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Mendes, Tania Flores

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THE SCHOOL OF ACCOUNTANCY



UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

A research report submitted to the Faculty of Commerce, Law and Management in fulfilment of the requirements for the degree of Master of Commerce in the field of Taxation

Mining tax regime reforms – de facto nationalisation

Applicant:	Tania Flores Mendes
Student Number:	303686
Supervisor:	Prof Warren Maroun
Head of Program:	Prof A P De Koker
Head of School:	Prof N Padia
Degree:	Master of Commerce (Specialising in Taxation)
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Abstract

The mining sector, the ownership of mineral resources and the taxation of mining profits have recently been the cause of much debate (Maoto, 2013). In response, the African National Congress (ANC) commissioned the drafting of the State Intervention in the Mining Sector (SIMS) report, in which the nationalisation of mining was firmly discouraged, in favour of the implementation of reforms to the current mining tax regime.

The aim of this research report is to analyse and interpret the proposals made in the SIMS report, to explore possible parallels between nationalisation and the reforms proposed in the report, and to discuss the pros and cons of the proposed reforms. To this end, this report will be based on gaining an understanding of the concept of nationalisation, as well as of the mining tax regime reforms proposed in the SIMS report.

Through an analysis of international literature on nationalisation and the taxation of minerals, this report will endeavour to apply the findings of this analysis to the reforms proposed for the South African mining sector. This will provide an alternate base for examining the South African context of the reforms, and will aid in identifying possible advantages and disadvantages of the proposed tax reforms.

It must be noted that the report will not be grounded in political theory but is rather intended for the purpose of analysing the technical taxation issues that relate to the debate on nationalisation of the mining sector.

Key words:

Nationalisation, mining-tax regime reforms, SIMS report, foreign precedent

Declaration

I declare that this research report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation) at the University of Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other university.



Tania Mendes
August 2014

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Table of acronyms utilised in the report

Acronym	Meaning
SIMS	State Intervention in the Mineral Sector
ANC	African National Congress
MEC	Minerals and Energy Complex
RRT	Resource Rent Tax
MPRDA	Minerals and Petroleum Resources Development Act
NAMDEB	Namibian De Beers (A Namibian Subsidiary of De Beers Corporation)
NMC	National Mineral Company
GDP	Gross Domestic Product
ZCCM – (IH)	Zambian Consolidated Copper Mines – (Investment Holdings)
IMF	International Monetary Fund
WACC	Weighted Average Cost of Capital
VAT	Value Added Tax
MRRT	Minerals Resource Rent Tax
ROM	Run of Mine
CIT	Corporate Income Tax
SARS	South African Revenue Service
STC	Secondary Tax on Companies
TLAB	Taxation Laws Amendment Bill No 39 of 2013
DTA	Double Tax Agreement
MPRR	Minerals and Petroleum Resources Royalty
EBIT	Earnings Before Interest and Tax
Cosatu	Congress of South African Trade Unions
Numsa	National Union of Metalworkers
IFRS	International Financial Reporting Standards
CGT	Capital Gains Tax

Chapter 1: Introduction

When faced with economic difficulties, many governments turn their focus to the mineral sector to increase taxation revenue (Ralbovsky, 2012). South Africa, being rich in mineral resources (SIMS Report, 2012), is no different. Since the end of the early 20th Century, the *Minerals Energy Complex* (MEC), consisting of the mining sector, as well as various sub-sectors of manufacturing which are closely related to mining, has been the core of the South African economy (SIMS Report, 2012). To this day, the MEC continues to contribute at least an average of twenty percent to the country's Gross Domestic Product (GDP), boasts an annual income exceeding R330 billion, is one of the country's largest employers with more than one million people in mining-related employment and continues to be the largest contributor by value to black economic empowerment in the country[1].

Recently South Africa has been placed in the bottom half of the rankings of the world's premier mining destinations, due to the uncertainty about its mining-tax policies (Maoto, 2013). Per a survey performed by Canada's Fraser Institute[2], South Africa was ranked fifty third behind many of the country's African counterparts (Maoto, 2013). This poor ranking, which came to light due to the uncertainty surrounding the country's existing mining regulations, contrasted with the mineral wealth found in South Africa, has resulted in the ownership of minerals and the taxation of the income generated by mining activities becoming a focal point for the country's politicians (Maoto, 2013). *Nationalisation* or *State participation* in the mining sector has been at the centre of this (Tshikovhi, 2012).

Globally, no tax has caused more controversy than that of the taxation of mineral resources (Otto *et al.* 2006). Many countries with large mining industries are eager to get more out of mining companies and, to this end, have been planning to introduce drastic changes to their existing mineral taxation policies[3] (Fasteem, 2011). This is no different for the countries on the African continent, with many of these countries[4] planning to impose higher taxes on the

[1] Data available from Mining IQ – Mining Intelligence Database: http://www.projectsiq.co.za/mining-in-south-africa.htm [Accessed 15 June 2014]. Please note that the effects of on-going strikes in the mineral sector have not been taken into account in the results reported for the sector.

[2] Data retrieved from the Survey of Mining Companies 2013 – Fraser Institute (Cervantes, M and Wilson, A. 2013). Available from: http://www.fraserinstitute.org [Accessed 25 May 2014]

[3] Countries such as Australia have already implemented drastic changes to the taxation on mineral resources. The introduction of the Mineral Resource Rent Tax in Australia is the most drastic of the changes introduced. Please refer to Section 4.4 for further considerations in this regard.

major mining companies operating within their jurisdiction (Fasteem, 2011). Another dimension to this controversy, is, however, brought to the foreground with regards to the taxation of minerals in Africa – nationalisation (Tshikovhi, 2012).

The taxation revenues derived from the mining sector represent a significant public policy issue (Mitchell, 2010). Inherently, mining is a cyclical industry and, as such, investment in exploration and mining development follows these cycles (Mitchell, 2010). For investors, a significant consideration, from an operational perspective, in determining investment decisions is the geological potential of the site. These operational considerations are strongly offset by the fiscal and socio-political factors prevalent in any targeted investee country (Mitchell, 2010). The fiscal factors include the tax rates and laws of the country in question, while the socio-political factors include the stability of the tax system as a whole (Mitchell, 2010). Taking these into account, it is considered reasonable that the ultimate goal of any government's taxation system is to ensure that the maximum benefit possible accrues to the public, while still simultaneously encouraging both local and foreign investment in the sector[5] (Mitchell, 2010).

In a study performed by the African Union, it was indicated that countries which successfully utilised their natural endowment for developmental purposes were successful at technical training of their people, as well as technological development – both being prerequisites for effectively utilising the opportunities presented by natural resources (African Union, 2011). At the forefront of South Africa's considerations is the need to utilise effectively the country's mineral resources to drive development – a development that can only be facilitated through equal and corresponding human and technological development (SIMS Report, 2012).

Nationalisation involves full or partial equity participation by a government in a country's mining companies (SIMS Report, 2012). In February 2012, a State Intervention in SIMS report was commissioned by the African National Congress (ANC), in which many issues concerning the minerals sector were considered, including the concept of nationalisation (Tshikovhi, 2012). The report was compiled in order to provide the ANC with a 'scientifically researched' overview of the minerals sector, while drawing on international experience to

[4] Per a study performed by KPMG entitled "Mining in Africa – Six Keys to Success", the following African countries are considering increasing taxation in the mineral sector: Zambia (Additional Royalties to be imposed), Ghana (Raised the company tax for mineral corporations from 25% to 35%) and Mozambique (Additional taxes to be imposed) among others.

[5] Although not within the scope of this research, it is interesting to note that this principle is consistent with Adam Smith's notion of a fair tax system being one in which citizens pay a fair share for the services received under the protection of the State (Vivian, 2006).

provide substance to any possible future decisions and actions taken with regards to the sector (Tshikovhi, 2012).

One of the objectives of the SIMS Report was to determine how, through a review of the current tax system, the State can collect revenue from mining houses in order to improve public spending (Faku, February 2013). The report, however, firmly discouraged the possibility of nationalising the mining sector in favour of, among other changes, the introduction of a resource rent tax (RRT) of 50% on mining profits above a certain threshold (SIMS Report, 2012), also referred to as a 'mining supertax' (Tshikovhi, 2012). In his 2014 national budget speech, then Minister of Finance, Pravin Gordhan, made no mention of introducing the mining supertax but it was confirmed that mining tax policy will remain under review in order to determine the impact of the mining-tax system on economic growth (National Budget Speech, 2014).

As a result, an exploratory analysis of the proposed mining tax remains relevant. Since the changes which have been proposed to the South African mining tax regime are an alternative to nationalisation (Tshikovhi, 2012), they will be interpretively analysed to highlight possible effects of the proposed changes on the mining sector. The research will pay particular attention to the proposed introduction of the 50% resource rent tax, or supertax, for South African mining companies, and will consider conceptual similarities between the tax and the nationalisation of the mining houses.

To this end, this research, despite its normative tone, makes an important contribution to taxation literature by exploring possible implications of the proposed mining supertax in South Africa. Taking into consideration the proposals in the SIMS Report, this research will provide a brief summary of the meaning of 'nationalisation', including its aims, objectives, advantages and disadvantages. This is to provide a context for this research and to offer a frame of reference for examining the proposed mining supertax in South Africa.

As part of this process, foreign precedent will be interpretively analysed to identify the primary benefits and shortcomings of mining supertaxes. This thesis will concentrate on the prior literature, detailing the taxation-related experiences of Namibia as an example of another developing African country that is economically and socially similar to South Africa, and which has a long established nationalised mining sector (SIMS Report, 2012). Zambia, on the other hand, is one of the few countries which have reverted from the State-ownership

of the mining sector[6] (McPherson, 2008). This reversal will also be examined to shed further light on the advantages and disadvantages of nationalisation in a South African context.
In addition, Australia's recently adopted resource rent tax (being the tax on which South Africa's reforms are based) in their coal and iron ore sector (Tshikovhi, 2012) will be examined to add to the debate on the advantages and disadvantages of the proposed tax. In this way, a thorough view will be provided which takes into consideration both courses of action as per the SIMS Report – Nationalisation and Taxation Reform - in order to provide appropriate recommendations.

1.2 Objective of the research

1.2.1 Research Statement

The purpose is to perform an interpretive analysis of the taxation reforms proposed in the SIMS Report for the mineral sector, and to contrast these to the notion of nationalisation.

1.2.2 Sub-problems

A number of sub-problems will assist in attempting to address the main research problem as detailed above.

1. What is 'nationalisation' and what are some of the advantages and disadvantages of nationalising the mineral sector?
2. What reforms have been proposed to the current mining tax regime in the SIMS report, and what are their objectives?
3. Based on the experiences noted from long-established taxation regimes in Namibia, Zambia and Australia, what are the pros and cons of each course of action being considered by South Africa?

1.2 Significance of the study

This research makes a number of important contributions. Firstly, it summarises the main features of the proposed supertax for the South African Mining Industry and highlights some of the similarities and differences between this tax system and those found in Namibia, Australia and Zambia. Namibia and Zambia are examined as both are countries of African origin, with developing economies which are similar to South Africa's (Bermudez-Lugo,

[6] These countries' tax systems are touched on in this thesis because they are mentioned in the SIMS Report. The research does not purport to offer a review of the taxation of the mining industry in Africa.

2013; McPherson, 2008). An analysis of developed economies would provide less relevant and less comparable information[7]. Secondly, it identifies possible advantages and disadvantages of the proposed supertax for mining companies operating in South Africa by drawing on internationally accepted characteristics of successful taxation regimes. Not only is this of interest for tax practitioners. The potentially significant effects of the supertax (Tshikovhi, 2012) means that exploring some of the implications of the tax system – before it is finalised – is important for informing the development of sound tax policies (McPherson, 2008).

Finally, the research makes an important theoretical contribution by considering the similarities between nationalisation and the proposed supertax. There is a considerable body of technical literature (for example, see McPherson 2008, Solomon 2012, Kwabe 2010 among others) but prior South African-specific research examining tax policy as a political instrument is rare (Cawood and Oshokoya, 2013). This thesis dispenses with a traditionally conservative approach to tax research (Cawood and Oshokoya, 2013). It relies on a growing body of critical international tax research to consider the possibility of a supertax being used as a ruse to achieve a State of de facto nationalisation of the South African mining sector (Cawood and Oshokoya, 2013).

1.3 Delimitations of the research

Although the research has a normative nature (and a critical tone), it is not grounded in political theory. Following the approach recommended by Llewellyn (1996; 2003), critical theory is used as a frame of reference only. This ensures that the thesis retains its tax-specific focus and is accessible to a broad group of readers. Secondly, this research will not attempt to conclude on an optimal mining tax policy for South Africa. As discussed in Section 1.3, the primary objective is to contribute to the debate on the proposed supertax with an aim to inform relevant stakeholders. Thirdly, it should be noted that this thesis does not provide a comprehensive review of the technicalities of mining tax and does not include a review of the taxation of the mining industry in every jurisdiction. As discussed in Section 1.2, only Namibia, Zambia and Australia are considered. This is because each of these countries provides experience which can be drawn on in relation to the changes proposed to the mineral taxation regime in South Africa. Namibia is a long-standing nationalised mining sector; Zambia is an example of reprivatisation and Australia introduced the Mineral Resource Rent Tax on which South Africa's reforms are based. It should, however, be recognised that the socio-economic context in each of these jurisdictions varies, something

[7] A more detailed analysis of nationalization in the mining industry is beyond the scope of this research.

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which would impact the perceived advantages and disadvantages of nationalisation. This thesis makes no effort to examine variations in these social, political and economic forces as part of the analysis of the proposed taxes for the mining industry. This is an inherent limitation, but it does provide the basis for future research in these fields. Analyses of the country-specific variations of these forces may provide a holistic impact of the proposed reforms from a socio-economic perspective.

1.4 Research Method

This research has been performed using a qualitative approach. It relies on an extensive literature review, culminating in an analysis of the reforms proposed to the mining-tax regime of South Africa. The review provides insight into the taxation reforms that have been proposed. The review is also intended to reveal the possible consequences, both beneficial and prejudicial, of the implementation of similar reforms abroad. The review also brings to light the similarities between nationalisation and the tax reforms proposed for South Africa.

1.5 Chapter Outline

In chapter 2, an overview of the concept of nationalisation or State intervention in the mining sector is provided. The evolution and objectives of State participation, as well as the currently encountered variations of State participation (McPherson, 2008), are discussed. In addition, the experiences of long-implemented taxation regimes have been examined to determine the advantages and disadvantages of State participation in the minerals sector.

The intention is not to provide a comprehensive review of nationalisation (Section 1.5) but to provide a context for the thesis. To this end, the long established nationalised mining sector of Namibia (Bermudez-Lugo, 2013) will be analysed. This will be contrasted with the reversal of nationalisation of Zambia's mining sector (McPherson, 2008).

Chapter 3 investigates the changes to the current mining tax regime proposed in the SIMS Report (2012). The similarities noted between the proposed changes, and the notion of nationalisation, will be examined. The objectives of, and the rationale behind, the changes proposed in the report will be analysed.

In chapter 4, mining-tax policies in Australia, as well as recent changes are examined. In addition, guidance provided by the Organisation for Economic Co-operation and Development (OECD), which describes the characteristics of successful taxation regimes, will

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be discussed. This will aid in providing guidance on the policies that have in the past been, and currently continue to be, the most successful in ensuring that a country's mineral resources are used for the greater benefit of its people (Gopaldas, 2013). The objective of this chapter is to provide an alternate, yet still normative base, for examining the South African context of the proposed reforms, and identifying possible advantages and disadvantages involved.

In particular, Chapter 4 concentrates on the recent implementation in Australia (Tshikovhi, 2012) of a resource rent tax, similar to the one proposed in the SIMS report, , and its implications for the Australian mining sector (Gopaldas, 2013). Chapter 4 will also highlight the principles of a good taxation regime through the analysis of international literature. This will assist in providing recommendations to be considered by the South African government by highlighting the successes and failures post-implementation of the Australian regime, and the principles of a good taxation regime noted from international literature.

Chapter 5 will collate the findings of the previous chapters and summarise them in order to address appropriately the problem Statement by drawing on the parallels and contrasts noted between the proposed mining tax reforms, and nationalisation. In closing, the chapter will provide concluding remarks and possible recommendations that have arisen as a result of conducting this research.

Please note that "nationalisation" and "State intervention / "participation in the minerals sector" will be utilised interchangeably in this research. Both terms are broadly defined to encompass the various types of State participation, from 100 percent equity participation to equity participation without financial obligation. Please refer to Chapter 2 for a detailed analysis of the types of nationalisation.

Chapter 2: Nationalisation

"The national wealth of our country, the heritage of South Africans, shall be restored to the people. The mineral wealth beneath the soil ... shall be transferred to the ownership of the people as a whole."

- The Freedom Charter

The principles of the Freedom Charter were applied in South Africa through the introduction of the Minerals and Petroleum Resources Development Act of 2002 (MPRDA). Under the MPRDA, the mineral resources of the country are considered to be the common heritage of the people of South Africa (Van der Zwan and Nel, 2010). On this basis, the MPRDA provided for all privately owned mineral resources to be placed in the custody of the State, thereby transferring the mineral wealth of the country to the ownership of the people as a whole, rather than the ownership of minority investors (SIMS Report, 2012).

In its capacity as custodian, the State has the authority, under the MPRDA, to determine and levy a fee on the level of consideration payable in respect of these resources. This power is what enabled the National Treasury and the Department of Mineral Resources to impose royalties on the extraction of the country's mineral resources through the development of legislation to that effect (Van der Zwan and Nel, 2010). In summary, the State owns and controls the mineral resources of the country but the extraction, production, and entire operational use and sale of minerals is left to private investors, in exchange for a usage fee, or what is more commonly known as taxation for the right to use such mineral resources (Van Der Zwan and Nel, 2010).

Nationalisation, on the other hand, is where the State has equity participation in the companies of the mineral sector and - depending on the extent of that participation - the State may have direct influence over the operations of the mine (Van Der Zwan and Nel, 2010). (The current taxation of mineral resources in South Africa will be analysed in detail in Chapter 3)

Of late, the manner of taxation of mineral resources in South Africa has come under scrutiny by various stakeholders: current investors, potential investors, the general public, and members of parliament (Cohen, 2013). This has resulted in organised mass action and violent protests filtering through the sector, culminating in calls for the nationalisation of the mining sector.

Due to the turmoil that has been created in that sector and the consequent uncertainty for investors (Cohen, 2013), a meeting of the African National Congress's (ANC) National General Council was called in 2010 (SIMS Report, 2012). With the principles of the Freedom Charter in mind, a resolution on the role of the State in the economic affairs of South Africa was adopted. This resolution resulted in the commissioning of the SIMS Report, the ultimate goal of which was to determine how best to utilise South Africa's mineral wealth to place the country on the most equitable growth path (SIMS Report, 2012).

The SIMS Report, through a researched overview of the minerals sector and the relevant taxation, both within South Africa and internationally, was intended to provide a researched basis on which to make informed political resolutions to introduce reform into that sector, in response to the wave of mass action in the mineral sector (SIMS Report, 2012). The call for nationalisation, which featured prominently in the demands of the trade unions (Congress of South African Trade Unions – Cosatu, National Union of Metalworkers – Numsa), was considered in the SIMS Report in order to provide a response to the calls for nationalisation (SIMS Report, 2012).

The SIMS report highlighted four clear objectives as the purpose for commissioning the study and as the reasoning behind the need for change in the taxation of the mineral sector. These four objectives drive the direction of the study and depict the direction in which the ANC policy-makers wish to lead the mineral sector in South Africa (SIMS Report, 2012). These objectives are:

1. To capture resource rents and invest in long-term knowledge, skills and physical infrastructure, in order to industrialise, diversify and generate additional jobs through the intensification of mineral linkages; essentially to maximise the developmental impact of minerals through labour absorbing development and growth.
2. To build and strengthen South Africa's economic potential domestically, and to realise the country's competitive strengths internationally in order to combat the reality that is the country's unemployment problem, through the effective harnessing South Africa's Mineral and Energy Complex (MEC). In order to achieve this, the MEC is required to be located at the core of the country's National Development Strategy, as it is South Africa's strongest comparative advantage in the global markets.
3. To achieve these two objectives, a significant and sustained investment in technical knowledge, research and development is required, as noted through the experiences of other countries which have successfully built and maintained a mature economy

based on their respective mineral sectors. A dramatic improvement in the quality of South Africa's education is required, as well as an alignment of this education with the needs of the MEC in order to create a fully integrated economy.

4. The final, and most notable, objective is the desire to capture resource rents for the use in social and economic development. The generation of such resource rents requires significant investment in what will need to be a partnership between the public and private sectors. The public sector is required to display commitment to a steadfast regime which will deploy instruments that facilitate the development of the sector. In doing so, certainty, predictability and transparency are required.

Nationalisation was only one of the methods considered by the ANC-led Government to achieve these objectives.

State participation in the mineral sector can be traced back to the end of the Colonial Period (Kwabe, 2010). From the end of this Colonial Era, mineral-rich African countries recognised that the ownership of mineral resources and the resultant revenues would become the core of their new found sovereignty (McPherson, 2008). This sovereignty led to the creation of National Mining Companies, which provided the platform for State participation to be introduced into that sector (McPherson, 2008). Direct sector participation and ownership of minerals was achieved either through partnerships between the newly formed National Mining Companies and the private sector, or through the nationalisation of foreign owned mining companies or their asset base (Kwabe, 2010).

In order to appreciate the objectives of State participation in the mineral sector, an understanding of the characteristics of the resource sector is required (Broadway and Keen, 2010). There are many features of the resource sector, not unique to the sector but highly prevalent, that require additional consideration upon forming the necessary fiscal legislation (Broadway and Keen, 2010). These characteristics can be summarised into the following broad categories which do not represent an exhaustive list: (1) extended periods of costly exploration and development, (2) high technological and geological risk, (3) high price volatility and commodity price uncertainty, (4) possible resource exhaustion, (5) shortage of knowledge and expertise in the extractive industry, (6) highly significant social and environmental impact, and finally, the (6) prominent political profile that the resource sector has in resource-rich countries (Broadway and Keen, 2010). These characteristics are what are considered in developing fiscal policy to ensure that a country receives the maximum benefit from its resources, subject to attracting the necessary investment in the sector to allow for the realisation of that benefit (McPherson, 2010).

Taking into account these characteristics, the objectives of this phenomenon – State participation – can be consolidated into two general headings: non-economic and commercial (McPherson, 2008). It must be noted, however, that due to differing circumstances and issues encountered in country-specific environments, the objectives of State participation my vary in their semantics (McPherson, 2008). The non-economic objectives are both symbolic and practical (McPherson, 2010). They are practical in the sense that State participation is expected to build national capacity in the resource sector through the transfer of information, technical skills and managerial skills from the private sector, to address the abundance of developmental goals that are found both within and outside the mineral sector (Kwabe, 2010). State participation is also expected to rein in the private sector, in order to align the goals of that sector with those of the nation as a whole (SIMS Report, 2012). The non-economic objectives of State participation are symbolic in that National Resource Companies have been portrayed as icons of freedom from the colonial era, as well as an integral part of the protection of a country's sovereignty and national interest (McPherson, 2008).

The commercial objectives of State participation place emphasis on the maximisation of revenue to the State from the mineral sector (Van der Zwan and Nel, 2010). This revenue maximisation is achieved through additional revenue generation from taxes and dividends arising from commercial profits, and by the recovery of fiscal benefits from the private sector (McPherson, 2008). Where fiscal benefits used to accrue to the private sector, State participation would cause a greater share of these fiscal profits to accrue to the State, and would enable the State to capture a larger share of the rent generated by profitable projects, including increases in the price of mineral resources (Van der Zwan and Nel, 2010). Taking into account the country-specific circumstances and issues encountered in the mineral sector, governments have embraced the concept of State participation in a selection of forms depending on the objectives of their fiscal policies (McPherson, 2008).

In line with the theoretical objectives of State participation in the mineral sector, the objectives behind the calls for nationalisation in South Africa are Stated as follows: to create a more equitable distribution of benefits realised from the mining sector; to fulfil the intent and spirit of the Freedom Charter of 1955; to increase the fiscal capacity of the State, to ensure that the State is able to deliver on its social programme commitments such as housing, education and healthcare; to increase the strategic capacity of the State in order to develop the mining sector; and to improve the levels of industrialisation in the mining industry.

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It is submitted that introducing, or even considering the introduction of nationalisation, often results in the State being vilified due to the misconstrued - and often preconceived - understanding that surrounds the concept of State participation (Guzek and Mc Donald, 2013; Cawood and Oshokoya, 2013). The negative connotations of resource nationalism for the industry are of particular concern for investors, due to research suggesting that investors view nationalism as an emerging market risk which could involve the transfer of value or ownership without fair compensation, undermining the economics of their project investment (Cawood and Oshokoya, 2013; Cook, 2012).

To this end, it is imperative to highlight that the State, by nature, has a vested interest in ensuring that there is an equitable allocation to the country and its people of benefits from the activities of the mineral sector[8] (Cawood and Oshokoya, 2013). It is further submitted that the concerns of the private sector, including both business and civil society, are as important as those of the State, and should be considered when analysing the impact of State intervention (Guzek and Mc Donald, 2013). This is in order to ensure that an appropriate working relationship is found among the State, mining companies, the markets and the citizens of South Africa (Cawood and Oshokoya, 2013).

The exploration for, and extraction and processing of, minerals is generally carried out by the private sector, despite the public ownership of the said mineral resources (Guj, 2012). The key characteristic of a nationalised mining sector is not a question of the ownership of resources but rather of the ownership of the companies extracting those resources (Cawood and Oshokoya, 2013). In many countries some form of State participation has featured prominently in the development of the minerals sector over the past 50 years (McPherson, 2008). For example: In Namibia government participation takes the form of a State-owned mining company, Empangelo Mining Company (Pty) Ltd which controls the planning, supervising, coordinating and implementing of Namibia's mineral policy (Bermudez-Lugo, 2013); Brazil, Algeria, Colombia, Ghana and Uganda are but a few of the other global nationalised mineral sectors (McPherson, 2008).

Due to the erratic surge in commodity prices noted, in addition to the global financial crisis and widespread wealth inequality (Cawood and Oshokoya, 2013), renewed enthusiasm has arisen for increased State participation in this sector, particularly among developing countries (McPherson, 2008). It is thus no surprise that amidst the unrest in the mining

[8] This is also consistent with Adam Smith's notion of a fair tax system characterized by equitable allocation of resources and the levying of taxes for services provided by the State in proportion to the taxpayer's ability to bear the tax load (Vivian, 2006). Further discussion of Adam Smith's tax framework is, however, beyond the scope of this report.

sector, resulting from the trade unions' mass action, nationalisation was brought to the foreground in the call for change (Hazelhurst, 2013). 'Resource nationalism', as a term, can be used to describe the desire of the people of countries that are rich in mineral resources to derive greater economic benefit from these (Solomon, 2012). The term also incorporates their respective governments' resolution to exercise greater control over their countries' natural mineral resources (Solomon, 2012).

'Nationalisation', in its simplest form, is the compulsory acquisition of private-sector owned firms by the State (Solomon, 2012). There exists a misconception that nationalisation only exists in one form – full ownership by the State of all mineral resources of a country (Kwabe, 2010). State participation encompasses various forms of the concept from equity participation without financial obligation to 100 percent equity participation through partial equity arrangements (McPherson, 2008).

2.1: State participation: Varying forms of 'nationalisation'

Four clear types of State participation have emerged since the concept materialised at the end of the colonial era, namely: Full equity participation, carried equity participation, free equity participation, and production sharing (Daniel, 1995). These varying forms of State participation, along with their pros and cons, were researched and considered in the SIMS Report (2012).

Full equity participation

Two possibilities arise under this form of State participation (Daniel, 1995). The State may invest directly in the mineral sector through its own National Mineral Company, without any private sector involvement (McPherson, 2008). The State may alternately, from the beginning of operations, invest *pari passu* with the private sector by acquiring a majority or minority interest in an incorporated or unincorporated joint enterprise (Daniel, 1995). In the latter case, the State would hold less than 100 percent of the equity for the joint operation but would incur expenditure and earn revenue in full proportion to its share in the operation (Daniel, 1995). State participation through the use of a National Mineral Company has been the most common form of nationalisation noted to date (McPherson, 2010).

Carried equity participation

The partial carry in the context of an unincorporated joint venture between the State and a private investor is the most commonly encountered form of carried equity participation (Daniel, 1995). Under this approach, the private investor *carries* the State through the initial phases of a project (Daniel, 1995). After the initial phases, a similar approach to full equity participation is followed, in that the State then spends *pari passu* with the private investor (Daniel, 1995). Compensation for the private investor for the funds it expended on behalf of the State may or may not occur, dependent on the initial agreement upon the formation of the joint venture (Daniel, 1995).

Free equity participation

Free equity participation involves the granting of an equity interest to the State by the private investor, without receiving any financial compensation in return (McPherson, 2008). In this form of equity participation, the State does not assume any financial obligation (McPherson, 2008). The granting of such an equity interest to the State used to be considered a payment for the right to exploit the country's mineral resources (Daniel, 1995). This is now the least common form of State participation rarely found in new agreements between the State and the private sector (McPherson, 2008).

Production sharing

Production sharing is a popular form of State participation as it encompasses the desirable qualities of free equity participation, carried equity participation and full equity participation, and often is combined with one of the cited forms of equity participation (Daniel, 1995). Similar to free equity participation, production sharing provides the State with an after-cost recovery equity share of income from private investors, without any resultant financial obligation on the part of the State (McPherson, 2008). In contrast to the free equity participation principle, production sharing provides the State with an active participant role, through its National Mineral Company, in the operations of the mineral project as a commercial party, a fiscal agent and a regulator (McPherson, 2008). The National Mineral Company, as the State's representative, participates actively with private investors in the operations of the project, as under full and carried equity participation (McPherson, 2008). In addition, the National Mineral Company oversees the operations of the project from a regulator's point of view, and for the share of production attributable to

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the State, it assumes responsibility for the assessment, collection and commercialisation of production and the resultant proceeds that require remittance to the State (Daniel, 1995).

Each of these forms of State participation has unique advantages and disadvantages for the State, the private sector and the economy of the country involved (Kwabe, 2010). Over the years, there have been regimes of State participation that have been highly successful, and that are still functioning in the present day. There have, however, also been some regimes which have failed to achieve their objectives, and these resulted in a complete reversal of nationalisation, or reprivatisation, in that country (SIMS Report, 2012). In order to relate South Africa to the successes and failures encountered by other countries, and to highlight the possible positive and negative consequences of the introduction of State participation into the mineral sector of South Africa, an example of a successfully nationalised mineral sector is investigated in Section 2.2 and Section 2.3 respectively.

2.2 Namibia – An example of a nationalised system

In Namibia, State participation is exhibited in many forms, the most notable of which is in the diamond sector (SIMS Report, 2012). In the diamond sector, the Namibian State owns a 50 percent share (through NAMDEB – a mining company owned in equal shares by The Namibian Government and De Beers Mining Corporation) in all diamond mining operations in the country, with the remaining 50 percent being held by De Beers Mining Company (Guzek and Mc Donald, 2013). The Namibian State further participates in the diamond sector through the Namibia Diamond Trading Company, also jointly owned with De Beers which manages the entity (Guzek and Mc Donald, 2013). This form of State participation can be likened to production sharing, as the Namibian State participates in equity, as well as in the operations and regulation of mining activities (Guzek and Mc Donald, 2013).

In 2011, the Namibian government introduced legislation which increased the Namibian State's participation in the mining of strategic minerals, in the form of increased taxes and increased control over operations (Bermudez-Lugo, 2013). 'Strategic minerals' as defined include, inter alia, uranium and diamonds (Bermudez-Lugo, 2013). This new legislation provided that State participation in the mining of these strategic minerals was to be undertaken by the National Mineral Company, Empangelo Mining Company (Pty) Ltd (Empangelo) (Bermudez-Lugo, 2013). State participation included the planning, supervision, coordination and implementation of Namibia's mineral policy (Bermudez-Lugo, 2013).

From the introduction of State participation into the mineral sector of Namibia, its policy makers have been transparent in the formulation and implementation of its nationalisation policies (Hawala, 2013). Per its public policy Statement with regards to State participation in its mineral sector, the Namibian State made it clear that the objective of State intervention in the country is to 'ensure national participation in the discovery and exploitation of Namibia's mineral resources, whilst developing and consolidating a portfolio of high quality assets and services for the benefit of all of its stakeholders' (Hawala, 2013). Through its transparency, Namibia has effectively managed the expectations of its stakeholders (Cook, 2012), including private investors, and has thus maintained the country's reputation as an attractive possibility for foreign investors (Guzek and Mc Donald, 2013).

Although the size of Namibia's mining sector may be modest compared with African and world sectors (Cervantes and Wilson, 2013), it contributes 8 to 10 percent of the country's Gross Domestic Product (GDP). The country is the fourth largest Uranium producer in the world, the seventh largest diamond producer and because of its contribution in the form of smaller mining operations, of a host of other commodities; Namibia is considered a prime mining destination (Guzek and Mc Donald, 2013; Cervantes and Wilson, 2013). Namibia's contribution to the commodity market, as well as its 'historically stable and predictable regulatory and fiscal environment' have ensured that the country has attained recognition as the third most attractive mining jurisdiction, trailing behind only Botswana and Morocco (Guzek and Mc Donald, 2013 (p.6)). Altogether, Namibia's reputation of being a country into which it is beneficial to invest in the mineral sector (Cervantes and Wilson, 2013), has not been tainted by the Namibian government's participation in the sector but, on the contrary, the State's intervention has ensured that the mineral sector continues to prosper – for the benefit of the State, the Namibian people and private investors in the sector (Guzek and Mc Donald, 2013; Cervantes and Wilson, 2013; Cook, 2012).

2.3 Zambia – Reprivatisation of the mining sector

The mid to late 1960's brought a drastic change to the economic structure of Zambia (Walters, 2010). Historically, Zambia's economy had been based on its well established copper mining industry, with the revenue from that sector contributing a third of the country's GDP, a third of its revenue and eighty percent of its foreign exchange earnings (Conrad, 2012). As a sign of its sovereignty, and in an attempt to capitalise on what was then Zambia's most lucrative business, the Zambian government declared its intention to acquire a majority share in the equity holdings of a number of the key foreign-held firms in the copper mining industry (Walters, 2010). In its policy Statement on nationalisation of the

mineral sector, the Zambian government stated that, by having control of mining companies, the State would be better able to carry out their developmental policies for the country (Solomon, 2012). This intention materialised through the creation of the parastatal conglomerate, the Industrial Development Corporation, which was later to become the Zambia Consolidated Copper Mines Ltd (ZCCM) company (Walters, 2010). With the introduction of nationalisation, all the rights of ownership of minerals, including the providing of permission of access to minerals, reverted to the Zambian State (Solomon, 2012).

In the first global oil crisis in 1974, which was followed by a collapse in commodity prices, the once rapidly increasing price of copper unexpectedly decreased exponentially, causing the Zambian government to borrow funds in an attempt to maintain the economic status quo (Walters, 2010). The second global oil crisis in 1979, which caused global copper prices to decline at an unprecedented rate, sent Zambia into a severe debt crisis, in turn causing the collapse of what was once one of Africa's most prosperous economies (Conrad, 2012). Throughout the economic crisis, the Zambian government exploited the ZCCM as a dependable source of income, without making the corresponding necessary investment in the development of the sector (Walters, 2010). Allegations of severe governmental mismanagement of funds and corruption arose at the time, damaging Zambia's reputation in the global market (Solomon, 2012).

Between the 1960s, and 1994, the income per capita decreased by fifty percent, and Zambia became the twenty-fifth poorest nation in the world (Walters, 2010). Although it cannot be said that nationalisation was the sole cause of the decline in the Zambian economy, a large number of factors that precipitated the downfall can be attributed to the State's intervention (Cervantes and Wilson, 2013). These factors include but are not limited to the following:

- The nationalisation of the mining sector caused a decline in foreign investment in the country and consequently in the country's foreign reserves (Walters, 2010);
- Centralising the economy, and consequently causing severe dependency on the copper industry, which ultimately caused the debt crisis due to the decline in copper prices (Walters, 2010);
- The use of the ZCCM as a "cash-cow" without making the corresponding investments in the mining sector to ensure its growth, which depleted the Zambian copper industry of its fervour in the global markets due to the country's ever declining copper output (Walters, 2010); and

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- The manner in which the Zambian government borrowed money from international financial institutions and did not utilise these funds to restructure and diversify the Zambian economy so as to lessen the country's dependency on copper (Walters, 2010).

In 1994, when Zambia was considered one of the most indebted countries in the world, and when its copper operations had all but ceased, the newly elected government of Chiluba, together with the help of the World Bank and the International Monetary Fund (IMF), introduced radical change to the economic policies of the country, as well as liberal fiscal reform (Conrad, 2012). The reprivatisation of the ZCCM, and other parastatals, was one of the radical changes made (Conrad, 2012). The reprivatisation provided a platform for foreign investors to invest in the copper industry, which led to the much needed development and upliftment of the sector after years of financial neglect (Cook, 2012).

In summary, the reprivatisation of the Zambian mineral sector introduced a variety of legislated changes, most notably the introduction of Zambia Consolidated Copper Mines – Investment Holdings (ZCCM – IH) as a successor to ZCCM (Conrad, 2012). This change took place through the sale of various divisions of the ZCCM to private investors, and by converting ZCCM to an investment holding company (Walters, 2010). The equity interest obtained by the Zambian State in ZCCM – IH, was granted as part of the purchase price of the mines, and took two forms (Conrad, 2012): (1) a free-carried interest[9] and (2) a carried interest repayable with additional interest out of the income generated from ZCCM –IH's equity stake concerned[10].

Through the introduction of ZCCM – IH, the Zambian State reduced the level of equity participation it held in the mining sector to make room for greater foreign investment into that sector (Conrad, 2012). The ZCCM – IH was statutorily required to utilise the returns it generated from its equity participation in the mines to discharge any prior obligations of the State, such as the servicing of State debt and settling any accumulated pension liabilities (Conrad, 2012).

[9] The free carried interest is a stake in the equity of the mineral company provided to the Zambian State without financial compensation for the original investor.

[10] The carried interest is an unincorporated joint venture formed between the mineral company and the Zambian State for the portion of the equity interest provided under this part of the agreement. In the carried interest, the private investor would carry the Zambian State through the initial phases of the mine, and would receive compensation from the Zambian State for the funds it expended on the Zambian State's behalf.

In addition to the equity interest, Price Participation Agreements were entered into through which ZCCM – IH was provided with a share of revenues generated above an agreed price threshold (SIMS Report, 2012). The effect of each of these mechanisms provided the approximate equivalent had the requisite payments been made directly to the Zambian government rather than to ZCCM – IH: The free carried interest was equivalent to a withholding tax; the reimbursable carried interest resembled a resource rent tax; and the Price Participation Agreements bore a resemblance to price-related royalties (SIMS Report, 2012). In structuring the reprivatisation of the mineral sector in this manner, a platform for the desired changes was created without drastic changes to the tax regime (Conrad, 2012).

As per the synopsis provided above, it can be concluded that the nationalisation programme in general was ill-timed due to the oil crisis and the slump in commodity prices that occurred at that time, resulting in the most severe debt crisis in Zambia's recent history (Walters, 2010). The debt crisis was exacerbated by the centralisation of the economy, which led to over-dependency on the copper industry, resulting in further economic decline in the country (Solomon, 2012). In addition to these factors, the lack of investment in the mining sector by the Zambian State ultimately led to the failure of the nationalisation programme – a failure that could only be rectified though the reprivatisation of the sector in order to attract foreign investment (Solomon, 2012).

2.4 Lessons learnt from the successes and failures of nationalised mining sectors

Several advantages and disadvantages of State participation in the mineral sector can be gleaned from the Namibian and Zambian cases. The lessons learned can be equally relevant for South Africa's proposed supertax system and current State participation in the Mining Industry.

2.4.1 Disadvantages of State participation

Experience with State participation in the resource sector has identified a number of economy-wide and sector specific (McPherson, 2008) issues or disadvantages as detailed below. The issues noted below are not intended to be an exhaustive list but are considered to be the most relevant to this research.

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Funding

The funding of State participation represents an economy-wide issue. As noted from the nationalisation of the Zambian mineral sector, the funding of significant State participation can draw resources away from other equally important and urgent budget priorities, jeopardising the overall developmental objectives of the State (Solomon, 2012).

Governance

The issue of governance is one of the most important and most prevalent issues noted at an economy-wide level with regards to State participation (McPherson, 2008). A tendency exists for resource wealth to undermine the ethical governance of resource-rich countries or to intensify any pre-existing weaknesses that may exist in the governance structure of those countries (Solomon, 2012).

National mineral companies are targets for control by elites who lobbied in favour of the protection of sovereignty and national interests, due to the ease of access to significant financial flows and the influence to exercise considerable power over the economic activity of the well-endowed resource sector (McPherson, 2008). The capture of such control of the National Mineral Companies encourages the erosion of governance at the economy-wide level, as well as inciting negative consequences for political stability of the country and economic and social development (Eifert et. al, 2003).

Nationalised mines are often viewed as a readily available source of cash to be utilised at every turn. It is imperative to appreciate that reinvestment of returns is a vital responsibility of ownership (Solomon, 2012). It is submitted that the abuse of power in relation to State participation has not been proved as inevitable (Eifert et. al, 2003). Political context is critical in determining such outcomes; this however, is beyond the scope of this research.

Conflicts of interest

When a National Mineral Company has the role of partner to private investors, as well as regulator and fiscal agent, a conflict of interest arises in which the State is required to act in its own commercial interests while acting for the benefit of the country as a whole (Eifert et. al, 2003). This issue is most prevalent where State participation takes the form of production sharing (Eifert et. al, 2003), as was the case in Zambia.

A further conflict of interest arises where long-run economic efficiency tends to be sacrificed for short-term political gain (Cervantes and Wilson, 2013). The ability of the State to balance its interests as financial investor and as custodian of mineral resources of a country has failed, Zambia being but one example (Solomon, 2012).

Commercial efficiency and investor weariness

Unlike private sector companies, the State, for political reasons, cannot react with as much flexibility to economic downturns by retrenching staff or curtailing marginal operations (Solomon, 2012). Additionally, as discussed in Section 2.3, due to an overall context of presumed weak governance, pervasive interference by the government, lack of accountability and transparency in operations, and the extensive assignment of non-commercial tasks all contribute to the inefficiency of mining sectors in which there has been State intervention (McPherson, 2008).

Should the nature and extent of intervention become untenable to private investors, they have the power and the freedom to withdraw their investment and locate it elsewhere, and to withhold future investment (Solomon, 2012). The reluctance of private investors to invest may have severe economic impacts for a country, as it may increase the level of sovereign risk which is directly translated into a higher risk-free interest rate or government bond rate (Solomon, 2012). This may also translate into increased risk premiums for the country (Solomon, 2012).

The two said rates form the basis of the Weighted Average Cost of Capital (WACC) – the rate utilised by investors to calculate the desired return on a capital project (Solomon, 2012). The greater the WACC rate of a project, the lower the return on that project will be; a low return provides for an unattractive investment (Solomon, 2012). These considerations raise investor weariness, and may ultimately cause loss of foreign investment in a country (McPherson, 2008).

2.4.2 Advantages of nationalisation and positive policy responses noted in issues of nationalisation

The following advantages of State intervention, as well as positive policy responses to historical issues noted with State participation emerge. The list below is by no means intended to represent an exhaustive list.

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- State participation provides a platform for the State to harness and maximise economic rents from the industry (Solomon, 2012);
- State participation ensures an altruistic view with regards to employment and social costs during recessionary periods (Solomon, 2012);
- Through the participation of the State, an efficient platform for the redistribution of profits from the sector is provided in order to reduce perceived inequalities (Solomon, 2012);
- In response to the historic issue of poor governance, countries have introduced greater levels of transparency and accountability. Credible audits, as well as regular public reporting and assurances with regards to the integrity of operations, have been emphasised and implemented (McPherson, 2008). This has been noted per the transparent fiscal policies in place in the Namibian nationalised mining sector.
- In response to the poor commercial efficiency with which State mining companies have been run, increased clarity on roles and responsibilities of government ministries charged with the oversight of minerals has been noted (McPherson, 2008). A trend is seen in which the re-assignment of roles has occurred in an attempt to reduce or eliminate potential conflicts of interest, and to promote commercial efficiency through transferring non-commercial roles and fiscal and regulatory activities from the National Mineral Companies back to the appropriate governmental ministry (McPherson, 2008).

2.5 Summary

As can be noted from the advantages and disadvantages of State intervention in the mineral sector the implementation of State intervention in any country could have both positive and negative effects on that country's economy (Kwabe, 2010). Many of the consequences noted from the implementation of State intervention are country specific, such as the resultant effects of poor governance and conflicts of interest (Eifert et. al, 2003), but these provide valuable information on the importance of ensuring that any reform introduced into the mineral sector, whether it be to introduce State intervention, or as detailed in Section 3 to provide an overhaul of the taxation of that sector, has considered the possibility of such negative consequences (Solomon, 2012).

The key in law and policy making in any country, particularly in the mineral sector, is to balance public and private sector interests in the face of regulatory change (Kwabe, 2010). In order to achieve this balance, while still providing maximum benefit to the State, the risks inherent in the sector must be considered in the creation and alteration of legislation

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(Cawood and Oshokoya, 2013). This will ensure that the sector maintains its appeal to foreign investors (Kwabe. 2010). Risks such as the security of tenure, stable tax rates, the right to repatriate capital, currency conversion and a well-structured and transparent government all exist in the mineral sector and should be considered in regulatory and fiscal policy decision-making (Cawood and Oshokoya, 2013).

Nationalisation was only one of the options considered for the reform of the South African mining sector per the SIMS Report. The SIMS Report concluded against the introduction of nationalisation, in favour of an overhaul of the tax. The challenges highlighted by the SIMS Report included the following: there are insufficient skills at the State's disposal to be able to control the mineral sector from both an operational and regulatory standpoint and complete nationalisation or participation at fifty-one percent would be unaffordable, based on the country's budgetary prospects (Tshikovhi, 2012). Lastly, free equity participation, or nationalisation without compensation, would require a change to the Constitution of South Africa as it currently stands, which may cause investor weariness due to regulatory uncertainty and may ultimately reduce the South African mining sector's appeal as an investment opportunity (Tshikovhi, 2012).

A study was conducted in which it was noted that the cost of implementation of nationalisation by compensation to the State, in order to acquire 100% of listed mining companies, would be just short of one trillion Rand (Keeton & White, 2012). The cost to acquire a fifty-one percent controlling share of listed mining entities is expected to be five-hundred billion Rand (Keeton and White, 2010). The cost of one-hundred percent acquisition would exceed the government's entire budget, which itself only exceeded one trillion Rand for the first time in the 2012/2013 fiscal year; while fifty-one percent acquisition would utilise over half of the government's entire budget, leaving both of the options untenable (Keeton & White, 2010).

In light of the challenges that would be faced in nationalising the South African mineral sector, the ANC-led Government has stated that it is against outright nationalisation (SIMS Report, 2012). The desired outcomes of State control will instead be explored in the form of rent share, growth and development (SIMS Report, 2012). This is to ensure that targeted interventions are made to achieve such desired outcomes (SIMS Report, 2012). In Chapter 3, the taxation reform option, as considered by the SIMS Report as a substitute for nationalisation, is investigated. Chapter 3 summarises the current tax regime and contrasts this with the proposed reforms in the SIMS Report (2012). Chapter 3 closes with the

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similarities and dissimilarities of the proposed reforms and nationalisation in order to address the research question.

Chapter 3: The South African mining tax regime

The notion of an *economic rent*[11] has been the target of taxation reform in South Africa. Mineral exploration companies and prospective investors to the mineral sector are subjected to a myriad of taxes, levies and other statutory costs that are unavoidable, based on the respective criteria legislated for each cost or tax (Ralbovsky, 2012). For the purposes of this research, these costs and taxes are collectively referred to as *governmental costs*.

The volatility in the price of mineral commodities provides mineral companies with the opportunity and the capacity to generate surplus revenues, or *economic rents*, in excess of costs of production (Guj, 2012). The economic rent of a mining operation is calculated as the margin realised after deducting all costs of production, including recurrent and capital recovery costs, and deducting a minimum return on capital from the gross mineral revenue generated by that operation (Harman & Guj, 2011). The minimum return, referred to as *normal profit*, is widely accepted as a return on capital high enough to attract capital and retain it in the mineral project (Guj, 2012).

The normal profit on a project is what compensates investors for foregoing the next best alternative investment opportunities, in addition to being considered compensation for the risk undertaken by the investor with regards to the uncertainty surrounding the timing and amount of cash flows to be generated by the project (Harman & Guj, 2011). The revenue in excess of total costs of production, being the *economic rent*, where the costs of production include *normal profit*, has typically been found to be the target of taxation reform in the mineral industry around the world (Harman & Guj, 2011).

An investor who prepares projections for a prospective mineral investment must determine the rate of return on the total project during all the phases of the mine (as discussed in Chapter 2). These phases include exploration, development, production and closure of the mine (Ralbovsky, 2012). The governmental costs attached to each of these phases, together with the current taxation policy and taxation regime trend in the investee country may be difficult to quantify but nevertheless remain an important factor in the decision making of the prospective investor (Ralbovsky, 2012). Major challenges often lie in the administration

[11] The minimum return, referred to as *normal profit*, is widely accepted as a return on capital high enough to attract capital and retain it in the mineral project (Guj, 2012). The *economic rent* in turn is the revenue in excess of total costs of production, where the costs of production include *normal profit* (Harman & Guj, 2011).

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of the rules and regulations by the tax authorities, rather than in the application of the legislation itself (Ralbovsky, 2012).

3.1 Current mineral taxation regime in South Africa

Currently, the taxation instruments utilised in the South African mineral sector include the following:

3.1.1 Corporate Income Tax (CIT)

Mining corporations are subject to the 28% flat corporate income tax rate (PricewaterhouseCoopers, 2013). This is the standard income tax rate levied at the national level by the South African Revenue Service (SARS). In addition to corporate income tax, mining companies are also liable for Value Added Tax (VAT), customs and excise duties and the skills development levy, all payable to SARS (PricewaterhouseCoopers, 2013). The average time for a VAT refund to be received from SARS is in the region of 3 months (Ralbovsky, 2012).

From April 2012, Secondary Tax on Companies (STC) (payable by companies for dividends declared to shareholders) was replaced by Dividends Withholding Tax (Ralbovsky, 2012). This is a withholding tax of 10% (payable by the shareholder and no longer by the company) on dividends declared to shareholders, subject to certain exceptions (Ralbovsky, 2012). This tax will be discussed further below with the other withholding taxes payable by mining companies.

The tax treatment of mining equipment and other various mining assets, such as land, buildings, plant and machinery, varies in relation to the phase in which the equipment is employed in the mining process (PricewaterhouseCoopers, 2013). For taxation purposes in South Africa, land is not considered a depreciable asset (Ralbovsky, 2012).

<u>Phase 1: Prospecting and exploration</u>

Per the Act, deducted from the income derived by the taxpayer from mining operations is any expenditure incurred by the taxpayer during the year of assessment on prospecting operations (prospecting work preliminary to the establishment of a mine) in respect of any area within the Republic, together with any other expenditure which is incidental to such operations (Section 15(b)). It is, however, the practice of SARS to require the capitalisation of

such expenditure until such time when the taxpayer derives income from the prospective mining operation (Ralbovsky, 2012). In this regard, and in order for the practice of SARS to be in line with the Act, Section 15(a) read with Section 36(11) (b) of the Act allows that the costs incurred be capitalised as "unredeemed capital expenditure" to be deducted against mining income once the mine has become operational.

Phase 2: Development

Deducted from the income derived by the taxpayer from mining operations is expenditure on development, general administration and management (including any interest and other charges payable on loans utilised for mining purposes) prior to the commencement of production or during any period of non-production (Section 15(a) read with Section 36(11)(b)). In this regard, development costs incurred will be capitalised as "unredeemed capital expenditure" to be deducted against mining income.

Phase 3: Production

Once the mine is fully operational and in the production phase, the Act provides for the following: there will be deducted from income derived from the working of any producing mine the amount of capital expenditure incurred (Section 15(a) read with Section 36(11) (b)). Per the Act, capital expenditure is defined as any expenditure on shaft sinking and mine equipment as defined (other than interest or finance charges and partial annual redemption assets) (Section 36(11) (a)). The Act does place a limit on the value of deductions in any year of assessment by a producing mine. The limitation States that the aggregate of the amounts of capital expenditure in respect of any year of assessment in relation to any mine must not exceed the taxable income derived by the taxpayer from mining, and any amount by which the aggregate would have exceeded such taxable income must be carried forward and be deemed an amount of capital expenditure incurred during the next succeeding year of assessment (Section 36(7E)). This clause precludes a producing mine from creating an assessed loss position which would be created from claiming capital deductions in excess of taxable income in any year of assessment.

As an incentive for mining companies with regards to their labour force, the Act provides that the acquisition, erection, construction, improvement or laying out of housing and furniture for employees, infrastructure for residential areas developed for sale to employees, recreational buildings and facilities owned and operated by the taxpayer mainly for use by employees, and railway or similar transport of minerals from the mine to the nearest public

transport system or outlet will all be deducted over 10 years (partial annual redemption assets) (Section36(11)(d)). Acquisition costs of motor vehicles for private or partly private use of employees will be deducted over 5 years (partial annual redemption assets) (Section 36(11) (d)). Further, a deduction is allowed in terms of Section 36(e) and (f) in respect of certain expenditures pertaining to the mineral rights and low cost residential units.

In addition, there is a limitation imposed on the use of mining losses, commonly known as *the ring fencing rule.* Per Sections 36(7E) and (7F) of the Act, the capital expenditure deduction of a mine as provided per Section 36 (11) of the Act is limited to the taxable income from mining operations, and is limited to the taxable mining income of that specific mine. These provisions are included in prevent the mine from utilising deductions specific to mining operations against any ancillary income that may be earned by the mining corporation, and to ensure that an assessed loss position is not created upon the use of the available deductions (PricewaterhouseCoopers, 2013). In this way, revenue expenditure incurred pre-production which would ordinarily have been allowed as a deduction is capitalised and utilised as a deduction against taxable mining income earned once the mine is fully operational (Ralbovsky, 2012). This pre-production, capitalised expenditure in excess of such taxable income is carried forward to future years in which taxable income is available (PricewaterhouseCoopers, 2013).

3.1.2 Withholding taxes

Dividend withholding tax

As noted above, from 1 April 2012, the provisions imposing STC on dividends declared by companies in South Africa were repealed in favour of the internationally accepted norm of a dividend withholding tax levied on the shareholder (subject to certain exclusions) for dividends declared by the company (Ralbovsky, 2012). Currently, the dividend withholding tax in South Africa is levied at a rate of 15%, the provision of which is governed by Sections 64D to Section 64N of the Act. Although the dividends withholding tax is a borne by the recipient of the dividend and not by the company paying the dividend, it remains relevant as it is still a tax to which the company may be subjected upon receipt of a dividend (Ralbovsky, 2012).

Withholding tax on royalties

Section 35 of the Act dealt with royalty withholding taxes in South Africa. This Section was repealed by the Taxation Laws Amendment Act, 2012 as from 1 July 2013. The new royalty withholding tax regime, at an elevated rate of 15%, substituted the old royalty withholding tax at a rate of 12%. The new regime is contained in Section 49A to 49G of the Act. The Taxation Laws Amendment Bill (B39 of 2013) (TLAB) provided that in terms of Section 49B of the Act, the 12% withholding tax on royalties will apply until 1 January 2015 after which the 15% withholding tax rate will apply.

These withholding taxes are not unique to the mineral industry (PricewaterhouseCoopers, 2013). In the interest of completeness, the royalty withholding tax is included in this discussion as it represents yet another tax which mineral companies are exposed to in South Africa. Mineral royalties, which are unique to the mineral industry, arise from the extraction and transfer of minerals, and are levied under the MPRDA (PricewaterhouseCoopers, 2013). These have been discussed in Section 3.1.3 below.

Withholding tax on interest

The TLAB confirmed the introduction of an interest withholding tax at a rate of 15% which will apply in respect of all interest paid or that may become due and payable on or after 1 January 2015. The rate imposed may be reduced through the use of a double tax agreement (DTA), for any person who may be liable for double taxation on such interest.

Withholding tax on service fees

In terms of the TLAB, withholding tax on service fees will come into effect from 1 January 2016 and will apply in respect of service fees that are paid or become due and payable on or after that date.

3.1.3 Mineral Taxes – A technical discussion

Since the advent of democracy in 1994, the political and economic landscape in which mineral companies operate in South Africa has changed significantly (van der Zwan, 2013). The most considerable change noted is the enactment of the MPRDA (van der Zwan, 2013). One of the main objectives of the MPRDA was to introduce into South Africa the

internationally accepted right of the State to exercise sovereignty over the mineral and petroleum resources (van der Zwan, 2013).

Prior to the introduction of the MPRDA, private ownership of mineral resources was possible under the Minerals Act (50 of 1991) (Cawood & Minnit, 1998). In order to achieve State sovereignty, Section 3 of the MPRDA was introduced which States that the mineral and petroleum resources of the country are the common heritage of the South African people, and that the State acts as custodian, to the benefit of all South Africans.

The right to exercise this sovereignty should not be confused with the concept of 'nationalisation' discussed in Chapter 2. Although the minerals belong to the State and its people the South African Government does not participate in or hold any ownership share in the mineral companies which perform the extraction and refining of minerals, and does not participate in the profit sharing (PricewaterhouseCoopers, 2013).

Section 3 (2) of the MPRDA bestows on the State the role of custodian over the nation's mineral and petroleum resources, the right to determine and levy any fee or consideration payable in terms of any Act in respect of these mineral and petroleum resources. This right is subject to the State obtaining adequate and reasonable consultation with the Minister of Finance (Cawood and Oshokoya, 2013). The MPRDA, which became effective from March 2010, was enacted so as to give effect to Section 3(2) (Cawood and Oshokoya, 2013). This legislation imposes a royalty on the transfer of any mineral resources by a person in South Africa (van der Zwan, 2013).

Mineral taxes are those taxes levied on the extraction of minerals or metals from the earth (Ralbovsky, 2012). In South Africa, the mineral tax is known as the Mining and Petroleum Resources Royalty (MPRR), and is levied by the MPRDA of South Africa, as described in Section 3.1.3 above. Otto *et al.* (2006) describe a mineral royalty as an instrument that enables the payment of compensation by an extractor of a mineral resource (the investor) to the owner of the mineral resource (the State), in exchange for the permission to access and develop the mineral resource for its own benefit – confirming that a royalty payment is in effect an *ownership transfer tax.*

International research conducted, further confirmed the State's justification by demonstrating that a mineral royalty represents an instrument that balances the risks involved in developing the mineral resource between the extractor or investor and the owner of the resource (Otto and Cordes, 2002). As the mineral royalty constitutes an instrument

that can be used to balance this risk, the instrument can further ensure that the owner retains a fair share of rent derived from the extraction of its mineral resources (Tsalik, 2004). The final argument from the State concerned the use of the royalty as a fiscal instrument Otto *et al.,* 2006). This indicated that where the ownership of a country's mineral wealth is vested in the State, the State's share of royalties could be, and internationally were found to be, used for the purposes of bringing about socioeconomic change (Otto *et al.,* 2006).

This tax, or royalty, is levied at State level and does not vary from province to province and so is considered a 'federal tax' by international investors (Ralbovsky, 2012). Similar to the global trend, the mineral taxes levied in South Africa are deductible in the Corporate Income Tax calculation of the mining corporation (PricewaterhouseCoopers, 2013). The only uniquely taxed mineral in the current mineral tax regime is gold (PricewaterhouseCoopers, 2013). The extraction and transfer of gold is currently taxed through a unique Gold Mining Formula, rather than by the blanket formula created by the MPRDA which is applicable to all other mineral resources (Ralbovsky, 2012).

In terms of Section 2 of the MPRDA, a person who extracts and transfers a mineral resource from within the Republic of South Africa is liable to pay a royalty to the State. The royalty is determined as the gross sales value of the mineral resource at the time of transfer (tax base), multiplied by a sliding royalty rate (tax rate), which is determined in terms of Section 4 of the MPRDA. When calculating the royalty, a clear distinction is made between refined and unrefined mineral resources. Refined mineral resources are defined per the MPRDA as mineral resources that have undergone a comprehensive level of beneficiation prior to their sale. To this end, the rate of mineral tax varies according to the type and State (refined or unrefined) of mineral or metal, rather than being a blanket rate applicable to all minerals and metals (Cawood and Oshokoya, 2013).

The gross sales value in respect of a mineral resource transferred in either its unrefined or refined condition, as defined per Section 6 of the MPRDA and its schedules, is the amount received or accrued in respect of the transfer of the mineral resource. If the State in which the mineral is transferred is not defined per the schedules of the MPRDA, Section 6 requires that the amount received must be adjusted upward or downward, depending on the condition that the mineral is transferred in, to an arm's length price as if the mineral were transferred in a manner specified per the schedules. Section 11 of the MPRDA contains an array of transfer pricing provisions. These allow the Commissioner of the SARS to adjust the

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gross value from any transfer to reflect the gross value had the transaction been entered into at an arm's length, should he feel that the transaction differs from that amount.

Per the MPRDA, the minimum royalty percentage applied to the gross sales value in the case of refined minerals is 0.5%, with the maximum percentage being 5% of the gross sales value. In the case of unrefined minerals, the minimum royalty percentage is 0.5%, with the maximum percentage being 7%. The following rates were obtained directly from the MPRDA:

Table 1

Mineral Resource	Minimum Rate	Maximum Rate
Copper	0.5%	7%
Gold	0.5%	5%
Iron Ore	0.5%	7%
Coal	0.5%	7%

The exact royalty rate applied to each mineral is, however, determined by a formula provided in Section 4 of the MPRDA. The formula creates a sliding royalty rate system based on the earnings before interest and tax (EBIT), calculated from a taxation perspective, of the particular mine in question. Section 5 of the MPRDA defines EBIT as the gross sales value of the extractor in respect of minerals in any year of assessment, less any amount deductible per the Income Tax Act from the taxable income of the extractor during that year of assessment in respect of assets used or expenditure incurred to win, recover and develop those mineral resources to the condition specified in the relevant schedule of the Act. The formulae guarantee the State a royalty of at least 0.5% of the gross sales value when the resource is transferred, irrespective of the profitability of the extractor (Cawood and Oshokoya, 2013). The formulae applied per Section 4 of the MPRDA are as follows:

Figure 1:

Royalty rate in respect of refined minerals $(s4(1))$: $0.5 + \left(\frac{\text{EBIT for refined minerals}}{\text{Gross sales of refined minerals x 12.5 (R-factor)}} \text{x} 100\right)$

Royalty rate in respect of unrefined minerals $(s4(2))$: $0.5 + \left(\frac{\text{EBIT for unrefined minerals}}{\text{Gross sales of unrefined minerals x 9 (R-factor)}} \text{x } 100\right)$

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Throughout the process undertaken to draft the MPRDA, the legislator acknowledged the capital intensive nature of the mining process and that capital expenditure undertaken by a mine had to be taken into account in the mineral royalty formula to avoid counteracting the incentives created by the Income Tax Act for capital investment in the mining sector (PricewaterhouseCoopers, 2013). Nonetheless, it must be noted that the maximum rates depicted above per Table 1, which represent the cap on the royalty rate levied on the extraction of minerals, are only triggered if the net profit margin of the mine exceeds 56.25% in the case of refined minerals and 58.5% in the case of unrefined mineral resources in line with the formula that is in place for the calculation of the relevant rate (PricewaterhouseCoopers, 2013). This implies that the cap provided on the royalty rate only becomes effective in extraordinary circumstances (van der Zwan, 2013).

3.2 Commentary on the technicalities

As noted in Section 3.1.1, one of the main deductions relating to capital expenditure by mining companies lies in Section 36 of the Act, which provides for an accelerated allowance for capital expenditure, subject to certain ring-fencing rules. By considering these deductions in the royalty formula, SARS has provided mining companies with limited levels of relief from what would otherwise be much higher royalty rates (van der Zwan, 2013). In a comparison (performed by van der Zwan and Nel, 2010) of royalty rates in South Africa to the levels considered to be the international norm, the South African royalty levels appeared relatively high. The international norm was found to range from 0% to 3% applied to a net smelter value, which is determined as the gross sales value reduced by expenditure incurred post the extraction of the mineral resource (van der Zwan and Nel, 2010). The South African royalty rate range of 0.5% to 7% is considered uncompetitive in the international market (van der Zwan, 2013).

In a pre-implementation analysis of the royalty regime, it was found that the overall level of the royalty was likely to reduce the net profits of a mining corporation that is actively extracting and transferring mineral resources in South Africa by between 10% and 13% per anum (PricewaterhouseCoopers, 2013). This pre-implementation analysis further found that, due to the calculation of the royalty tax being dependent on the tax-calculated EBIT generated by the mine, the royalty does not achieve its purpose of taxing the mine in relation to the rate of its extraction of mineral resources and the depletion of those resources from the national resource base, but rather on the level of profit generated from a taxation perspective by the mine (van der Zwan and Nel, 2010).

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The cap provided on royalty rates is a further point of interest. Introducing a cap on royalty rates which is only triggered in exceptional circumstances (van der Zwan, 2013) is akin to a profit participation feature as recommended in the SIMS Report. Utilising the principle of economic substance over legal form, similar to that found in the International Financial Reporting Standards (IFRS), the royalty tax can be seen to be more than it appears. The economic reality of the royalty tax suggests that it consists of more than a mere charge for the extraction of minerals. As noted per the pre-implementation analysis, the royalty ultimately taxes mines on the basis of their profits, rather than on the rate of extraction of minerals – the latter being the Stated intention of the royalty (van der Zwan and Nel, 2010; Cawood and Oshokoya, 2013)

Consequently, it can be argued that the State, through the basis on which it is to implement the royalty, has a profit participation feature in the income generated by the mines. This is in contrast to the fixed rate of taxation noted for other companies – namely 28% of taxation calculated earnings. As such, these proposals provide the State with as much stake in mineral profits as if the State was the majority shareholder in mineral companies – de facto nationalisation.

Due to interaction between the MPRDA and the Income Tax Act, found in the formula utilised to calculate the royalty rate to be applied to the gross sales value of a mine, the level of the royalty rate is not applied evenly over the life of the mine, neither is it applied in relation to the accounting profit generated by the entity (Cawood and Oshokoya, 2013). This distortion is noted due to the fact that for tax purposes, the mine receives accelerated capital allowances in the initial phases of the mine's lifecycle, greatly reducing the tax-calculated EBIT of the mine, and consequently reducing the royalty rate applied per the formula in the MPRDA (PricewaterhouseCoopers, 2013). It is only in the later stages of a mine, once it has surpassed the stages in the lifecycle which provide for accelerated allowances, and once profitability has started declining, that the mineral royalty rate applied begins to increase, providing the State with a larger share of the mine's profits.

The distortion in timing, noted above between the profitability of the mine and the royalties applied to that profitability, is created due to the fact that the accelerated capital expenditure allowances provided in the Income Tax Act, which are considered in the EBIT calculation to determine the royalty rate to be applied, were not intended to be an indicator of profitability in all instances (Cawood and Oshokoya, 2013). Some of the deductions provided for in the Income Tax Act were aimed at providing incentives to attract prospective investors to mining projects in South Africa (van der Zwan, 2013).

Based on these observations, the use of the tax-calculated EBIT does not result in a mineral royalty that truly reflects the rate of depletion of mineral resources or the ability of the extractor to pay the mineral royalty (Cawood and Oshokoya, 2013). In addition, the current definition of EBIT per the MPRDA prevents the State from collecting its share of commodity booms noted in the later stages of a mine's lifecycle once the capital expenditure allowances have been fully utilised by the mine (PricewaterhouseCoopers, 2013). This is due to the fact that the cap on the royalty rate may be triggered as the mine has reached full profitability, with minimal taxation deductions, causing it to attain the required profit percentage to result in the effective application of the cap (van der Zwan, 2013).

This observation, that the State is not collecting its *fair* share of the profits generated from mineral extraction in South Africa is one of the catalysts that led to the commissioning of the SIMS Report (Cawood and Oshokoya, 2013). This was done in anticipation of uncovering the best manner in which to ensure that the State is receiving its share of mineral wealth, whether through nationalisation or through taxation (Cawood and Oshokoya, 2013).

The fundamental principles of *fairness* in taxation can first be traced to Smith's (1776) Canons of Taxation[12], which are still regarded today as the characteristics of a good taxation system (Maroun et al, 2014; Vivian, 2006). It is important to note that alterations to taxation policies are often defended by the State on the grounds of *fairness* (Maroun et al, 2014).

Through the analysis performed in the SIMS Report, mining tax regime changes were clearly favoured over the nationalisation of the mineral sector (Tshikovhi, 2012). Although many advantages were found in countries that have successfully implemented nationalisation in their mineral sectors - advantages which may be translated into South African successes - the disadvantages and challenges to be faced in attempting to nationalise the mineral sector were found to be too onerous to implement (SIMS Report, 2012; Tshikovhi, 2012).

As noted per the SIMS Report, many changes are proposed for the South African minerals sector, many of which are not relevant to this study. Below, a synopsis of the relevant changes has been performed, detailing those changes that would impact the taxation of the extraction, development and sale of minerals, and the investors who have an interest therein.

[12] Smith's (1776) four Canons of Taxation can be broadly summarised as equity, certainty, convenience and economy. Although beyond the scope of this research, fairness in taxation is inextricably linked to the characteristics of a good taxation system (Cawood and Oshokoya, 2013). These characteristics are further explored in Section 4.3 below, to aid in the formation of recommendations for the State in terms of its latest taxation reform proposals.

3.3 Proposed Mineral Tax Regime Changes

> "Nationalisation is but one instrument that we could use to achieve our developmental objectives"
>
> ANC – SIMS Report

As discussed in Chapter 2, nationalisation was firmly rejected in favour of taxation reforms. The principal outcomes, or developmental objectives desired from the overhaul of the mineral system in South Africa (SIMS, 2012) are a much greater share of resource rents (fiscal linkage) and the development of all the mineral economic linkages (utilising a variety of instruments, for accelerated job creation). In order to achieve this objective, nationalisation is considered to be a policy option by the ruling ANC (SIMS Report, 2012).

Per the SIMS Report, it is imperative that as the *owner* of the mineral resources of the country (the State) ensures that the people of the country are receiving their share of resource rents from the extraction of minerals by mining companies. A resource rent has been defined as the surplus value generated by mineral companies, or the difference between the price at which the mineral resource can be sold, and its extraction costs, including normal returns (Cawood and Oshokoya, 2013).

To this end, it has been proposed that, in a similar manner to many countries abroad, a new Resource Rent Tax (RRT) of 50% should be imposed on all mining operations in the country, in addition to the taxes currently in place in the industry. The RRT will only be triggered after a normal return has been achieved by the mineral company, so as not to impact on marginal profits (Cawood and Oshokoya, 2013). A 'normal return', or the RRT threshold, was given the proposed definition of the South African Treasury Long Bond Rate plus 7%. This threshold return would ensure that the return earned on mineral resources is competitive with that that could be achieved elsewhere in the economy in relation to labour, entrepreneurial and management skills and a competitive return on capital (Cawood and Oshokoya, 2013). The RRT is imposed only on *super profits*, and is not intended to impact the ordinary profitability of the mine, up to a reasonable level of return (SIMS Report, 2012).

In order to standardise the mineral fiscal regime, the current gold mining tax formula would be replaced with corporate income tax plus the RRT, which would be applicable to all minerals (SIMS Report, 2012). Upon the introduction of the RRT, it is proposed that mineral royalty rates should be reduced to 1% of revenue to enhance optimal resource extraction, as in the study's view, mineral royalties on production add to costs and increase the cut-off

grade of minerals (Cawood and Oshokoya, 2013). The study concludes that the fiscal impact should be neutral, by compensating the fiscus with an equivalent amount from the RRT. The remaining level of royalties charged on mineral resources would be ring-fenced and utilised to fund the Minerals Commission, fund the rehabilitation of ownerless mines and the remediation of historical damage, and lastly to invest in local sustainable economic development (Cawood and Oshokoya, 2013).

In order to prevent the speculation of mining rights, which are only available initially for purchase from the government as per the MPRDA, a tax akin to capital gains tax, of 50% on the sale of mining rights has been proposed in the SIMS Report. The introduction of such a tax is intended to ensure long-term investment in the mineral sector, and to dissuade investors from entering into the South African mineral sector for speculation purposes only (Cawood and Oshokoya, 2013).

In addition to the introduction of the RRT, a further tax has been proposed for introduction: a *Mineral foreign shareholding withholding tax* (SIMS Report, 2012). This proposal was introduced due to many international mining companies investing in South Africa through a subsidiary registered in a tax haven, rather than investing directly in South Africa (Cawood and Oshokoya, 2013; SIMS Report, 2012).This tax would apply to all foreign mining houses that invest in South Africa through such an off-shore subsidiary holding company in a tax haven, and would be levied at a rate of 30%. Should the off-shore holding company be in a country not considered a tax haven, the withholding tax rate levied would be reduced to 10%.

The Carbon Tax, a tax on carbon emissions released through manufacturing, has been proposed for reconfiguration, together with a postponement in its implementation (SIMS Report, 2012). The Carbon Tax was due to be implemented on 1 January 2015 but in his 2014 National Budget Speech, the then minister of Finance Pravin Gordhan delayed the implementation to the 2016 fiscal year (Donnelly, 2014). The SIMS Report (2012) alleges that the Carbon Tax, as currently configured, would add to mining costs, henceforth ceasing further investment in the mineral industry in South Africa amid the current uncompetitively high cost of mining in South Africa. The manner proposed per the SIMS Report in which to reconfigure the Carbon Tax is to levy a higher RRT – above the proposed 50% – linked to carbon emissions, and should also include realistic measures to assist in reducing national carbon emissions. Further discussion on the Carbon Tax is considered to be out of the scope of this research.

In keeping with international trends, the SIMS Report has suggested that the proceeds earned from the collection of the RRT should be kept in an offshore Sovereign Wealth Fund (SWF), to ameliorate any gains to be earned from the strengthening of the Rand during commodity price booms. By investing the resource rents earned from the RRT in a SWF, the rents would be protected from 'Dutch Disease' (SIMS Report, 2012). Dutch Disease has been defined as the negative consequences arising from large increases in a country's income (Lexicon, 2014) – quintessentially the negative impact of a strong Rand on the economy, particularly on manufacturing exports and jobs (Cawood and Oshokoya, 2013). It is proposed that the SWF should be funded by ring-fencing the proposed RRT to invest in long-term projects and instruments that will safeguard South Africa's economic prosperity beyond the depletion of its mineral resources.

In table 2 below, the changes proposed to the current mineral tax regime, as discussed above, have been contrasted with the mineral tax regime as it stands:

Table 2	Current Mineral Tax Regime	Proposed Tax Mineral Regime
Corporate Income Tax	• Corporate Income tax at 28% • Various Capital Expenditure deductions • Carry-forward of tax losses	• No change proposed
Withholding Taxes	• Dividends withholding tax – 15% subject to DTA reduction • Royalty withholding tax – 12% subject to DTA reduction • Interest withholding tax (to be introduced) – 15% subject to DTA reduction • Serviced fee	• Maintain all current withholding taxes and those that are imminent • Introduce new Mineral Foreign Shareholding Withholding Tax – minimum 30%

	withholding tax (to be introduced) – rate to be advised	
Mineral Taxes	• Resource Royalty on extraction and transfer of any mineral – Rates vary based on MPRDA formula and thresholds vary based on type of mineral – 0.5% - 7% • Resource Royalty for gold is based on a different formula, with lower maximum rate – 0.5% - 5%	• Removal of unique gold royalty formula • Reduction of royalty rates to 1% of revenue applicable to all resources. • Tax of 50% on sale on mining rights
Resource Rent Taxes (RRT) and other taxes	• No RRT currently in place • Carbon Tax to be introduced in 2016	• Introduction of RRT at 50% of super profits as defined • Carbon Tax to be reconfigured, and implementation to be postponed further • Increase in the rate of RRT to compensate for carbon emissions

As can be seen from the table, many more taxes have been proposed. The consequence of introducing these new taxes into the currently saturated tax regime will be to increase even further the effective tax rate on mining companies (Tshikovhi, 2012).

The rates proposed in relation to the new taxes seem exorbitant when compared to the rate of similar taxes abroad (Tshikovhi, 2012). For example, the mineral resource rent tax recently introduced in Australia is levied at a rate of 22.5% , (see Chapter 4 for further details) a rate significantly lower than the 50% proposed for South Africa's RRT. A withholding tax of 25% is imposed by the Brazilian tax authority for all payments made to

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persons resident or domiciled in tax havens, a rate notably lower than that proposed for the Mineral Foreign Shareholding withholding tax of 30%.

Even though the call for nationalisation of the mining sector seems to have faded into the background, it can be noted that the State, although not holding a direct stake in mining companies, is proposing to introduce reforms to the tax system which will have the net effect of increasing the amount payable to it from the mining houses (Cawood and Oshokoya, 2013). With this being the Stated intention of the State purporting to act 'for the people' (SIMS Report, 2012), it is reasonable to conclude that the effects of the proposed taxes will be similar, in substance, to State participation in mining profits.

3.3.1 Analysis of nationalisation versus the proposed taxation reforms

As this point, it is logical to highlight the similarities and dissimilarities between nationalisation (Chapter 2) and the proposed taxation reforms.

Table 3	Nationalised Mineral Sector	Proposed Taxation Reforms
Ownership		
	• Ownership (either 100% or by majority shareholding) of mineral companies would vest in the State • Ownership of mineral resources remains with the State as custodian	• Ownership of mineral companies vests in current investors • Ownership of mineral resources remains with the State as custodian
Decision-making		
	• Decision-making in all respects (financial, operational, prospective decisions, taxation) would rest in the State as owner of minerals and owner of mineral companies	• Decision-making with regards to operations, financial decisions and prospective decisions for the mineral company would remain with the mineral company • Decision-making with regards to taxation would rest in the State through its ownership of

		minerals • Ownership of minerals by the State can confer a certain degree of control over operations, as the State retains the right to provide mineral licenses for the extraction and distribution of minerals
Profit Sharing		
	• As the shareholders of mineral companies, the State will share in profits of the mine • State as owner of minerals will also receive further stake of profits through taxation of the profits of mineral companies • As outright owners or majority shareholders, the State may determine the level of profit to be paid to shareholders	• Shareholder of the mineral companies will share in profits through dividends and other profit sharing instruments • State will not directly participate in profit sharing; however as the custodian and owner of minerals, the State will receive its share of profits through taxation. • The State maintains power to increase and decrease taxes. • As currently proposed, 50% of super-profits would go to the State – With the State having the ability at any time to change the percentage • To the extent that the tax rate on super-profits is higher than the long-term average rate of return for other capital intensive businesses, this could be seen as nationalisation as these profits would never have accrued to the State, but rather to the investors themselves.

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As per Table 3, one of the main similarities between a nationalised mineral regime and the proposed taxation reforms is the State's authority to control the amount of profits it will eventually receive from mineral companies – whether in the form of dividends or in the form of taxation. The 50% supertax is akin to a dividend paid to shareholders out of a company's excessive profits the only difference being that, in the case of the supertax, the company has no choice in whether to distribute its excessive profits or to retain them for use in future investments.

Table 3 also highlights the possible functioning of clever impression management on the part of the State. On the one hand, it condemns nationalisation of the mines as an unviable option (Cawood and Oshokoya, 2013). This is an important political Statement, given that dissent among investors and the risk of radical policy changes may lead to the cessation of foreign investment (Cawood and Oshokoya, 2013; Cook, 2012). The State, however, must balance the interests of capital with the electorate, the majority of whom have been effectively excluded from active and material participation in the economy due to various social, economic and political challenges[13] (Cawood and Oshokoya, 2013; Tshikovhi, 2012). Consequently, although government publically rejects the idea of nationalisation, the policy decision remains a point of discussion for the ANC (SIMS Report, 2012; Tshikovhi, 2012; Faku, 2013; Cawood and Oshokoya, 2013) and is frequently raised in the financial press (Faku, 2013; Gopaldas, 2013; Tshikovhi, 2012). A key part of this clever balancing act is the SIMS Report itself. It is an official 'scientific-styled' report which opposes nationalisation, as per the interests of Western capital (Tshikovhi, 2012). Practically, however, it suggests the introduction of additional 'taxes' which, in substance, have the effect of declaring profits above a prescribed level as a dividend to the State (Tshikovhi, 2012).

In other words the proposed taxation reforms replace the *notion* of nationalisation. They also dispense with arguably the most controversial issue associated with nationalisation by leaving companies in the de facto control of shareholders (SIMS Report, 2012). Symbolically, the report is a celebration of the balance between ensuring the private rights of shareholders with the needs of the State to secure a fair share of revenue from the mining industry (cf Vivian, 2006). The substance of the proposals in SIMS Report (2012) is different (Tshikovhi, 2012). By retaining its custodianship over minerals, and through the introduction of the RRT, the State is, in effect, acting as a shareholder in the mineral industry, taking a large share of the accumulated profits akin to receiving dividends from mineral companies (Tshikovhi, 2012).

13 The specifics are beyond the scope of this thesis

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The principles of taxation and dividends vary greatly in their substance. *Taxation* is broadly defined as a means by which governments finance their expenditure by imposing charges on citizens and corporate entities (Vivian, 2006); *dividends,* in contrary, are defined as a share of after-tax profit of a company, distributed to its shareholders in accordance with their shareholding in that company[14]. It can be noted that where taxation is a means for financing expenditure, dividends are a means of earning a share of profits. Through the introduction of the RRT, the government has moved away from the idea of a simple tax as a source of expenditure-funding to a form of profit participation similar to that sought after by an investor (Tshikovhi, 2012; Cawood and Oshokoya, 2013). This highlights the close similarity between the taxation reforms and nationalisation, both of which have the goal of revenue or profit maximisation for the State. A more critical interpretation is also possible.

It may not be coincidence that the SIMS Report makes extensive reference to the ideals of a fair tax system. For example, as noted in chapter 2 and chapter 3, one of the catalysts for the commissioning of the SIMS Report was the State wanting to collect its *fair* share of resource rents (Cawood and Oshokoya, 2013; SIMS Report, 2012). Critical governance and tax research, however, tells us that altruism is rare. In order for the State to balance its own interests with private providers of capital, it is critical for the recommendations in SIMS Report 2012 to be perceived as fair and, thus, credible (see Vivian, 2006; Maroun et al, 2014; Cawood and Oshokoya; 2013). To paraphrase Humphrey (2008), "policy making is inherently a political process rather than a scientific process" (p. 176).

In a tax setting, Farrar (2011), for example, argues that claims to fairness and justice are used to secure compliance with tax laws and regulations. In a South African setting, Maroun et al (2014), argue that motifs of fairness, inherent in the introduction of Capital Gains Tax (CGT), are critical for the legitimisation of the new tax form (Vivian, 2006). Arguably, the same applies to the proposed taxes in the SIMS Report. As noted by Maroun et al (2014), prior to the introduction of CGT, the State reasoned that by increasing State revenues, government would be able to tackle more effectively nation-wide poverty and the struggles of the previously disadvantaged. One of the rationales for commissioning the SIMS Report, noted in chapter 2, is *fairness* in taxation revenue collection in order to assist the poor (Cawood and Oshokoya, 2013). Studies show, however, that in the long run, *fairness* plays a secondary role in tax legislation (Maroun et al, 2014; Farrar, 2011; Marriott, 2010). The similarity between the substance of the proposed taxation reforms and nationalisation suggests that the RRT is a means to an end, hidden in politically pleasing language (Tshikovhi, 2012).

[14] Definition obtained from Oxford Dictionary (www.oxforddictionaries.com, accessed 30 July 2014).

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Regardless of the intention behind the taxation reform proposals, the possible consequential effects of such taxation reform are of relevance to this study. Being the taxation system on which the RRT has been based, it is useful to consider the experiences of the Australian tax authority and mining industry in order to evaluate the proposed taxation reforms for the South African mining system in more detail. Chapter 4 evaluates the internationally found best practice for mineral taxation regimes, in conjunction with the recent implementation of the Mineral Resource Rent Tax in Australia.

Chapter 4: Internationally based findings

The perceived stability of a tax regime over time is a risk for potential investors (Mitchell, 2010). Such stability is equally significant for governments due to the risk-return trade-off; where investors perceive greater risk, they will expect a higher return, which consequently reduces the returns available to the government (ICMM, World Bank and UNCTAD, 2008). The tax system, thus, plays a vital role for a government in terms of influencing the attractiveness of a jurisdiction for investors (Mitchell, 2010), and accordingly, for attracting the quality of investor that will ensure that the government's objectives are delivered and achieved with conviction and a level of certainty (Solomon, 2010). For the mineral industry, the design and implementation of a tax system that balances the interests of the parties involved is imperative for the efficiency of the mineral sector of any country desiring prosperity in that sector (Kwabe, 2010; Mitchell, 2010).

In the sense that the extraction of mineral resources permanently depletes a country's resource base, such resources can be considered finite and non-renewable (Harman & Guj, 2011). The role of any government with regards to its mineral sector should be to manage the exploitation of its country's mineral resources in order to maximise the economic benefits to their community, while considering the consistent need to attract and retain the extraction and development capital necessary to realise these benefits for the greatest time possible (Guj, 2012).

The United Nations performed a survey on the top ten decision criteria considered by companies in making mining investments. Of these ten criteria, three were tax-dependent, and two were tax-related, resulting in half of the decision criteria being associated in some way with the taxation system in the potential investee country (Otto, 2005). The three tax-dependent criteria were as follows: profitability of potential operations, ability to predetermine tax liability and stability of the tax regime. The two tax-related criteria noted were the ability to repatriate profits and the stability of exploration terms and conditions. It

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is clear that internationally, investors seek mining sector investments by intensely considering the taxation in the targeted investee country (Otto, 2005).

In an international study commissioned by the OECD, the key issues affecting taxation systems were investigated. The study emphasised the factors that are unique to the mining sector: these require full consideration in designing and implementing a taxation regime in that sector (Henderson, 2005). The primary factor unique to the mineral sector was the cyclical nature of mines, and the consequent financial cyclicality that results (Henderson, 2005). This cyclicality means that different mines have differing capacities at different points in their lifecycle to pay taxes (ICMM, World Bank and UNCTAD, 2008). As per Appendix 1, there exist four distinct stages in the lifecycle of a mine, each with unique implications for the taxation that may be applied during that phase. In designing an effective taxation system for the mineral sector, the stages of a mine's life-cycle should be considered due to the uniqueness and capital intensive nature of the industry.

4.1 Characteristics of an effective mineral tax regime

Given the diverse range of operations in the mining sector, researchers suggest that it is impossible to define an ideal tax system for all mining jurisdictions (Otto, 2005). The commonalities that can be found in mining operations, as detailed above, can be reduced to the shared objective of encouraging the implementation of sustainable and successful projects that fully exploit the mineral wealth of a country, while avoiding social costs (McPherson, 2008). With this in mind, three features can be observed as forming the basis of a good mining taxation regime.

4.1.1 Transparency in taxation levels

In order to maximise long-term taxation revenues, governments need to incentivise investment in their jurisdiction, and to ensure that their mineral sector maintains its profitability and is technologically advanced (Otto *et al,* 2006). In order for long-term success to be feasible, neutral or progressive tax systems motivate corporate innovation and profit-seeking, ultimately resulting in the success of the mineral sector as a whole (Otto *et al,* 2006). Regressive taxation systems, in which an increasing share of profits is taken by the State, have been found to be discouraging to investors, and may ultimately lead to dis-investment (Henderson Global Investors, 2005).

The decision on the government's optimal share of economic rent should consequently balance the revenue-maximisation objective with that of attracting the necessary level of international exploration and developmental capital into the country (Harman & Guj, 2011). In so doing, the government should consider the international perception of the country's infrastructure, political stability and other non-monetary socio-economic costs and benefits (Guj, 2012). It is submitted that unexpected reviews may become necessary in the event of a government discerning that actual royalty collections, individually or in aggregate are not in line with the originally desired levels, or in circumstances where these original levels are no longer representative of the economy's emerging needs (Otto *et al,* 2006). To minimise the perceptions of such sovereign risk, the government must adhere to its transparency policies, by preparing the ground for changes in full consultation with the industry itself (Guj, 2012).

Taxation rates and the mix of taxes levied on any commodity are based on assumptions about the future prices and costs of that commodity over time (Seager, 2010). These assumptions will inevitably change as the global market changes (Seager, 2010). In order to maintain a relationship of trust between the public and private sectors, a multi-stakeholder body should be set up to provide a platform for collective reviews of the key assumptions on which taxation rates are based (Mitchell, 2010). This will provide investors with the transparency they require with regards to the future taxation of profits, as well as providing predictability in policy changes, and consensus in decision-making (Otto *et al,* 2006). By ensuring that policy decisions are formulated by incorporating clear processes, timing, triggers and boundaries within which possible future reviews of royalty or tax rates would take place, such decision become predictable for investors, allowing them to consider all alternatives, in turn increasing the investment appeal of a country (Guj, 2012).

4.1.2 The mix of taxes levied

The objectives of a taxation system should include, as a base, simplicity and uniformity, to relieve the administrative burden on both the State and the investor (Otto *et al,* 2006). These base objectives also reduce the ever-present risk of corruption, poor policy decision-making and fragmented public expenditure (Otto *et al,* 2006). In contrast to the objectives of simplicity and uniformity, international experience has shown that the mining industry is often subject to a number of varying taxes, which, in turn, are levied by varying levels of government (Mitchell, 2010). This sort of taxation counters the objectives of a successful taxation system, and in turn, may also lead to disinvestment in the industry of one country in favour of a country with a more centralised, direct taxation system in place (Otto *et al,* 2006). The mix of taxes levied on the mineral sector in totality should be given careful

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consideration by the State, to ensure that the integrity of the base objectives of a successful taxation regime are maintained (Henderson Global Investors, 2005).

4.1.3 Uniformity of taxation across sectors

There is a common trend for countries to have unique taxation systems for their mineral industries (Mitchell, 2010). As noted, disparity between the taxation of different sectors raises the complexity, costs and risks associated with mining (Mitchell, 2010). As such, all sectors within a country should be placed on an equal footing with regards to taxation (Henderson Global Investors, 2005). This provides greater certainty, constancy and proficiency in the taxation regime, and may increase incentives for governments to regularly improve taxation administration and the transparency of policy-making (Henderson Global Investors, 2005).

Through various studies conducted, the principal objective of fiscal policy is to ensure that a country receives the maximum benefit from its resources, subject to attracting the level of investment necessary to realise that benefit (McPherson, 2010; Otto *et al,* 2006; Henderson Global Investors, 2005). It is, therefore, no surprise that the fiscal reforms noted in the mining sector over the last 100 years were motivated by the common desire to encourage greater levels of mining investment, while addressing the concerns about the public-private shares of mining tax revenue (Otto *et al,* 2006).

In addition to the characteristics of best and worst practice noted through the analysis of foreign precedent, this research will now look to the resource rent tax that was recently implemented in Australia. Australia has been selected specifically due to the similarity of the resource rent tax implemented with the taxation reforms proposed for the South African mineral industry discussed in Chapter 3. This will aid in determining the possible impact of the introduction of such reforms to the industry, as well as in identifying its possible advantages and disadvantages.

4.2 Australian Mineral Resource Rent Tax

On March 19 2012, Australia's Upper House introduced the controversial Minerals Resource Rent Tax (MRRT), which was to take effect from 1 July 2012 (The Economist Intelligence Unit Ltd, 2012). The MRRT was introduced to replace the mineral taxation system in which royalties were collected by the State, and where investors and their companies were charged for the volume of minerals they extracted (The Economist Intelligence Unit Ltd, 2012). In

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conjunction with the introduction of the MRRT, a reduction of the country-wide corporate income tax rate was also to take effect (Swanepoel, 2013).

Australia had experienced an increase in demand for its commodities and, consequently, an increase in their prices, for a period of eight years prior to the conception of the MRRT (King, 2013). The changes to the taxation system introduced by the MRRT resulted in a tax of up to 30% on profits above a certain threshold being imposed (The Economist Intelligence Unit Ltd, 2012). This tax applied to large coal and iron-ore mining firms which generated profits above the threshold of seventy-five million Australian dollars (The Economist Intelligence Unit Ltd, 2012). The new tax thereby introduced a change from the method of royalty taxation of minerals, to the taxation of minerals by resource rents (Guj, 2012).

The MRRT is determined at a taxation point referred to as the Run of Mine (ROM), being the point in the mining process at which the value of the resource is as close as possible to the net value of the resource in its raw form before further processing and transportation (Guj, 2012). The MRRT paid by a mining company is deductible for the purpose of assessing corporate income tax in order to avoid the double taxation of mining profits (Guj, 2012). In determining the amount of MRRT payable, the taxable amount is calculated by subtracting from total revenue at the ROM all the capital and operating costs to be incurred upstream from that point (Guj, 2012). Any unutilised taxation losses and royalty credits generated by a mining corporation can be carried forward and uplifted at the long-term bond rate plus 7%, and can be transferred against any MRRT profits that the corporation may have in relation to any other iron ore or coal mining projects in its portfolio (Guj, 2012).

Only mining operations generating profits in excess of the seventy-five million Australian Dollar threshold are subject to paying the MRRT (Swanepoel, 2013). This limit was created to shelter smaller mining operations and emerging developments (Guj, 2012). This benefit is progressively reduced for mining profits between seventy-five million and one-hundred-and-twenty-five million Australian dollars (Swanepoel, 2013). A cap of one-hundred-and-twenty-five-million Australian dollars has been placed on the level of profits on which the MRRT is payable (Swanepoel, 2013).

To capture the substantial rents generated by a small number of large, existing mining operations, the MRRT has been legislated to apply to both current and future operations (Swanepoel, 2013). The taxation legislation was drafted in such a manner as to recognise capital investments that were incurred before the MRRT was announced in its initial phases in 2010, and during the transition period to the MRRT's enforcement in 2012 (The

Economist Intelligence Unit Ltd, 2012). The owners of existing projects were provided with two alternatives which may be utilised in determining the starting value of their projects for the purposes of the MRRT (The Economist Intelligence Unit Ltd, 2012):

1. The project could be valued at book value as a starting point, excluding the value of the mineral resource, and would be depreciated over five years, using an accelerated rate of apportionment; or
2. The project could be valued at market value on 1 May 2010, including any capital investment that took place during the transitional period, and would be depreciated on a straight-line basis over the life of the mine to a maximum of twenty-five years. Market value for this purpose is deemed to include the value of the mineral resource, as in some cases, this may constitute the bulk of the value of the mine.

The decision as to which option to choose rests solely on the owners of the mine, and is considered to be a key strategic decision to ensure the longevity and profitability of the mine (The Economist Intelligence Unit Ltd, 2012).

At the time of its introduction, it was expected that the MRRT would generate an estimated eleven billion Australian dollars in its first three years of implementation (The Economist Intelligence Unit Ltd, 2012). With this additional revenue, the Australian government intended to implement a reduction in the corporate taxation rate as noted above, increase payments into pension funds, and in addition, six billion Australian dollars were intended for infrastructure development (Economist Intelligence Unit Ltd, 2012).

Although the *committed* investment in the Australian Resource and Energy sector reached a record high of two-hundred-and-sixty-eight billion Australian dollars in 2013, as reported by the Bureau of Resource and Energy Economics, one-hundred-and-fifty billion Australian dollars of new project investment was delayed or cancelled in that year (King, 2013). The boom in coal and in iron ore, which had allowed the sector to flourish since 2000, has slowed as evidenced by the fact that 80% of all new committed mining projects in Australia are in liquefied natural gas (King, 2013). The decline in commodity prices, combined with the additional MRRT payable by investors on achieving the sought after (for investment purposes) yet so greatly undesired (due to being subjected to additional taxes at this level) level of profit; has been named as the culprit for the reduction in investment (King, 2013). Further contributors to the decline in revenues from the mineral profits-based tax were cited as being general global instability and a higher trading value of the Australian dollar (King, 2013).

The MRRT can be said to have *fallen short of expectations* in terms of attaining the Australian government's desired level of revenue (King, 2013; Economist Intelligence Unit, 2012). International commentators have criticised the design of the MRRT, stating that the tax was introduced to generate revenue for the government at the time of the resource price boom, without taking into consideration the impact of a slump in resource prices on the taxation revenue that would be collectible (Guj, 2012).

In addition to the lower than expected revenues generated by the MRRT, and the investor weariness generated on the implementation of the tax, the tax also caused much anger and despondency in the Australian mining industry (Swanepoel, 2013). It was submitted by the Australian Federal Resources and Energy Minister, Martin Ferguson, that there was a lack of consultation with the mining industry before the introduction of the tax, adding to the frustration of investors (Swanepoel, 2013). Prior to the introduction of the MRRT, the industry was already subject to income tax, royalty tax, payroll tax, stamp duties, levies and a myriad of further fees payable to the local, State and federal factions of the Australian government, resulting in the MRRT having been referred to as a *double tax* (Swanepoel, 2013).

While such a tax is effective in taxation revenue collection during times of resource booms, these booms do not continue indefinitely (King, 2013). A mineral resource rent tax should take this into consideration in its design, revenue forecasting and optimal time and length of implementation (King, 2013). Flexibility and transparency, being two of the key attributes of a successful and efficient taxation regime, should be written into the legislation to allow for unexpected changes in economic circumstances (Harman & Guj, 2011).

Taking this into consideration, it is recommended that before the introduction of the RRT in South Africa, the State consider the following:

- The estimated revenue to be earned from the RRT should incorporate the likelihood of both booms and declines in commodity prices, so as to avoid unexpected budgetary shortfalls (Cawood and Oshokoya; 2013);
- Effective and robust consultation should be held with current and prospective investors in the mineral industry with regards to the design and implementation of the RRT and further reforms in order to avoid investor anger and despondency as occurred in Australia (Guj; 2012; King, 2013);

- The design of the RRT should provide for flexibility and transparency in order to be able to adapt easily and timeously to changes in economic circumstances (Swanepoel; 2013); and
- The optimal length and time for implementation should be considered to provide investors and prospective investors with the opportunity to incorporate such considerations into their forward planning and budgeting (Swanepoel, 2013; King, 2013).

4.3 Recommendations based on scrutiny of the MRRT

Considering the reforms proposed per Chapter 3, it can be noted that South Africa is intending to introduce further mineral-exclusive taxes to the mineral sector. Contrary to the international guidance for best practice for the design of taxation systems, this will introduce further disparity into the taxation system as not all sectors would be considered on equal footing (Henderson Global Investors, 2005). Prior to the introduction of the proposed taxation reforms into South Africa, it is recommended that the State consider aligning the taxation of the mineral sector with other sectors in the country so as to improve efficiency and provide investors with the certainty, constancy and proficiency they desire (Henderson Global Investors, 2005).

In addition, through research into such reforms in Australia, it is noted that investors seeking to make an investment into the mining sector of a particular country pay specific attention to the taxation that they will be subjected to in that country, in contrast to the taxation in a directly comparable alternative country (Otto, 2005). In this regard, the rates of taxation in the prospective investment country are notably important (Otto, 2005). In Chapter 3, it was noted that the proposed rate for the RRT is 50% of *super profits*. This rate, in comparison to other countries which have implemented a similar tax, is well above that noted abroad and consequently uncompetitive in the global market (Tshikovhi, 2012).

Considering section 4.1 above, a summary and a comparison in the design of the MRRT of Australia to the characteristics of an effective mineral taxation regime is performed. Due to the South African RRT being based on the Australian MRRT, similar shortfalls noted will be applicable.

Table 4	Australian MRRT
1) Transparency in taxation levels	
	• Flexibility was not written into the design of the MRRT, causing rigidity in times of economic change (King, 2013; Swanepoel, 2013). • Due to minimal initial consultation with mineral investors, anger and despondency resulted post implementation of the MRRT due to lack of transparency (Swanepoel, 2013; Guj, 2013).
2) Mixes of taxes levied	
	• Minimal initial consultation with the mineral industry caused the perception of double taxation as a result of the MRRT (Guj, 2012). • MRRT caused further disparity in taxes levied on different industries in the country as the mineral sector was, yet again, subject to a unique tax, in addition to the taxes levied on other industries (Mitchell, 2010; King, 2013).
3) Uniformity of taxation across sectors	
	• The MRRT, being unique to the mineral sector, introduced further disparity in the realm of taxation in Australia as drew attention to lack of uniformity of taxation across sectors (Mitchell, 2010; Guj, 2012).

The factors above suggest that the MRRT fell short of meeting the suggested criteria for an effective mineral taxation system (Otto, 2005; Henderson Global Investors, 2005; Swanepoel; 2013). Contrary to the initial objectives of the MRRT, it resulted in poor transparency for investors, further disparity in the manner of taxation across the sectors of the Australian economy, and resulted in incongruity in the Australian taxation system as a whole.

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At the time of the commissioning of the SIMS Report (March 2012), the Australian MRRT was in the process of being implemented. As such, an analysis similar to Table 4 was not possible. Should the proposals of the SIMS Report be introduced to the South African taxation system, the shortfalls noted in Table 4 of the MRRT may cause South Africa's taxation system to move further from what is internationally accepted as effective and efficient taxation (Swanepoel, 2013; Cawood and Oshokoya, 2013). The benefit of hind-sight, providing the opportunity to analyse the shortfalls of the MRRT in Australia was not available at the time of the commissioning of SIMS Report. This analysis thus provides a valuable contribution to the literature being considered in the formulation of the new RRT.

In addition, per the concluding remarks in Chapter 3, the 50% tax rate proposed for the RRT is one of the factors that compare the proposed taxation reforms to nationalisation. It is recommended that the State reconsider this taxation rate so as to remain competitive in the global market. This will further maintain investor confidence in the industry by assuring investors that such a tax is not intended to be, and will not be utilised as a form of de facto nationalisation (Tshikovhi, 2012).

The analysis performed above has affirmed that there are certain characteristics of taxation systems that are required to be in place to ensure the success of the taxation system. These characteristics ensure that investor confidence is maintained in the country. It is recommended that the State consider these characteristics prior to the implementation of its proposals for taxation reform in the mineral sector. This will aid in ensuring that the possible negative consequences of such an implementation do not occur in South Africa.

Chapter 5 – Conclusion

5.1: Summarising remarks

Nationalisation is a well-established, yet misunderstood concept. There have been successes and failures when attempting to nationalise mining operations in various jurisdictions. The accomplished, long-nationalised, system of Namibia and the failure of nationalisation in Zambia were analysed in this regard, providing an interesting view of the possible advantages and disadvantages of nationalisation in any particular economy. Considering the various types of State participation, one common and distinctive factor was brought to light: the commercial objectives of State participation place emphasis on the maximisation of revenue flowing to the State from the mineral sector (Van der Zwan and Nel, 2010).

The analysis presented in Chapter 2 suggests that the disadvantages of nationalisation outweigh the advantages. Shortages of funding, commercial inefficiency, investor weariness, conflicts of interest and fears of governance and corruption issues are the main concerns brought to light through the research performed (Section 2.4). These are considered to outweigh the advantages of maximising economic rents and profit redistribution that would be noted upon the implementation of nationalisation. The ANC, in concluding on nationalisation in the SIMS report, recognises the disadvantages outweighing the advantages (SIMS Report; 2012).

In Chapter 3, the current mineral taxation regime in South Africa, as well as the changes proposed by the SIMS Report, was analysed. One of the main objectives for the State proposing taxation reform for the mineral sector was the realisation that State is currently not collecting its *fair* share of profits generated from mineral extraction in South Africa (SIMS Report, 2012; Tshikovhi, 2012). In order to rectify the situation, the State proposed various reforms for the taxation of minerals. The most significant, per the SIMS Report, was the introduction of the RRT, which will see the State receiving 50% of the super profits earned buy a mineral company.

Although the ownership of mineral companies would not vest with the State because of the introduction of the RRT, the basis of the tax suggests that government has moved away from the idea of a simple tax as a source of expenditure-funding, to a form of profit participation, similar to that sought by an investor. A critical interpretation of the similarity between the substance of the proposed taxation reforms and nationalisation suggests that the RRT is a means to an end, shrouded in politically pleasing language (Tshikovhi, 2012). As noted in Section 3.3.1, taxation reform is often diplomatically defended as a measure put in place to achieve this illusive concept of *fairness* (Maroun et al, 2014). Practically, it appears that the proposed RRT is a form of de facto nationalisation marketed to investors and the mining industry and the State seeking to ensure an equitable tax system.

In chapter 4, the MRRT was analysed and the internationally accepted criteria for an efficient taxation system were introduced. Through the comparison performed, the shortfalls of the MRRT were highlighted in order to evaluate the possible negative consequences that will be faced by South Africa on the introduction of the taxation proposals contained in the SIMS Report. These shortfalls, which are indicative of an inefficient taxation system per the guidance from the OECD, included a lack of flexibility written into the legislation and deficient upfront communication with investors in the industry, which led to a decline in investor confidence in the Australian mineral industry. The MRRT was also found to have

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introduced further disparity in the taxation of various industries, and a lack of uniformity in the Australian taxation system. This report recommends that the objectives and design of the tax be revisited so as to avoid similar inefficiencies into the South African taxation system.

5.2: Limitations and areas for future research

It is considered appropriate to iterate that this research has made no attempt to examine the various socio-economic factors which would affect the advantages and disadvantages of implementing a change to the mineral taxation system in South Africa. This is an inherent limitation of the study. The study does, however, make an important theoretical contribution by considering the similarities between nationalisation and the proposed taxation reforms and by highlighting the possible negative consequences of introducing such taxation reforms without thorough consideration.

In a survey performed by the United Nations on the top ten decision criteria considered by companies in making mining investments, of these ten, three were tax-dependent, and two were tax-related, resulting in half of the decision criteria being associated to the taxation system in the potential investee country (Otto, 2005). It is clear from this survey that, internationally, investors seek mining sector investments by intensely considering the taxation in the targeted investee country (Otto, 2005). This confirms that taxation is a significant factor in decision making for investors and potential investors in the mineral sector.

To preserve investor confidence in South Africa and to ensure that the people of South Africa obtain the benefits envisioned for them, it is imperative that the State maintain transparency, consider the experiences and knowledge that can be obtained from looking abroad, and that it firmly uphold the principles of the Freedom Charter. This report has provided the basis for further research in this regard. While the report made no attempt to investigate the socio-economic impact of the proposed taxation reforms in South Africa, such research would aid in improving the proposals for change to the South African mineral taxation regime.

In addition, no attempt has been made to conclude on an optimal mining taxation policy for South Africa. By highlighting the pros and cons of the proposed taxation reforms, this report has provided the foundation for further research into what the optimal policy would be for the South African economy, and may be expanded into determining the optimal taxation policy on a jurisdiction by jurisdiction basis.

Based on this report, comprehensive studies into the fiscal, socio-economic and political effects of introducing the RRT into the mineral industry in South Africa should be performed. This will provide a researched basis displaying the possible consequences of the introduction of such a tax into South Africa's developing economy. A quantitative analysis should be performed in relation to the impact on the return to be earned by investors after the introduction of the RRT. This will provide current and future investors with the knowledge to make informed decisions with regards to mineral operations in South Africa.

Appendix 1

This appendix provides an explanation of the phases of the life-cycle of a mine. The manner of taxation of a mineral company is based on this life-cycle, because the life cycle materially affects the generation of profits from mining operations.

1 A mine's life-cycle

Below, the four stages of a mine's lifecycle have been provided, together with the taxation risk and governmental response:

1.1 Exploration phase

This phase is characterised by substantial costs without any income being earned in return. Due to the high-cost/no-return phenomenon, this stage is considered to have great risk for the investor involved (Mitchell, 2010). Investors will be attracted to fiscal regimes that provide for early pay back of these large upfront costs in order to meet their desired targeted return on investment (McPherson, 2010). In order to mitigate the high-cost/no-return risk, and to encourage mining companies to continue beyond the exploration phase into the development phase, governments respond by permitting the carry forward of losses to be offset against profits earned in the production phase (Mitchell, 2010).

1.2 Mine Development phase

This phase is characterised by the incurral of significant costs for the purposes of purchasing substantial capital inputs that are to be utilised throughout the life of the mine (ICMM, World Bank and UNCTAD, 2008). Many of these capital inputs require importation into the investee country (ICMM, World Bank and UNCTAD, 2008). Governments have typically responded to these high capital expenditures by enabling the accelerated recovery of these costs once production is initiated through increased tax allowances (ICMM, World Bank and UNCTAD, 2008). The lowering of importation duties, as well as relief from VAT has also been noted (Mitchell, 2010).

1.3 Production phase

Minerals production is the lengthiest and most lucrative phase in the life-cycle of a mine. It is during this phase that payments to the government, in the form of taxes, begin to be

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generated (Mitchell, 2010). The risk associated with the volatility and uncertainty of resource prices is systematic and not easily diversifiable within a resource project portfolio (ICMM, World Bank and UNCTAD, 2008). Due to the erratic nature of commodity prices and considering that minerals are sold in competitive markets in which commodity prices fluctuate, it has been found that governments typically respond by providing flexibility in the taxation of profits generated. This flexibility is often provided in the form of relief from export duties and VAT, or in other cases, relief is provided from additional substantive taxes (Mitchell, 2010).

1.4 Post-mining phase

This is the last stage in a mine's life-cycle where production ceases and the mine is decommissioned. Significant rehabilitation costs and extended liabilities for site management are often incurred at this stage, at which both mining operations and the inflow of income has ceased. The typical response noted by a number of governments has been to provide tax deductibility for these costs during the production phase in order to encourage companies to progressively set aside funds for this purpose during this stage, while cashflow is rife and income is flowing (Mitchell, 2010).

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