seeks to have its position winning the day and consequently, debates are inevitably to be as heated as countries considered in the paper. It would be the functions of this paper to critically look at the differing positions and provide an analysis of issues, as they stand, and try to find middle way by proposals for the successful implementation and administration of the mining and petroleum royalty scheme in South Africa.

6. South African position on royalties

6.1. The night before the dawn of the new era

The South African mining jurisprudence has a long history to it, from its origins to the developments led by the new government. Van Blerck points out that "[A]mple evidence exists that mining of base mineral and gold by the indigenous peoples of South Africa occurred since the ancient times. Many of these mining sites are still preserved and may be visited by those interested in the origins of an industry which has dominated the events in Southern Africa's more recent economic and political history."[52]

Indeed the author is right when one has regard to the discovery of the *Maphunguvhe* mines which have been declared national heritage sites and their golden rhino statute which is being used by South Africa as one of the very old evidence of the African people's involvement with precious metals and other related ores. Van Blerck notes that a turning point was reached in the 1860s with the discovery of diamonds in the vicinity of the Orange River and at some other areas in the country, discoveries which he says set the stage for the subsequent enormous growth of the mining industry in South Africa.[53]

The legislative era began as early as the 1900 with each of the colonies of the Union government having their own little pieces of legislation regulating mining industries in their own lands. The then Transvaal's Precious and Base Metals Act 35 of 1908 allowed for private ownership of the ore, the land in which minerals were found. The right to prospect, mine, extract, produce, and dispose were all in private hands with mining houses only being liable to the state for taxes and other related rates. Tetrault[54] notes that "[S]ince the development of deep underground mines in the late 1800s, the South African mining industry has been dominated by large mining enterprises." The immediate communities were in turn to benefit from the state distribution of funds or revenue to all the provinces equally and not according to the minerals extracted from certain parts of local communities.

This state of affairs went on for many decades and the twenty-first century's new South African democratic dispensation brought with it fundamental changes in the mining

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[52] Van Blerck, M.C Mining Tax in South Africa 1990, at page 1-2
[53] Ibid
[54] See infra for full reference at fn 64

industry. These changes saw the state taking back through legislative means all the lands, minerals, ores, un-mined precious stones and the rights to mine, extract, prospect, produce and to dispose. All these were codified in the Mineral and Petroleum Resources Development Act[55] (to be referred to as "the Development Act"). Before the Development Act, South Africa had all these Acts from the colonies and most of these Acts conferred mining rights on the mining rights holder in accordance with the common law position on land ownership. However the position changed when section 123 of the South Africa Act 1909 provided *"All rights in and to mines and minerals, and all rights in connection with the searching for, working for, or disposing of minerals or precious stones, which at the establishment of the Union are vested in the Government of any of the colonies, shall on such establishments vest in the Governor-General-in-Council."*[56] This official position represented the governmental and jurisprudential shift of ownership of land and mineral rights.

The unification policy on mining went on until it was confirmed by section 107 of the Republic of South Africa Constitution Act 32 of 1961. Franklin and Kaplan, however, note that consolidation of these colonial mining laws resulted, between the years 1964 and 1967, in the passing of four important consolidated mining laws. Among those was the Mining Rights Act 20 of 1967. This Act vested ownership of mining rights, particularly of base minerals on and under any land onto the holder or owner of the right.[57] The State, however, reserved for itself ownership of precious metals[58] and natural oil. This vesting of ownership of base minerals onto the holder or owner of the land was the legal philosophy of the legislature concerning the searching for and exploitation of all minerals and metals other than precious stones. This policy was furthermore carried into the new Mining Act that came to be known as the Minerals Act 50 of 1991.[59] The dominating "hands-off" approach by government was reminiscent of the common law position in respect of the owner or holder of land or mineral, being a *dominus cuius est solum eius est usque ad coelum et ad inferos, i.e.* being an owner of a land and of everything that is

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[55] Act 28 of 2002

[56] Franklin and Kaplan "The Mining and Mineral Laws of South Africa" (1982) Butterworths at 1

[57] Ibid, at 35, 91 and 334. Section 2(1)(b) of the Mining Rights Act 20 of 1967 provides that "*the right of prospecting and mining for and disposing of base minerals on any land is vested in the holder of the right to base minerals in respect of the land.*"

[58] This preservation of ownership rights in respect of this mineral continued under section 46(1) of the Minerals Act 50 of 1991.

[59] Section 5(1) of the Act provides that the holder of the right to any mineral shall have the right to enter upon such land for the purposes of prospecting or mining and to prospect or mine for such mineral on or in such lands and to dispose thereof. See further and more clearly section 47(2), which dealt with "*Continuation of mining rights*".

in and/or outside it.[60]

The State was able to issue rights, on contractual and financially beneficial bases, relating to all those minerals owned by it to commercial miners for a financial consideration payable to the State for the right to use and exploit those rights. There was, at that stage, a possibility that the State provided lease for the granting of such mineral rights and received what was known then as the lease consideration. Franklin and Kaplan noted that "[T]his consideration may take the form of a share of profits, in which event the share of profits is fixed by the Mining Lease Board".[61] These were not received as tax income but were treated in the same way as the current proposed royalties are. The Minerals Act of 1991 in various provisions[62] made provision for holder consenting to another person using the holder's rights in and on land or mineral. It furthermore acknowledged, particularly in section 47(2) thereof, that the holder shall have the common law rights to his mineral rights and to the to use of his land. These were extra-curial payments together with rental income and for that reason, it is respectfully submitted that royalties, in any form shape or title, are not new in the history of South African mining industry. Mining houses were even allowed tax deductions on payment of royalties.[63] It should therefore be noted, when discussing this topic, that these species of levies have always been part and parcel of the payments by mining houses to the holder of mineral rights.

6.2. The day after the dawn of the new era

McCarthy Tetrault,[64] of Marchand Snyman, Muratie Investments Pty Ltd, correctly noted that the South African mining sector today is a vastly different arena than the one previously controlled by the big mining houses, having undergone series of changes in the past two years. These changes include: (i) the Mineral and Petroleum Resources

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[60] See the decision of Caney J in *SA Permanent Building Society v Liquidator, Isipingo Beach Homes (Pty) Ltd and Others* 1961 (1) SA 305 (D) at 313C; Howitz AJP, in *Odendaalsrus Gold, General Investment and Extensions Ltd v Registrar of Deeds* 1953 (1) SA 600 (O) at 604D and Butterworths Forms and Precedents: Commercial Transaction 6, at 21 and Frankiln and Kaplan, op. cit at 5-7

[61] Franklin and Kaplan, op. cit at 701

[62] See specifically section 47(1)(b) which clearly illustrates that these mining rights could, in the past and will in the future, be capable of being ceded, transferred, let, sublet, tributed, subdivided, mortgaged wholly or in part, and section 47(1)(c) which specifically makes reference to payment to the holder of periodical compensation by virtue of such mining right or share therein immediately prior to expiration of such period of two years, unless otherwise agreed upon by the parties concerned.

[63] Franklin and Kaplan, supra at 710, see further below where the writer suggests that this consideration be extended even under the 2004 Mineral and Petroleum Royalty Bill

Development Act, 2002, (ii) the introduction of Broad Based Socio-Economic Empowerment Charter for the South African Mining Industry[65] ("the BEE Score Card"), and now (iii) the introduction of the Mineral and Petroleum Royalty Bill.

It is appreciated that the authors herein captured the essential aspect of a changing South African mining face and have aptly dealt with various challenging issues that beset the industry in their well-considered and rounded analysis of this sector. The author also note that "[A]lthough the industry has seen significant restructuring in the past ten years, the fact that the bulk of mineral title (especially the more prospective titles) in South Africa has been held privately by the mining majors has precluded the emergence of a significant junior mining sector or the operation in practice of free entry principles, notwithstanding that exploration for and the exploitation of minerals has for a long time been controlled under a system of state permitting."[66]

It therefore appears that the State had, in the past, authority to permit certain mining activities and held mining rights, which it never actually used. The state further never monitored this industry and left it in the hands of the mining houses in the hope and belief that these houses will work to the benefit of the entire country and continue to promote business by including and encouraging smaller companies to also partake in the mining business. Tetrault seems to point out that smaller players were sidelined and it would appear that most of small players indeed preferred to hold on to their mining rights and licences and stood by the side, leaving the industry in the bigger corporations' hands. It is clear now that, with the introduction of the new Mineral and Petroleum Resources Development Act “the Development Act”, smaller players have now no option but to jump into the industry lest they stand to loose their titles and rights if those are not used.

This is the apparent *"use it or loose it"* attitude that seems to dominate the intentions of this new Act. Tetrault further points out that the Development Act legislates the abolition of private mineral rights in South Africa and replaces them with a system of state licensing based on the patrimony over the minerals being vested in the nation, as is the case with the bulk of minerals in other established mining jurisdictions such as Canada

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[64] Roger Taplin, McCarthy Tetrault LLP “Doing Business in South Africa's New Mining Environment: A Legal Perspective” September 2003 at 1 of 19

[65] Published in draft form in October 2002 and the related check-list document released in February 2003

[66] Tetrault, op. cit, at 1 of 19

and Australia."[67]

The aim of the Development Act is to take back the ownership of mining, as an industry, into the hands of the state and the state basically will henceforth grant mining houses permission or access, through licences, permits and leases, the right to prospect, reconnonainse, mine, extract, produce and dispose those mined products.[68] In return for such rights, government is looking to gain two important objectives in the form of (i) financially compensating the local communities from whose areas or communities minerals and ores are being extracted with some kind of payments in the form of royalties and (ii) inclusion of those who have been systematically excluded from the mainstream economic activities by the Apartheid laws *via* the adoption and implementation of the Broad-Based Black Economic Empowerment "BEE" objectives and BEE score cards. Tetrault observes that "the Act is an ambitious statute with wide-ranging objectives, including sustainable development and the promotion of equitable access to South Africa's mineral wealth by the inclusion historically disadvantaged South African ("HDSAs") in the industry."[69]

Regarding royalties, there has, prior to the advent of the new democratic era, been no specific legislation to deal directly with royalties[70] except what appears, in the past, to have been disguised payments by mining houses of lease considerations and currently, private arrangements between local authorities of communities like the Royal Bafokeng in the North West province of South Africa and the mining houses that are engaged in mining operations in those communities.

The fact of the matter is that there are many areas from which certain minerals and ores are being mined and no such specific agreements exists hence it became apparent that the South African government saw it necessary to enact a law of general application that would deal exclusively and specifically with royalties. This move has, as in other mining countries where royalty payments have been proposed, sparked heated debates between governments, mining houses and economists.

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[67] Tetrault, supra
[68] ITC 652 15 SATC 373 at 375 held, correctly so it is submitted, "the right to mine is an incorporeal right and as such it can be let." See also the reference to the pre-amble in page 44 hereinunder.
[69] Tetrault, supra
[70] This paper has also shown, through the work of Kaplan and Franklin, op. cit, that the 1967 Mineral Rights Act allowed Government to share profits with mining houses for essentially what worked more or less like the current royalty scheme.

Government through the minister of finance seeks, *inter alia*, to recover and boost the national revenue through the collection of royalties. The proposed rate of chargeable royalties varies from 1 to 8 *per cent* on specific minerals such as diamonds. The initial indication is that there is a clear understanding that royalties are not taxes but separate levy chargeable by government to the mining houses for exploiting national minerals. Van Blerck, at pages 3 to 6, takes the point further by showing what South African courts have found to distinguish characteristics of tax from those of royalties. In South Africa, as in many advanced countries, a taxpayer can, when submitting tax returns, claim deductions of all expenses and losses that he incurred in the production of income, provided such expenditure and losses are not of a capital nature.[71] The remainder of the returns would be a taxable income. "Once the taxable income is determined the taxpayer's liability is determined by applying the applicable tax rate(s) against the taxable income."[72] This is how the South African government collects revenue for its administration of the country.

The Commissioner of Revenue Services can, in his discretion, allow many various deductions (general or specific) that, in his opinion, are in accordance with the general formula for the determination of taxable income. The special deductions are, *inter alia*, repairs, interest, finance charges, legal expenses, manufacturing expenses, and wear and tear.[73] Van Blerck points out that with the South African mining taxation system, there are categories of mining deductions that are provided for in the special deductions provisions. These are: (i) the capital redemption deduction and the capital allowance in sections 15(a) and 36; (ii) the prospecting deduction in respect of prospecting outside a mining lease area as provided for in section 15(b); (iii) the beneficiation allowance in section 15A …[74]

The relevance of this formulation of taxable income herein is that in enacting the national mining and petroleum royalty scheme, government has to, by all means, avoid incidences of double-taxation of taxpayers hence it becomes vital to classify and treat royalties as non-tax related payments. Furthermore, it is imperative that government does not, in avoiding double taxation of taxpayers, unduly and without any just reason impose punitive levies on its citizen particularly when those levies could have unintended consequences of killing off business and preventing growth, prosperity and economic

[71] See section 11 (a) of the Income Tax Act 58 of 1962 as amended.
[72] Van Blerck, op. cit at 5-3
[73] Sections 15 and 36 of the Income Tax Act make provisions for these specific deductions.

development.

Van Blerck notes that the determination of mining industry's taxable income follows a general formula but with certain important modifications, among others, the special deductions referred to hereinabove. It is argued that it would also be easier to exclude royalties from the definition of tax as provided for in the opening paragraphs of this essay *i.e. whether it is a requited payment by mining house*. It is, however, not clear as to whether mining houses would be able to claim, as tax deductions, royalties paid to the government. It is submitted that royalties, if one accepts the definition and the main reasons why they are being levied, are by nature expenses that mining houses incur for the production of income and are therefore deductible from taxable income, possibly as wasted capital expenditure. This, it is submitted, has the desired effect of balancing out the losses by both government and mining houses when one considered the debates herein above regarding the formula to be followed in levying royalties *viz*. on revenue or profits.

The reasoning behind this conclusion is that government would like to impose royalties on revenue taken from deemed tradable figures and ignore the loss or profit incurred by the payer and this would guarantee constant revenue from mining houses. Mining houses that would like to have royalties imposed on profit are consoled by the fact that what they pay as royalties is deductible in determination of a taxable income. It is only fair for the mining houses that would otherwise be compelled to pay tax based on a clear formula in the Act, but yet the same tax formula refuses them to deduct what is clearly an expenditure of a capital nature.[75] This position seems to be foregone that it will be made an official position if and when the Bill is signed into an Act.

Is it apt to impose the royalty scheme in South Africa and if so why? Is their imposition an added strain to the economy, and most importantly, is there a specific need to impose royalties. The debates in South Africa have polarised into what the business sector feels are the unintended and possible devastating effects of royalties on their industry while government sees a necessity of levying these royalties.[76] It is apt therefore to consider in detail what each sector has to say in this regard. Mining houses, chamber of mines, and

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[74] Van Blerck, supra at 5-19; see also Franklin and Kaplan, op. cit at 708

[75] Van Blerck agrees with the writer at pages 10-5 and at fn 8 therein he suggests other possible deductions on royalty expenses.

[76] The writer has read many business newspapers (print and electronic) and found that the concerns are all the same.

financial institutions represent the business sector while government and its like-minded organisations defend the Treasury's Bill.

6.3. South African business' position on the Royalty Bill

At the outset, it is apt to note that business is not too happy with the introduction of this levy, and with the proposed formula used by government in levying royalties. In an article in the Financial Mail daily newspaper, Andrew McNulty is of the view that the Minister and the Department of Finance are in a process of reviewing the entire tax regime of the mining industry. He observes, "the proposed review seems to reflect a recognition that changes are already being made in the industry's tax regime. The announcement came with reference to the Mineral and Petroleum Royalty Bill, on which, Manuel [the finance Minister] said the government is continuing with its work. The Bill provided an opportunity for a broader review of the industry."[77]

It is perhaps this perceived changing environment and an uncertainty-riddled context that the introduction of Mineral and Petroleum Royalty Bill has been sceptically viewed by business. In fact, McNulty concludes his analysis by arguing that "[W]hile some recognise that the tax mining formula may need to be updated, and needs to be considered alongside other aspects of mining tax, including the royalty bill, there are concerns the review may lead to a lesser tax-friendly environment for long-term projects or marginal mines."[78]

Marius Van Blerck, a director of group tax at Standard Bank, one of the four major banks in South Africa is quoted as saying that royalties have no place in the modern world and that it is a medieval or pre-medieval term.[79] The main issue from the financial institutions' point of view is that royalties create an unnecessary scare to the much-needed investment revenue and it creates uncertainties and unnecessary risks in an inherently unstable investment area. This has the potential to thwart any hopes of potential investment in the industry and the country at large. Mining and financial analysts argue that the Bill might engender the destruction of small mining businesses, increasing of operational costs, increasing of unemployment and downscaling of current labour forces,

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[77] McNulty "Mining Tax: Five year reprieve clouded by new area of uncertainty" *Financial Mail* 20 February 2004 at 1 of 1.
[78] Ibid, at 2 of 2
[79] See Platinum today website in an article titled "Royalty bill will 'stifle' mining industry" 21st July 2003 at http://www. platinum.matthey.com/media_room/1058774404.html

thwarting Black Economic Empowerment potential businesses and defeating the mining houses' efforts of lending helping hands in the fight against HIV/AIDS.[80]

Van Blerck is further quoted as saying that "[E]mployment was the major problem in South Africa, and a revenue-based royalty, as is currently proposed by government would drive up costs, leaving less cash for new projects and the creation of sustainable jobs."[81] In so saying he joins business analysts who would rather see the revenue-based royalty being replaced with profit or in-tax formula. The South African Mineral Development Association “Samda” which represents junior mining houses shares this view. Its chairperson, Bridgette Radebe, notes with concern that the Bill, as it stands, would have the unintended and undesirable effect of double-royalties payment on some mining houses.[82]

She gave an example of Impala Mining Company, the second largest platinum producer in the world, which currently pays royalties to the Royal Bafokeng nation who owns the land from which platinum mining is carried out. This outcome would indeed result in a negative financial burden on such mining companies and they would in certain instances be justified to label such additional levy as punitive. This is a noteworthy issue that deserves a proposal in the form of either reconfiguration or reconsideration.

Eric Lilford, of Investec Resource Finance Department has also emerged as a leading financier to criticise the current Mineral and Petroleum Royalty Bill. He is quoted as saying that while the Mineral Development Act was workable and could make substantial contribution to enticing investment, the royalty Bill "seems to be rather punitive to the industry". His concern was that the proposed royalty Bill would reduce the fundamental values of all mineral properties while royalties would take precedence over debt redemption. This consequence, Lilford observes, would mean that the financiers might have to consider longer facility terms or require greater equity contributions by the sponsors. The end result of this financial wrestling would contribute to higher project hurdle rates, resulting in less attractive projects not being financed. He further notes that the negative effect of this hurdle is that black economic empowerment projects would be choked out of life and would suffer in the long term.

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[80] These views are also raised and contained in the submissions presented by the Competition Commission.
[81] Platinum today, supra
[82] platinum today, supra

Furthermore Lilford is quoted as pointing out that initially the royalty Bill would contribute handsomely to the national treasure, but the long-term result of the Bill would be that "mines would have shorter lives, leaving ore uneconomic to mine in the ground. This may in due course lead to wide scale unemployment in the mining industry, possibly negating the earlier benefits."[83] Harmony Gold's Ferdi Dippenaar who argues "his group will support a profit-based tax but any fixed revenue-based royalty would increase costs and could put severe pressure on the bottom line" clearly shares this view.[84]

The views of Lilford deserve more illustration and hearing, as was the case in the Business Africa Online.[85] In this article further concerns from Lilford show that commodity producers will be treated differently in terms of the applicable royalty rates according to what is mined. This will result in de facto prejudicial treatment of certain mining entities over others. Furthermore shareholders' returns will be reduced both in terms of distributable income (dividends) and capital appreciation, contributing to South Africa becoming a less attractive mineral investment jurisdiction."[86]

At page 2 of 2 Lilford comes to the conclusion that "[T]he royalty is effectively an additional tax, which will reduce profits and therefore have a direct impact in the shareholder value. Tax rates are said to be disparate than the government currently states. Depending upon the commodity produced and the applicable royalty rates, inequitable effective taxation increases will be levied against operations." The actual concern of Lilford herein is that as the taxation rates of South African mining industry are already internationally competitive on their own, introduction of royalty rates in addition thereto will have an effect of being, as he noted, punitive. The Competition Commission, in dealing with taxation of mining operations, starts by stating:

> *"[W]ith the implementation of the royalty bill, all royalties will be tax deductible. According to the Treasury, the mining sector has benefited from low tax payments. In 1990 the industry income tax of 6.7% of gross sales, which fell to 1.5% in 200/2001(sic). But that decrease in tax was partly attributable to a the (sic) declining profitability of South African mines. This does not imply that mines*

[83] See article titled "Criticism piles against royalty bill" July 1, 2003 at http://www.sadocc.at/news/2003-192.shtml
[84] McNulty, op. cit at 2 of 2
[85] http://www.businessafrica.net/features/mining/320282.htm in an article titled "Mining Royalties to Cost billions" 01-Aug-03

are taxed at extremely low levels, but rather that the costs incurred in mining operations rising as reserves are depleted (especially gold) and therefore lead to lower levels of taxable income are realised."[87]

This concern by the Commission lends credible support to Lifford and Van Blerck's views that the Bill will be counter productive in its present format. In fact the Commission say that South Africa's tax burden on mining houses "is already higher than in other mining countries like Chile and Canada which are both strong competitors for mining investments."[88] It is trite that the Competition Commission has been established to promote and maintain competition in the Republic in order-

(a) *"to promote efficiency, adaptability and development of the economy;*

(b) *to provide consumers with competitive prices and product choices;*

(c) *to promote employment and advance the social and economic welfare of South Africans;*

(d) *to expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic;*

(e) *to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons*."[89]

The Commission[90] sums up its analysis by saying "[I]f one considers the purpose of the Competition Act, Act 89 of 1998, it is clear that the royalty proposals are counter to each and every purpose listed in section 2 of the Act."[91] Its reasons for attacking the validity of the Bill is that "[T]he Royalty proposals seek to levy additional taxes on the extraction of natural resources in an industry characterised by cyclical and volatile prices, which are in long-term decline, and rising production costs. The royalties proposed might exacerbate the decline of the mining industry."[92] It therefore "recommends that the imposition of

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[86] Business Africa website supra, at 1 of 2

[87] See Comments by the Competition Commission on the Mineral and Petroleum Royalty Bill at 2, sourced from www.google.co.za a specific internet search on 'South African Royalties'

[88] Competition Commission, supra at 4

[89] Section 2 of the Competition Act, Act No 89 of 1998

[90] Comments by the Competition Commission, supra at 1

[91] Ibid.

[92] Chapter 2 at 2 and 3 summarizes the Commission's main concerns and argues:
"*[B]y affecting the viability of mining operations, the royalties proposed will lead to a contraction in output of the affected commodities and subsequently a decrease in employment in those sectors. Foreign exchange earnings of the country will also be reduced, which will exert pressure on the balance of payments and the exchange rate.*"

royalties be reconsidered or at least that royalties be charged on profits rather than on turnover."[93]

Furthermore the Commission argues that marginal operations will suffer, as they will be excluded from the mainstream operations if royalties as proposed are retained. The caveat, as it argues, is that SA is a mineral rich country with a potential to provide smaller miners with opportunities. Fixing or sinking costs "by charging royalties on gross sales, irrespective of profit margins that mining operations are yielding", is therefore counter this competition objective. It states "the lower royalty rates leads to smaller declines in employment and economic development and lead to the promotion of downstream benefication of minerals."[94] On an international analysis, the Commission argues that royalty rates will destroy the sector's competitiveness given the fact that there will be an increase in mining costs without commensurate increase in commodity prices. It warns that the likely beneficiaries of a weakened mineral prices would be the developed world's central banks, which are always looking for opportunities to sell their gold reserves, built up in years when gold was a monetary asset.

The writer finds the comments of the commission persuasive and of notable impact. The comments leave one pondering and seeking answers to the foundational question that government has to answer *viz.* does South Africa really have a definite and specific need for the royalty Bill in additional to those individual agreements that currently exist. Countries that have royalty Acts or considering having those Acts intend to use royalty payments for compensating particular communities from which mining operations take place. The South African Royalty Bill is, however, silent on whether the revenue collected from such levies would be used to compensate the immediate communities who suffered or who are suffering at the hands of the mining houses or will it be used as part of the national economic development as is currently the case with the National Revenue Fund. It is submitted that the Competition Commission's view that imposition of royalties becomes an additional tax, although foundationally incorrect, makes sense.

The above sentiments were echoed in an internet feature article/ story of Minesite.com wherein the author points out that the estimation by Trevor Manuel that "had the royalties been payable in 2002, government would have raised about US$518 millions", is ignorant. He says "[I]n so saying he [Manuel] managed to forget the fact that corporate

[93] Competition Commission, supra
[94] Ibid, at 3

tax rates in South Africa are among the highest in the world at 46 per cent. Various bean counters have already come to the conclusion that even though these royalties can be deducted from income tax, a typical gold mining company could find that its tax rate has effectively increased by over 25 per cent."[95]

Although the author's article is riddled with war language against the Minister and the department involved with the Royalty Bill and is mostly speculative, as an economist should be, the article raises one vital issue that this paper will consider in looking at a way-forward and proposals to the debates. A mining company like Anglo American has various divisions each mining different minerals. It would be subjected to the royalty rates on all its different products, a situation which may indeed be harmful to the overall operations of the company.[96] The unintended economic harm to the parent company may or may not be a government's consideration in levying royalties because of the different rates attaching to different minerals. But the harm, *i.e*. reduced income, and raising costs, would unavoidably be serious to the cohesive parent body forcing it to engage in economic destructive cost cutting mechanisms, the first of which always entail job cuts and losses. It would be advisable that government in redrafting the bill formulate something that would ameliorate this possible harm to such companies.

The Chamber of Mines (to be referred to as the "Chamber") has also come out strong against the bill. It states that "[I]t is the view of the Chamber that this Bill is not good for economy nor the mining industry..."[97] The Chamber points out five areas of concern which are (i) principle of Royalty on Revenue, (ii) international competitiveness which they sub-divide into a: quantum, b: fiscal stabilisation, c: internationally competitive tax regime, (iii) Black Economic Empowerment, (iv) local/ rural developments offsets and (v) Double Royalty.

It is not surprising that the Chamber would also prefer that the royalty be imposed on profits as opposed to government's proposed revenue *ad valorem* formula. Its reasoning is that the introduction of a revenue-based royalty adds fixed costs to every mining operation. This, it argues, will have a disproportionate toll on less profitable mines. The unintended result thereof would be the increased costs of mining operations and

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[95] http:/www.minesite.com/archives/features_archives/2003/views250303.htm

[96] In terms of the State's proposed royalty rates, Gold would be levied at 3 per cent, and Platinum at 4 per cent, see annexures at end of the essay.

[97] Chamber of Mines Statement on the Royalty Bill: A press statement by Zoli Diliza, Chief Executive of the Chamber of Mines on 17 April 2003 at 1 of 2

"possible job losses."[98] The Chamber accuses the government of having incomprehensible rationale for the establishment of royalty quantum. The Chamber goes further to point out that government has arbitrarily categorised commodities for imposition of royalty rates thereon which categorisation implies an illogical application of the rates and backed by unresearched and arbitrary act by government.[99]

It says according to this categorisation, government assumes that diamond mining is twice as profitable as platinum or that gold mining is three times as profitable as the mining of granite. The same argument goes to the government's proposed fiscal stabilisation which the Chamber counters by arguing that this would only "diminish certainty, raise investment hurdles and aggravate foreign investor aversion to South Africa's mining sector."[100] Some of the Chamber's criticisms of the Bill are that the Bill would raise costs of capital and increase project risks thus making it more difficult for the black empowerment companies to raise debt finance on suitably favourable terms and to generate cash flow that is needed to for their development into prosperous business.[101] The Chamber argues that the Bill is quiet on an important issue of offsetting royalties with any corporate social investment projects. It would be favourable, on their views, if any such projects could be taken into account in exempting mining companies from paying any royalties. It is therefore disappointing, in the Chamber's view that the Bill does not seem to make any provision for such offsetting mechanism.

This submission by the Competition Commission raises two different issues, which are to be responded to differently in the following manner. The comment on the possible and unintended burdening of Black Economic Empowerment companies to raise finance is particularly correct and persuasive. This is in view of the fact that South Africa, on the economic front, is currently grappling with the definition and implementation, let alone financial administration and modelling of Black Economic Empowerment transactions.[102]

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[98] Competition Commission, supra

[99] The Competition Commission, at 4 of its Comment, takes the criticism further by arguing that there is no co-relation between the minerals out put in SA and the price of the mineral that is finally sold in international markets. It says that mineral products' prices are determinable by many factors, some which disadvantage SA, which in some instances is the main producer of these minerals. It mentions that the OECD favors royalties because they improve the competitiveness of scrap/ recycling relative to primary production. This is because many of the minerals now compete with recycled mineral and the international trend is to subsidize the collection of scrap, something that disadvantages the producers of mineral in SA's position.

[100] Chamber of Mines, supra at 1 of 2

[101] See also the comments by the Competition Commission, supra at 1

[102] Recently the South African Minister of Public Works has uncovered million rands worth of fraudulent BEE related companies and contracts that were awarded by government to apparently BEE companies.

Black Economic Empowerment as a concept is troubling government in so far as conceptualising and advancing it and the real intended BEE companies, on the ground, are further being hampered by financing terms which are either unfavourable or palpably defeat the purpose with which the transaction was intended. Only when this particular problem is resolved, could it be possible to resolve the effects of the royalties on cost of capital.

On the second issue raised by the Chamber, it is respectfully submitted, that the offsetting proposal is not practical and is open to conflicting opinions and possible application. The primary points of contention between the mining companies and the beneficiaries of such corporate social benefits would be to determine the value or extent of the said corporate social project. Secondly a debate on *what* is a sufficient corporate social investment project to warrant exemption must be resolved and agreed to and finally the extent of the proposed exemption must be resolved or agreed. It is submitted that these points are seriously contested terrain with very little of meeting of the minds. It may be that government, in excluding or not considering those other subjective factors, preferred guidelines in the form of competitive and independent market indicators would be objective and would be capable of standing up to a constitutional scrutiny. Speculations, conflicting subjective views and prolonged unnecessary debates over what was done; what was contributed; and the value of the contribution to communities, must respectfully be given little if not chance at all. It is envisaged that government, in passing the final legislation, will not entertain this offsetting suggestion.

The double royalty concern, on the other hand, raises a *justiciable* and a legitimate issue in that the Chamber is, correctly, of the view that the Development Act as the parent Act of the Royalty Bill, preserves the existing *status quo* wherein royalties are payable to local communities that own land from which mining houses exploit minerals. The Royalty Bill does not address the possibility of double payment of royalty as it will, on its implementation and application, force these mining houses to pay additional royalties in terms of the rates that have been determined by the Bill.[103] The government would therefore do well to remedy this possibility, as adverse consequences are likely to result should this problem not be attended to as a matter of urgency.

6.4. Government's position on the South African Royalty Bill

The Department of Finance promulgated the Development Act, which provided a guideline on the new mining regime in South Africa. It also indicated that new route will be taken by government in line with the said regime for levying royalties on minerals extracted from the country and transferred outside the Republic. The objective is to impose a royalty on the extraction and transfer of South Africa's mineral resources. The Mineral and Petroleum Royalty Bill was presented and tabled in parliament on the 10th March 2003 and ever since, was subjected to intense debates by mainly the sector and the investment community. These debates resulted in the Bill being revised. The essay will comment on the original and briefly on the revised[104] Bill and compare those points that were dropped off or picked up, and where possible provide possible reasons therefor.

The preamble of the Bill recognises "*that South Africa's mineral resources are non-renewable and are part of the common patrimony of all South Africans such that the nation is accordingly entitled to a consideration for the value of those resources when extracted and transferred; It further considers the need to create an internationally competitive and efficient mineral resource royalty regime that contains rules seeking: (i) maximum certainty for the investor community in support of sustainable economic growth, and (ii) royalty rate stability within foreseeable future*." Finally it affirms the State's obligation to provide for economic and social development.

At the outset, it is apparent that the financial compensation that the State is seeking from the royalties would not be used to only develop those communities from whom mineral extraction is taking place, but rather will be used to develop the entire country in line with its obligation to develop national socio-economic aspects. This does not differ at all with the other developing countries that also introduced the royalty regimes and provided similar reasons therefor. This, for the writer, may be problematic because the view taken by mining houses and investors may seem justified to cry foul if royalties are to be State regulated instead of being consensual between the parties. For example the question why should mining houses pay taxes and other levies which all meant for national fiscus which may in the end have nothing to do with mining development can legitimately be

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[103] Government Press Statement on Mineral and Petroleum Royalty Bill at 2 of 2, see fn 118 hereinbelow

[104] The writer, when researching for this essay, was reliably informed that the revised Bill has been put on hold by the Minister of Finance and may be released for public comments around early 2006.

asked. The complaint herein has in it possible constitutional implications where the mining houses could challenge the Bill for singling out the rich and forcing them to add to the national coffers. This analysis requires a chapter on its own. At least with the existing agreements with communities, some development ought to be taking place therein.

It is the writer's suspicion that such a question will be answered by reference to the fact that the State owns the land and minerals and what it does with those payments does not concern any person. There may be reasonable justification for picking on mining sector to increase national fiscus but for the investors and miners, it may seem to be a serious infringement of their business and basic investment objectives. Government has adopted certain mutually protective measures in facilitating its imposition of, and justifying State regulated royalty Bill in SA.

6.4.1. Arm's length valuation proposal by Government

The notion of arm's length trading has been known world wide to be fair dealing which is only subject to external aids as reference pointers to the true value or price of a commodity on the market. The concept was also used extensively by governments when seeking to determine 'just compensation' where it has interfered with private property rights by means of expropriation. It will be shown that this arm's length valuation was specifically preferred by government because of its judicial certainty as has been laid down by courts. It has been considered in the context of just compensation hence the law, as set down would apply with certainty to the parties to royalty rates.

In this instance, it is essential to allude to this valuation as a form of just compensation by the mining houses to government and take the reader through why this formulation is so preferred. Furthermore the reader will note that the arm's length formulation has also been criticised by the business analysts and miners alike, hence it becomes necessary to interrogate their complaints in light of the Act itself. The phrase and concept of just compensation is said to originate in the early 17th and 18th century American fifth amendment from the jurisprudential writings of scholars like Grotius, Pufendorf, Bynkershoek, Burlamanqui and Vattel.[105] The basis of establishing 'just compensation' back then is still as relevant and instructive as currently, hence it becomes logical that fair price must dictate business dealings between equal men who have no relations.

Sax correctly points out "[J]ust price, a fundamental premise of the medieval economic life, was founded upon the notion that property and economic position must be subordinated to the attainment of social justice."[106] It is upon this above basis that there will be a brief discussion about the royalties, in the context, of the Royalty Bill of a need and fairness of compensation as proposed by government. Is noteworthy that the Bill only refers to arm's length value definition.[107]

It is conceivable that notwithstanding the fact that compensation is mostly dealt with under the government interference with individual property rights, the same principles *viz*. fair price, just price and social justice could be used by government and or any person for the determination of just price. It is submitted that there are sufficient guidelines that have been generally accepted as international norms in determining *'just price'* whether be it in property deprivation matters or in non-property instances.[108] The main consideration is the market value of the item in sale or the price to pay for a commodity.

The essay deals briefly with this aspect of the Bill (compensation as determined by the Department of Finance) because it has been alleged that the method of valuation and the basis of imposing royalty rates is unfair or incomplete. The government's view is that the method and formula it proposes are reasonable and fair, while its opponent on the discussion argue otherwise. The essay would indicate what a reasonable compensation is and its basis in this instance. The reason is that royalty represents compensation to government for the extraction and transfer of the minerals out of the republic. It is from that angle that the word 'compensation' would need to be interrogated briefly to see whether the proposal of government stands to fail the constitutional and/ or market scrutiny.

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[105] Joseph L. Sax "Eminent Domain" *Yale Law Journal* 1964 Vol. 74:36 at 54

[106] Ibid, at 55

[107] Section 2(1) of the Royalty Bill defines arm's length value of a mineral resource as meaning the "*commercial price or a fair market value that would have been agreed to by unconnected persons for such mineral resource (excluding any transportation or insurance) if those persons were freely negotiating on the open market under similar circumstances taking into account solely the characteristics of quality and quantity of the mineral resource transferred."*

[108] See the decision of the Privy Council in the Indian case of Raja Vyricherla Narayan v The Revenue Divisional Officer [1939] A.C. 302 at 312, is said to be authoritative in this regard. See also Ng'ong'ola, infra at 129 and Sax, supra

Reference is had to constitutional scrutiny in the context of royalties, instead of property clause in section 25 of the Constitution.[109] It must be acceptable that there has never been any mining/ mineral royalties chargeable by state to the mining houses save between individual agreements in the form of private individuals or communities that own the mineral filled land and the mining houses that conduct mining operations on the said land. It would therefore be submitted that the same constitutional obligation and principles or guidelines on government to pay 'just and equitable' compensation to its citizen for interfering with their property rights must by necessary and logical implications apply to government when seeking to determine fair compensation that should be payable to it when imposing royalties. In other words government is probably obliged to use the constitutional formula on compensation to determine the just/ fair method and formula for charging or imposing royalty rates on mining houses.

Section 25 (3) of the Constitution states that:

> *"The amount of compensation and the time and manner of payment must be just and equitable, reflecting an equitable balance between the public interest and the interests of those affected, having regard to all relevant circumstances including –*
>
> *(a) the current use of the property;*
>
> *(b) the history of the acquisition of the property;*
>
> *(c) the market value of the property;*
>
> (d) *the extent of direct state investment and subsidy in the acquisition and beneficial capital improvement of the property; and…"*[110]

It is submitted that section 2 is important particularly if one is to ponder about the propensity to litigation the private individuals tend to be when faced with uncertain clauses in the Act or uncertainties flowing from government conduct. It is further submitted that failure to do so on the part of government, or a use of any other formulation would be unconstitutional and would fail the constitutional muster.

The South African Mineral and Petroleum Royalty Bill imposes royalties on gross revenue / "*gross sales value*" of any mining production based on rates that are further determined in Schedule 1 thereof. It further uses *ad valorem* basis calculation for the rates, a point that has raised serious objections from the mining community. The

[109] The Constitution of Republic of South Africa Act 108 of 1996
[110] Constitution, 1996, ibid

department will publish tradable value of any mineral resource that is subject to royalty and will use those values to determine what the extractor is obliged to pay by a way of royalty. The tradable values are to reflect the arm's length sales price of that mineral on local as well as international markets.[111]

The Bill has, as its applicable rates, a market-related arm's length valuation that is based, *inter alia*, on comparison between local and international markets. The constant criticism that beset the Bill has always been its lack of consideration of effects of tradable currencies and/ or market fluctuations, which transactions invariably fail to take into account the strengths or weaknesses of major international currencies *vis-à-vis* local currency. Critics argue that the proposed formulation of the Bill *i.e*. revenue based royalty regime, fails to consider the role that the local currency (Rand) plays in international markets and how its strength in particular hurts their industrial returns and operations costs.

Could it be that the critics are wrong in accusing the Department of Finance for not considering the effects of the international currencies and their effect on local mining and mineral markets? It is submitted that the proposed bill provides an answer to the query in Section 2 thereof.[112] Firstly, the Bill proposes a quarterly levying of royalties based on arms length valuation of the price of any mineral resource extracted and transferred from the Republic. The said valuation is, as shown hereinabove, the usually trusted method of determining fair price that is used largely in property expropriation and compensation transaction.[113] The said method is of willing buyer and willing seller in an open market. It seeks to rely on external proof for demonstrating the arm's length value of a mineral resource. In so doing it will look at all the relevant fair and independent factors that would assist both parties to come to a fair price or valuation of the commodity at hand."[114]

It is submitted that reference to international and local commodity indices, sales lists and contemporaneous unit prices must, by necessary implications, take into account the

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[111] See Section 6 (1) and (2) of the Royalty Bill

[112] Section 2(2) illustrates the *reliable external proof of demonstrating how the arm's length value of a transferred mineral resource was derived* as,

> *(a) "a local or international commodity index;*
> *(b) a local or international sale price list; and*
> *(c) local or international contemporaneous unit price obtained between unconnected parties."*

[113] Sax, op. cit and Ng'ong'ola infra

current and existing daily effects of the market forces at play. It therefore would be safe to argue that the valuation that looks and considers market forces has been provided for in the Bill and forms the crucial arm's length basis within which to determine a standing mineral value and a royalty rate payable.

Section 2(1) defines arms length value as "the commercial price or fair market value that would have been agreed to by unconnected persons for such mineral resource (excluding any transportation or insurance) if those persons were freely negotiating on the open market under similar circumstances taking into account solely the characteristics of quality and quantity of the mineral resource transferred." Section 6(2) informs the reader thereof that the Publishable Tradable Value of any mineral will reflect the arm's length sales price of that mineral resource on the relevant local and international markets. This concern is also reflected in section 7(1)(e) and (2)(c) wherein the mining houses and investment communities are informed that the operating free markets (local or international) forces operating as at the date and times of trading and levying the royalty in issue.

It would therefore be, respectfully, misleading to suggest that market forces, particularly of international arena are excluded from consideration. The said conclusion is made in consideration of various sections in the bill that purports to safeguard the mining houses and investment communities from various factors that may affect the market value of their mineral and come to a fair determination of a mineral value. It would have certainly constituted a major omission and a breach of the bill's proposed obligation to provide for socio-economic development, had it ignored the effects that markets have on most advanced economies of the world.

The fact that arm's length valuation has been adopted must, with respect, allay the fears of any potential investor instead of scaring them away. The formula has found authoritative judicial approval in many leading cases relating to assessment of fair value in expropriation; deprivation of property running short of expropriation; state interference with private proprietary rights; or straight-forward compensation cases. Most of these cases had to do with government's interference with litigants' constitutional rights to property and its obligation to compensate the litigant a fair value for such interference and/or expropriation.[115]

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[114] Section 2 (2)(a)-(c)
[115] See Manitoba Fisheries Ltd v The Queen 88 D.L.R. 3d 462 at 473

It is not suggested herein that the imposition of royalty scheme on mining houses is neither deprivation, interference with nor is it not an expropriation of mining houses' proprietary rights. The point is that the valuation as formulated in the Bill, also uses or follows, to a large extend, the same judicially tried and tested formulation. Clement Ng'ong'ola assessed compensation in the context of land expropriation laws of the SADC countries and found that the objections these African countries had, was mainly with the market-linked common law interpretation of compensation. This interpretation had 'market value' as its central tool of assessment. He correctly points out that "[T]he concept is readily interpreted as referring to the price which the acquired property could realise in an open market sale between a willing seller and willing buyer. The assumption is that a willing seller and a willing buyer in arriving at such a price would not fail to take into account prices of comparable properties as well as the potentials of the particular property and all its lucrative possibilities."[116]

It then becomes a matter of calculations and figures to arrive to a formulation that results in a set price. Investors and the private sector, it is submitted, must find solace in the fact that the compensation or arm's length formulation could, on the balance of probabilities, pass the South African Constitutional muster and be accepted as a determinant of just and equitable price. It is respectfully submitted that this complaint *may* also not see the light of the day. The use of discretionary *'may'* in the last sentence becomes crucially important when regard is had to the Competition Commission's comments on the use of international tradable figures and indices. The Commission, it is submitted makes a very strong case of those minerals that are not traded on the international markets like the London Stock Exchange. How easy would it be to determine a 'just price' of a mineral when there would be no tried and tested indices to work from?[117] This, it is submitted, is a valid concern that the government of the day has to soberly confront and resolve.

The only issue that remains then on this arm's length aspect is the option of profit versus revenue determination. It is submitted that the essay deals comparatively with different

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[116] "The Post-Colonial Era In Relation to Land Expropriation Laws in Botswana, Malawi, Zambia, and Zimbabwe" *International and Comparative Law Quarterly*, January 1992, from 129 to 135. The objection referred hereto was that sometimes, when considering the potentialities of a property under compensation, sellers tend to inflate their price, which may ultimately discredit the fairness of compensation methods.

[117] The Competition Commission, supra at 2 argues that "*…the publication of tradable values may raise competition concerns in terms of would publish those tradable values. If use is made of international prices, prices quoted on the LME seem to be the most appropriate, but what about minerals not traded on*

angles and formulae that government and private sector would prefer and the reasons therefor. This appears in various chapters in the entire essay and conclusion.

6.4.2. Ad profit vs revenue royalty based debates

The Royalty Bill provides that it would not move away from the gross revenue sales method of levy because of the same reasons the Latin American writers found applicable. According to the Press Statement issued by the Government, "the use of gross *ad valorem* charge is consistent with international best practice. International experience with profit based royalty regimes suggests that it could be avoided by artificially inflating costs and thereby reducing royalty collections to marginal levels."[118] In an attempt to allay investors and miners' fears, government states that "the gross value of any mineral resource will equal its readily tradable 'fair' market price to the extent published by the Department of Minerals and Energy or international commodity price lists." These prices are said to "represent the best approximation of a mineral resource's intrinsic value extracted from South African territory."[119]

Furthermore the Bill proposes to grant certain entities exemptions and reductions. The first of these entities would be marginal mines, wherein the Minister of Minerals and Energy would be empowered to issue regulations that partially or wholly exempt such mines from royalty payments. Part III titled Exemptions and section 8 which in turn is entitled "*Marginal Mine Rate Relief*" provides, at subsection (1), that a mineral extractor who obtained mining rights under the new Mineral and Petroleum Resources Development Act of 2002 may be exempted where the mineral extracted is of low-grade ores remaining as independently verified; and of questionable economic viability.[120] Subsection 2 thereof has many various considerations that the Minister in regulating the exemptions must take into account.[121]

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the LME, and what about different grades of the affected commodities? There would also be administrative costs of determining these values upon which the royalties are to be charged."

[118] Press Statement on the Mineral and Petroleum Royalty Bill dated 20th March 2003, sourced from the http//www.treasury.gov.za

[119] Press Statement, supra at 2

[120] Section 8 (1) (a) - (b)

[121] The Competition Commission is not convinced with the practicality of these exemptions, it argues in its Comments op cit at 4, "[*T]his provision* [Section 8 of the Bill] *raises certain challenges, not least of which is determining whether a mine is marginal. In addition there are a number of public interest concerns such as the effect on employment before a mine is declared marginal, and streamlining concerns, which could lead to increased uncertainty in the mining sector. There will also be excessive spending on determining whether the ore remaining in the mine, inter alia, is of a sufficiently low grade to render the mine marginal.*"

The purpose of such exemptions and reductions of rates, the Press Statement continues, "is to ensure that the royalty does not force the closure of low-grade mines, thereby causing a loss of employment." The second category of those liable for exemptions is the miners who extract minerals for sampling and analysis purposes.[122] The reasoning herein is that small-scale minerals would indeed attract little revenue and it might not be prudent for government to stifle such important aspects of mining operations with royalty charges.

It is however accepted and realistically so, it is respectfully argued, that some mineral extractions, like diamonds and other gem-stones, even though could take place in small quantities may attract huge revenue hence gemstones and diamonds are specifically not exempted from royalty payments. The final group identified for exemptions are the domestically used minerals. These are minerals that are used domestically for the improvement of social infrastructures. Reference is made to minerals like cement, low-grade coal, brick-making resources. These are also low revenue generating minerals which government is of the view that "minerals falling under this exemption have relatively small values and, hence the revenue potential is limited."[123] It has been showed that the Competition Commission singled out, *inter alia*, the imposition of royalties on coal as potentially harmful to the consumers of electricity, as this may escalates costs of living. The Bill, if retained in this format, should allay those Commissions' fears so long as entities charged with providing electricity on government's behalf would benefit from exemptions thus further benefiting the end consumer.

The other provision of the Bill that has created a stir in the investment field is the fiscal stabilisation clause. In terms of this clause, the government wished to lock the mining houses to a premium that guarantees certainty of the royalty rate for thirty years. This provision is found in section 15 (Part iv) and states that the mineral extractor may make this selection which would then be applicable between the parties for the entire duration of the mining, exploration or production rights which is thirty years. There is also a possibility of forfeiture of the fiscal stabilisation election as outlined in section 16 of the Bill.

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[122] Section 9 of the Bill
[123] Press Statement, op. cit at 3

The section does provide for the consequences of failing to comply with section 15 (2) and that is forfeiting the election, but this does not provide most importantly to the mineral extractor and the investor as what would be the consequences of such forfeiture. Is the extractor bound to pay for thirty years the agreed maximum premium of royalty rate irrespective of the productivity of his business? Or does the forfeiture concomitantly bring about the annulment of the entire agreement between the parties?

7. Conclusion

It is particularly clear that economies of the world are enjoying most uncertain wave of market instability. Markets all over the world are affected by various negative socio-economic factors and these results in unsettling price fluctuations if not down spiralling of most securities. Cost of living is also fast rising and governments are forced to reconsider productive ways of making life worth living for their citizens. Corporations are also being forced by the invisible hand of the market to rethink their business strategies and to adopt viable business models and actions. It is no longer safe to rely on single economic activity as competition both locally and internationally is pushing out those already on the margins.

What is also particularly clear is that the mining sector is also experiencing difficult periods in recent years. International competition is very high, cost of local production is high and foreign proceeds are reduced by the strength of the SA's local currency. It is clear that operations are suffering and have no consummate adequate cash in-flow to sustain their business. On the other hand mining taxation and tax regimes in many countries including South Africa are said to be unfriendly to both local and international companies. All these factors affect, negatively, business in SA. However, there are those who argue that most of these negativities were long in the coming and could have been avoided.

The difficulty for miners are compounded when government seeks to levy additional charges like the royalty scheme in addition to the existing taxes which are said to be internationally competitive. The international business sector is already of the view, as one reads this essay, that South African mining environment is not investor friendly and are consequently considering divesting their investments to other countries that are perceived to be financially viable. The Competition Commission noted, "South Africa has a wide variety of minerals, but none of them is unique to the country. Countries like

Australia, Canada, Brazil Chile and Russia have equally attractive mining deposits, as do countries on our doorstep. Graham Birch, manager of Merryl Lynch's World Mining Investment Trust, has already indicated his opposition to all royalties by suggesting that the company would diversify its geographic exposure in mining away from South Africa if the imposition of royalties renders the industry unprofitable."[124]

These threats must have some measure of economic truth in them and must not be taken very lightly due to their potential destructive effects. The main question is, before one answer whether we need royalties or not, whether royalties would add to the so-called uneconomic nature of this industry? This has been, it is submitted, the root of all heated debates in all the countries that were discussed in this essay. The issue is really that global economy and Globalisation is taking its toll on many businesses worldwide and does not discriminate against any sector. Labour movements worldwide are seeking government's protection from fading jobs while governments, on the other hand, are looking at private sectors to assist the national economies. Business at the about the same time continues to wrestle with many cost-saving mechanisms to cope with competitive business.

Government of South Africa acknowledges that mining as a business sector is undergoing difficulties, but it says that there is no one specific reason that is attributable to the failure and/or difficulties of this sector. It is a known fact, particularly in South Africa that the main target reason for mining failures is the strength of the SA's local currency. Others experience mining accidents that cause them huge sums of monies to salvage their operations. Harmony and Goldfields have just been from a hostile takeover bid that left Harmony with deep financial wounds to an extent that it has to retrench thousands of workers in order to recoup its losses.

The business reporters stated that the former Minister of Minerals and Energy Mrs Phumzile Mlambo-Ngcuka "criticised gold companies that tried to solve the problem of lower profits because of strong rand by retrenching workers."[125] She is quoted as saying "[I]t is our [government's] view that the rand exchange value alone is not causing the demise of the industry."[126] Linda Loxton who writes for *Business Report*, notes that "[M]any of the problems facing the gold industry were due to ageing infrastructure,

[124] Comments by the Competition Commission, op. cit at 4
[125] *The Star's Business Report*, Friday, May 20 2005 at 3
[126] Ibid

commodity price cycles, currency fluctuations and business models that were outdated."[127] It is apparent that no one single factor can be attributable to failures of the mining industry.[128]

Some of the countries that are said to be competitive with South Africa also have royalty schemes in addition to mining taxation systems.[129] In Chile, Colombia, New South Wales, Australia and Peru, for example, the debates have begun and there is likelihood, given the existing negative local perceptions about mining houses, that royalty schemes have been or will be implemented despite business protestations. It is therefore worthwhile to concede in end that the same will happen in South Africa. There is a need to compensate government, if not its citizens directly, for the damage to their once green environment but now mountains of white dust and useless land space. Mining houses on their own did little to dispel these persisting negative perceptions of careless attitudes, greed and corruption. They often have to be forced, by legislation, to be engaged in some socio-economic activities, be it through specific taxes, levies or environmental laws.

It is also helpful to note that royalties may indeed play an important role in shaping and dictating how mining companies manage to stay afloat given the promises that the Bill will use to aid those in need. The Bill in its overall presentation and content seems to have been thought through and many points of concerns seem to have been considered and provided for. It may, indeed, be that the new proposed royalty scheme would have taken into consideration the up coming overhaul of mining taxation system which may or may not benefit mining houses. It must be conceded, however, that this Bill has some room for improvement and particularly for clarity, which may in some important aspects shed light regarding government and investor intentions.

7.1. Proposals to the Mineral and Petroleum Royalty Bill

The Bill could use some meaningful clarity on certain aspects. The potential double royalty charges on mining companies that, *inter alia*, will be forced to pay royalties in terms of the Bill to the National Revenue Fund in addition to their local royalty payments

[127] The Star, supra

[128] It is, however, encouraging that the South Africa's ruling party the African National Congress, has begun debates on economic policies which if accepted at its General Council in June 2005 may have positive effect on the strength of the rand and its effects on the exchange market.

to tribes like the Royal Bafokeng and the Bakubung in the North West Province deserves greater clarity. It is suggested that in the current royalty arrangements between the mining houses and these local tribes, government can join in and secure an amicable portion of those royalty payments, and avoid a position, which would force mining houses to pay twice to different entities. The possible effect of this problem may be to deprive these tribes their existing rights to these royalties. This move, any one can guess, would be fiercely resisted and may even be tested in the corridors of the highest courts of the land. It is therefore imperative that government treads this area very carefully and with the necessary sensitivity as other factors are also at play. The right balance, which may not seriously upset or undermine the rights of the parties, may be called for.

As an alternative to implementing a national Act, government may consider localising the entire Royalty scheme to those tribes wherein mining activity takes place, meaning that the scheme would not be national but would be restricted to areas and localities wherein mining activities occur. The unfortunate consequence of this position is that only those areas will benefit from royalty payments and may develop more rapidly than other impoverished areas of the country. The downside of this quagmire is that should government ignore the existing royalty agreements and impose its national scheme, mining houses may be forced to abandon those private agreements and risk being sued by those local tribes for contractual issues. Local communities may base their claims on expropriation compensation for deprivation of their economic benefit/ rights. This, either way, will delay the successful implementation of the Royalty scheme. The more aggressive possible route is that mining companies may seek to test the legality of such legislation, to the extent that the effect of double royalty levies has not been corrected, in high courts and this step may prove prolonged and problematic for the proper implementation of the Bill.

On tax position, the Bill could benefit from classifying these royalties as capital expenses to which mining companies could claim deductions when declaring their income for each tax year. This benefit and other similar benefits like the group taxation schems particularly enjoyed by the Australian miners would seriously ease the difficulties faced by mining houses particularly in the view of their concerns that South African taxes are already internationally comparatively higher and competitive. It has been noted

[129] See the tables of international royalty schemes emanating from the RSA Press Statement on Royalty Bill and the Mining and Sustainable Development Series considered in this essay, ‘annexed’ at 50 - 53.

hereinabove that there is a new mining taxation system in the offing, however, this admittedly is a subject for another longer essay.

The Bill would also do well to address the Competition Commission's apt concerns regarding imposition of royalties on those minerals that may burden the State's duties and responsibilities to its citizens. Imposing royalties on coal that is mined for, among others, the provision of electricity by state owned utilities like *Eskom* and/or other nuclear agencies. The commission notes, correctly so it is submitted, that the imposition of royalties on these minerals may be counterproductive, "counter to the object of the Completion Act, and counter to the State's policy of inflation targeting."[130] The essay has supported the Commission and found that in consideration of the proposed royalty Bill, there are various exempt prospects for those socially useful minerals. It is submitted that this position should be retained, if not specifically clarified, in the final Act.

The Bill has to address itself with more insight on imposing royalty rates on minerals that are not competitively traded and/or on the recognised and reputable international markets. The main issue herein is, what is to be the fair and competitive method of valuation of these minerals. The Bill has to also deal with the Commission's concern and clearly explain what method is that and why should reference be had to outside methods of valuation. This clarification must note both when there are disputes in terms of valuation and where no disputes are foreseen. Put differently, the Bill must, with competition concerns 'in its mind', clearly state the basis upon opting for and relying on outside determinators as its fair evaluating methods.

The Competition Commission is further correct, it is argued, in arguing that the fact that diamond miners would be paying 8% of royalty rate might, in the hindsight, entrench the trading monopoly of big companies like De Beers which *might* not feel a pinch of the proposed levy as opposed to junior miners who may be forced out of this lucrative sector. The revised Bill can, with respect, give clarity and a meaningful way of ensuring that such an anticompetitive position, which could lead to all sorts of competition problems, does not arise.[131] It is easily conceivable that ignorance of this issue by government may end up being tested by the Competition Commission, the Tribunal and all the higher courts of South Africa, causing immeasurable delays and administrative collapse of the Bill. It is however suggested this particular task might not be easy to

[130] Comments of the Competition Commission, op. cit at 2
[131] Ibid, at 5

solve, as it ultimately boils down to how deep De Beers' pockets are. This is because either way the royalty rate goes, De Beers would not be complaining about payment thereto. It may be wise to focus attention on assisting junior miners to trade competitively and recoup those financial means from the 8% royalties of De Beers or reduce your royalty percentage to a lower figure to enable competition among the miners, irrespective of their pockets.

Criticism of the Competition Commission must finally be understood in the context captured by respectful commentators thereon. Authors of Competition Law[132] give the reader a sense of understanding the main object of the Competition Act. Brassey et al, state that the "[T]he traditional objects of competition law, 'namely to promote efficiency, adaptability and development of economy' and provide consumers with competitive prices' see section 2(a) and (b) of the Act) are to be implemented by way of a range of provisions which draw heavily on the Anti-trust legislation of the United States of America and the competition law of the European Union."[133] In this regard the writer is of the view that the commission is vigilant enough to safeguard consumers' interests against any violation of its objects.

The Bill and the administration of the entire royalty scheme could immensely benefit from a dedicated and specialised entity that would deal with all the problems of this Bill. The writer suspects that South African Revenue Service (SARS), proposed to be used as a collection body for royalty payments, has other various sectors it services as revenue collector and an additional department of royalty collection may compromise the effective administration of the royalty scheme. It is therefore suggested that a National Royalty Fund[134] or some other specialised body or committee be provided for in the Bill as the body that must deal with collection, dispute resolution, continuing research, exemption investigations and formulations, classifications and analysis of marginal mines.

Failure to do this might create a problem of splitting these aspects of royalty administration wherein royalty related disputes would be referred to another body for

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[132] Martin Brassey (ed), John Campbell, Robert Leigh, Charles Simkins, David Unterhalter and Jerome Wilson. Competition Law (First Edition) (2002) Juta Law at 1.
[133] Brassey et al, op. cit at v, "Foreword by D. M Davis Judge President of the Competition Appeal Court."
[134] Chapter 5 of the Development Act 28 of 2002 provides for the establishment and functioning of the Minerals and Mining Development Board. Maybe and simply for cost saving purposes and avoidance of possible duplication of duties, a royalty specific unit may be incorporated in this Board to address royalty related issues.

resolution, while exemptions or otherwise of marginal mines might be left with the Department of Minerals and Energy or some thing in the middle. This would create an administrative nightmare, as the other hand might not know what the other hand did and this, it is argued is a receipt for disaster.

The Bill has since been revised and the implementation thereof has been put in abeyance until 2009. This move is to be welcomed in the light of the sudden introduction of the Bill without giving all the stakeholders sufficient time to digest the possibility of this Bill and its possible effects in their long and short-term investment decisions. McNulty[135] notes that under the new Royalty Bill, mining houses would only be liable to pay royalties on conversion of their mining rights which were held prior to the advent of the Mineral and Petroleum Resources Development Act of 2002, rights which are now known as the "old order rights" into the "new order rights" promulgated under the new Act. He also points out that Trevor Manuel has, since the presentation of the first Bill for public comments and consideration, deferred the implementation of the said bill from 2007 to 2009. This move he observes would be advantageous for two main reasons *viz*. It obviously defers the implementation by five years, and more importantly delinks the payment of royalties with the conversion from older to new order mineral and mining rights.

This deferment, he correctly notes, could have a large and positive effect on some share valuation. This observation is correct in that the deferment time period would allow the necessary market adjustments and prepare the investment community for a thoroughly considered implementation and application of the Bill. This must be sufficient to cover the investment worries of mining houses and analysts alike. Martin Grote of SAMDA also notes, correctly, that the five-year grace period of deferment "would enable mining firms to prepare for new rules and also to evaluate potential technical difficulties in the Royalty Bill."[136]

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[135] McNulty, op. cit at fn 71

[136] Platinum today website in an article titled "South Africa details mining royalty bill plans" 30th March 2004 at http://www. platinum.matthey.com/media_room/1080651605.html