Fiscal stability agreements offer protection against increases in mining royalties

By Betsie Strydom

There is no guarantee that in South Africa, mining royalties will remain capped at 5% for refined mineral resources and 7% for unrefined mineral resources.

Internationally, several countries have recently increased mining royalties. For example, Chile's mining royalties, which are payable on the extraction of non-renewable resources, was 5% until 31 December 2010. An amendment published in Chile in October 2010 proposed an increased effective tax rate of between 5% and 14% - however, if mining companies conclude Foreign Investment Contracts with the Chilean government, they can agree a fixed royalty rate. Australia recently raised mining royalties and announced new resource rent tax arrangements, which are applicable from 1 July 2012 to Australia's most highly profitable non-renewable resources; namely oil, gas, iron ore and coal. Brazil is contemplating increases in mining royalties, Russia has introduced a tariff on nickel exports and Ghana has raised mining royalties from 3% to 5%.

The Mineral and Petroleum Resources Development (MPRD) Act 28 of 2002 allows the State, as custodian of South Africa's mineral and petroleum resources, to impose royalties on the transfer of mineral resources and the Mineral and Petroleum Resources Royalty Act 28 of 2008, ("the Royalty Act") which came into effect on 1 March 2010, prescribes how the royalty rate should be calculated. The royalty rate is calculated by applying complex formulae, which take into account the profitability of a mine. Royalties are currently capped at 5% for refined mineral resources and 7% for unrefined mineral resources. Will these caps remain in place for a significant period, particularly in an environment where the State's stake in the exploitation of mineral resources is the subject of vigorous debate?

Mining companies can "peg" the maximum royalty rate payable of on the extraction on mineral resources by concluding "fiscal stability agreements" with the State.

Fiscal stability agreements can apply to extractors' existing mineral resource rights or to mineral resource rights which the extractors anticipate acquiring.

What do fiscal stability agreements do, exactly? They protect the extractor from increases in the mining royalty rates, by guaranteeing the terms and conditions that will apply to the mineral resource rights (for as long as the extractor holds the rights) and to all participating interests subsequently held by the extractor in respect of the rights. Changes to the mining royalties legislation will have no force and effect if the changes result in an increase of the agreed royalty rate. Where mining royalties are reduced, the extractor is still able to benefit from the reduction in the royalty rate.

Fiscal stability agreements do not apply to mining or reconnaissance permits, but fiscal stability agreements can be concluded in respect of prospecting rights, exploration rights, mining rights and production rights granted in terms of the MPRD Act, including leases or subleases mentioned by the Act's section 11.

Bear in mind that a binding fiscal stability agreement relating to the anticipated acquisition of a mineral resource right is only valid if that mineral resource right is granted *within one year* after date of conclusion of the fiscal stability agreement.

The stability that fiscal stability agreements offer, is reinforced by the fact that binding fiscal stability agreements may be freely assigned by the extractor to another person who is acquiring *prospecting rights* or *exploration rights* from the extractor. However, an extractor may only assign the rights arising from fiscal stability agreements in respect of *mining rights* or *production rights* to another person if both the extractor and the other person form part of the same group of companies, as defined in section 1 of the Income Tax Act, on the date of disposal. This allows for intra group reorganisation.

An extractor can unilaterally terminate a fiscal stability agreement at any time. The termination will become effective in the next year of assessment .

If the State breaches a fiscal stability agreement, and the failure has an adverse economic effect on the royalty payable by the extractor who signed the fiscal stability agreement, the extractor is entitled to compensation (which includes interest) in respect of the increase in the royalty or to an alternative remedy that eliminates the impact of the State's failure.

Betsie Strydom is a director in the tax practice at corporate law firm Bowman