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Comments/suggestions on the Consultation on amendment of the Minerals (Other than Atomic and Hydro-Carbons Energy Minerals) Concession Rules, 2016 (MCR, 2016) on the issue of double incidence of royalty due to inclusion of royalty in the calculation of ASP.

We are writing with reference to your Consultation on amendment of the Minerals (Other than Atomic and Hydro Carbons Energy Minerals) Concession Rules, 2016 (MCR, 2016) on the issue of double incidence of royalty due to inclusion of royalty in the calculation of ASP dated 2 June 2023.

Background

The National Mineral Policy (NMP) which was notified in 2019 declares: "*Natural resources, including minerals, are a shared inheritance where the state is the trustee on behalf of the people to ensure that future generations receive the benefit of inheritance.*" It goes on to say that *"State Governments will endeavour to ensure that the full value of the extracted minerals is received by the State."* In other words, since Royalty and Auction Premia constitute the sale proceeds, the goal is to ensure that these are set so that there is zero loss to the State, or grant of largesse to miners.

In 2021, the Ministry appointed a committee under Shri Praveen Singh, IAS (retd.) to examine the incidence of double calculation of royalty due to inclusion of royalty in calculation of the average sale price (ASP) of minerals and developing a National Mineral Index for valuation of mineral resources, determination of value for auction of mineral concessions and statutory payments for future auctions. The Terms of Reference (ToR) of the committee for examining the issue of double taxation and developing NMI are as under:

i. *To examine incidence of double calculation of royalty, if any, due to inclusion of royalty in calculating of ASP and suggest measures to address the same.*
ii. *To examine issues and shortcomings in fixation of ASP currently being done and suggest measures to overcome these till NMI is formulated for individual minerals.*
iii. *To suggest formulation of NMI for various minerals in a phased manner.*

iv. To consult States, stakeholder Ministries, industry associations, experts etc. for preparing its recommendations.

The Committee shall submit its report within six months of its formation in a phased manner. Firstly, it shall submit its report on Sl. No. (i) and (ii) of Terms of Reference, thereafter on NMI for individual minerals like iron ore, limestone, bauxite, manganese, chromite, etc.

As per the ToR, the Committee is required to first submit its report on Sl. No. (i) and (ii) of the ToR, and thereafter on NMI for individual minerals. However, we are unable to find any report on the first two aspects of the ToR, viz, the incidence of double taxation; and issues and shortcomings in fixation of ASP currently being done.

On 24 November 2021, the Ministry of Mines initiated a consultation on the National Mineral Index (NMI, Sl. No. (iii) of the ToR). As part of this consultation, an Approach Paper by the Committee on the NMI was attached. We responded to this consultation vide our letter dated 2 December 2021. The Ministry has not published any results from this consultation.

Subsequently on 25 May 2022, the Ministry of Mines initiated a consultation on proposals to make further amendments to the Mines and Minerals (Development and Regulation) Act, 1957 for bringing reforms in mineral sector. There were six proposals for reform, the very first item being "*Calculation of ASP: Removing cascading impact of royalty on royalty*". However, the Committee reports or papers on this issue were not provided. The Ministry has not published any results from this consultation either.

We note that in the current consultation, the Ministry has yet again not provided the report of the Committee dealing with Sl. No. (i) and (ii) of the ToR, which pertain to this issue. As this is the third consultation based on the reports of the Committee, and the Approach paper on NMI was provided, we can only assume that the report of the Committee on the royalty on royalty and ASP issue is not convenient to make public. <u>In the absence of the report(s) of the Committee – and adequate time to analyze them – our comments can only be preliminary in nature, but we make them nonetheless. This is apart from any legal relief we may wish to pursue in the matter.</u>

Justification for the current proposal

In the current consultation, there is very little justification provided for the proposed change. The Ministry states (our bold highlights)

> "*there is an additional charge on the miners under the current methodology. … The charging of royalty, DMF, NMET and auction premium on the sale value*

which already includes royalty, DMF and NMET is ***not appropriate way to collect revenue*** *and leads to* ***cascading effect on both royalty and auction premium****.*"

The previous May 2022 consultation states as justification (our bold highlights)

"*As ASP has become an important factor in auction regime, it was recommended to include it in the Act for* ***future certainty and stability in the fiscal regime*** *in the mineral sector. … ASP is not defined in the law. It is defined in Rules which mandates non exclusion of royalty, DMF and NMET from the calculation. However, the same Rules mandate exclusion of taxes like GST. Thus, recent changes in GST on ores has not affected ASP and as a result royalty and premium were also not affected. Charging royalty and premium on the sale value which includes royalty is* ***not appropriate way to collect revenue*** *and leads to* ***cascading effect on both royalty and premium****. It also creates* ***complications in changing royalty rates****. … Removing the cascading impact of royalty on royalty is expected to* ***increase participation in future auctions,*** *thereby making* ***additional revenue available to the State Governments****. This is expected to* ***give fillip to the sector****.*"

The stated core rationale is to increase auction participation leading to additional revenue to states and a fillip to the mining sector. Auction participation presumably is reduced due to the ASP being defined by the Central Government, not Parliament, which leadings to uncertainty and instability in the fiscal regime; and the cascading effect on both royalty and auction premium, which seems to be a problem.

Summary of the current proposal

In short, the proposal is to define a second Average Sale Price (2^{nd} ASP) that will apply only to leases granted after the proposed rules are in force. The present average sale price published by the Indian Bureau of Mines (IBM ASP) would continue to apply to leases granted before these proposed rules are in force.

Further, the 2^{nd} ASP would not apply for those minerals where the rate of royalty is specified with reference to a "*price published by the London Metal Exchange, London Bullion Market Association or any other exchange or agency.*"

As per the existing MCR 2016, the IBM ASP is computed as below:

38. Sale Value.- *Sale value is the gross amount payable by the purchaser as indicated in the sale invoice where the sale transaction is on an arms' length basis and the price is the sole consideration for the sale, excluding taxes, if any.*

Explanation – For the purpose of computing sale value no deduction from the gross amount will be made in respect of royalty, payments to the District Mineral Foundation and payments to the National Mineral Exploration Trust.

***42. Computation of average sale price**.- (1) The ex-mine price shall be used to compute average sale price of mineral grade/ concentrate.*

(2) The ex-mine price of mineral grade or concentrate shall be:

(a) where export has occurred, the free-on-board (F.O.B) price of the mineral less the actual expenditure incurred beyond the mining lease area towards transportation charges by road, loading and unloading charges, railway freight (if applicable), port handling charges/export duty, charges for sampling and analysis, rent for the plot at the stocking yard, handling charges in port, charges for stevedoring and trimming, any other incidental charges incurred outside the mining lease area as notified by the Indian Bureau of Mines from time-to-time, divided by the total quantity exported.

(b) where domestic sale has occurred, sale value of the mineral less the actual expenditure incurred towards transportation, loading, unloading, rent for the plot at the stocking yard, charges for sampling and analysis and any other charges beyond mining lease area as notified by the Indian Bureau of Mines from time-to-time, divided by the total quantity sold.

(c) where sale has occurred, between related parties and/or where the sale is not on arms' length basis, then such sale shall not be recognized as a sale for the purpose of this rule and in such case, sub-clause (d) shall be applicable.

(d) where sale has not occurred, the average sale price published monthly by the Indian Bureau of Mines for that mineral grade / concentrate for a particular State:

Provided that if for a particular mineral grade / concentrate, the information for a State for a particular month is not published by the Indian Bureau of Mines, the last available information published for that mineral grade / concentrate for that particular State by the Indian Bureau of Mines in the last six months previous to the reporting month shall be used, failing which the latest information for All India for the mineral grade / concentrate, shall be used.

(3) The average sale price of any mineral grade/concentrate in respect of a month shall be the weighted average of the ex-mine prices of the non-captive

mines, computed in accordance with the above provisions, the weight being the quantity dispatched from the mining lease area of mineral grade / concentrate relevant to each ex-mine price.

The 2nd ASP is defined with reference to the IBM ASP. The 2nd ASP is defined as the

(i) the average sale price to be used for calculation of the payment of the royalty, payment towards District Mineral Foundation and National Mineral Exploration Trust and payment under rule 13 of the Mineral (Auction) Rules, 2015 shall be the average sale price of the mineral grade or concentrate published by the Indian Bureau of Mines for the relevant month minus the royalty and payment towards District Mineral Foundation and National Mineral Exploration Trust calculated on the average sale price published by the Indian Bureau of Mines;

Numerical example

At present, royalty on iron ore is 15% of IBM ASP, DMF is 10% of royalty and NMET is 2% of royalty. Let us assume that the IBM ASP for iron ore is Rs. 1,000. If we follow the proposed notification, the 2nd ASP will be Rs. 832 (IBM ASP minus royalty, DMF & NMET calculated on the IBM ASP). If we then use the 2nd ASP to calculate the actual payables, we find that the total amount payable is Rs. 140 instead of Rs. 168.

IBM ASP		**1000.00**
Notional Royalty	15.00%	150.00
Notional DMF	1.50%	15.00
Notional NMET	0.30%	3.00
Notional R+DMF+NMET	**16.80%**	**168.00**
2nd ASP		**832.00**

2nd ASP	**832.00**
Royalty	124.80
DMF	12.48
NMET	2.50
Proposed R+DMF+NMET	**139.78**
Total	**971.78**

However, if we add the actual amounts payable to the 2nd ASP, we get Rs. 972, lower than the IBM ASP. This is an outcome of the poor manner in which the 2nd ASP is defined, and indicates that this proposal could result in grant of largesse to miners.

Substantive comments

Don't fix what isn't broken: Ad valorem royalty on the existing basis has been continuing for decades in India and for centuries globally. It is not clear why this is not an *appropriate way to collect revenue*. Even GST is calculated on the market sale price, which is the basis of the IBM ASP. The *cascading effect* is neither defined, nor is it explained why it is a problem. In other areas where revenue sharing is common, such as telecom or airports, this inappropriate way to collect revenue or the *cascading effect* isn't an issue. Why now, why only with minerals, why only prospectively? Are there any instances globally where this approach has been taken with ad valorem royalty? We doubt there would be a single instance. We strongly oppose the proposed change as it has no economic rationale, while it will make management and governance more complex.

Economic effects: As discussed earlier, this proposed change would lead to granting of largesse if applied to existing leases. The prior consultation stated "*The committee recommended to apply new method of calculating ASP on the both cases, i.e., (i) mining leases (MLs) to be auctioned/ granted after the amendment to the ASP formula and (ii) the existing MLs including the MLs auctioned till the date of amendment to the ASP formula.*" Thankfully, the Ministry has come to its senses and ignored the recommendation of the Committee to extend this to existing mining leases in the current proposal.

The Revenue Equivalence Theorem in auction theory suggests that whether we use the IBM ASP or the proposed 2nd ASP, the end result in money terms would be the same. In practical terms, bidders have spreadsheets for their bid calculations, and there is a total amount they are willing to pay. If the proposed 2nd ASP is utilized, then the bids would simply increase in order to adjust. We use the first mineral block auction in Goa, the Bicholim block won by Vedanta to illustrate this point.

IBM ASP		**1000.00**
Royalty	15.00%	150.00
DMF	1.50%	15.00
NMET	0.30%	3.00
Auction Premia	63.55%	635.50
Total Payments	**80.35%**	**803.50**

2nd ASP		**832.00**
Royalty	15.00%	124.80
DMF	1.50%	12.48
NMET	0.30%	2.50
Auction Premia	79.77%	663.72
Total Payments	**96.57%**	**803.50**

Reduction
25.20
2.52
0.50
-28.22
0.00

The winning bid was 63.55%, leading to total payments of Rs. 803.50 (assuming IBM ASP of Rs. 1,000). If the 2nd ASP were the basis for calculation, then a bid of 79.77% would result in the same total payments. The only reason that this change would increase participation in future auctions is if miners were not rational actors.

DMF, NMET losers: It is worth noting that under the proposed 2nd ASP, the sums towards DMF and NMET would decline while the mineral sale proceeds - royalty and auction premia - received by the State in exchange for the minerals would increase. Put simply, the economic impact is to reduce the amount towards the mining affected areas and people, as well as towards national mineral exploration, and this reduction is captured by the states in form of higher auction premia. <u>This impact is hidden, and should have been disclosed.</u>

Royalty changes complicated: In many cases, reducing royalty rates increases the payments required under the lease. If we continue with the Goa example, and assume royalty rates are reduced to 10%, we find that the total amount payable **increases** from Rs. 803.50 to Rs. 807.85.

2nd ASP		**832.00**
Royalty	15.00%	124.80
DMF	1.50%	12.48
NMET	0.30%	2.50
Auction Premia	79.77%	663.72
Total Payments	**96.57%**	**803.50**

2nd ASP		**888.00**
Royalty	10.00%	88.80
DMF	1.00%	8.88
NMET	0.20%	1.78
Auction Premia	79.77%	708.40
Total Payments	**90.97%**	**807.85**

Reduction
36.00
3.60
0.72
-44.67
-4.35

And if we assume royalty rates are increased to 20%, we find the total amount payable **decreases** from Rs. 803.50 to Rs. 792.87.

2nd ASP		**832.00**
Royalty	15.00%	124.80
DMF	1.50%	12.48
NMET	0.30%	2.50
Auction Premia	79.77%	663.72
Total Payments	**96.57%**	**803.50**

2nd ASP		**776.00**
Royalty	20.00%	155.20
DMF	2.00%	15.52
NMET	0.40%	3.10
Auction Premia	79.77%	619.05
Total Payments	**102.17%**	**792.87**

Reduction
-30.40
-3.04
-0.61
44.67
10.63

Both results are counter-intuitive. Changing royalty rates under the proposal would make mineral management even more complex than earlier. <u>Given the additional complexity in changing royalty rates, we believe the proposed change is more likely to dissuade bidders in future auctions, not encourage them</u>.

Other issues

The proposal would also apply on auctions of minerals where royalty is on a tonnage basis. It is not clear how the IBM ASP or 2nd ASP would be calculated. <u>Such minerals must also be excluded from this change</u>.

We note that the proposal contemplates excluding those minerals where the rate of royalty is specified with reference to a "*price published by the London Metal Exchange, London Bullion Market Association or any other exchange or agency.*" Surely the IBM ASP is a *price* published by an *agency*? Why then is the wheel being reinvented?

Finally, an unnecessary additional layer of complexity will be created as now there will be both an IBM ASP as well as the 2nd ASP.

Procedural comments

Why not MMDR Amendment? The average sale price is only mentioned in the Second Schedule of the MMDR Act. Section 9(3) of the Act provides that the Second Schedule can be amended by the Central Government by notification in the Official Gazette.

In its May 2022 consultation, the Ministry states "*The issue needs to be addressed through amendment in the MMDR Act by defining ASP excluding royalty.*" It goes on to propose the introduction of a new section in the MMDR Act regarding ASP instead of simply changing the Second Schedule.

It was the Ministry's position that this issue on hand needs to be addressed through amendment in the MMDR Act, and not by redefining ASP in the Second Schedule through a notification. There is no explanation for why this change is being proposed as an obscure amendment to the MCR 2016, instead of amending the MMDR Act or its Second Schedule.

This proposal changes the royalty that would be received by the States as mineral owners. We note that the National Mineral Policy proposes constituting an inter-ministerial body with representation from various ministries as well as state governments, to advise the Government on rates of royalties, dead rent, etc.

> *"**A unified authority in the form of an inter-ministerial body** under Ministry of Mines, with members like Ministry of Coal, MoEarth Sciences, MoEFCC, Ministry of Tribal Affairs, Ministry of Rural Development, Ministry of Panchayati Raj, Ministry of Steel, **including state governments**, shall be constituted to **institutionalise a mechanism** for ensuring sustainable mining with adequate concerns for environment and socio-economic issues in the mining areas, and **to advise the Government on rates of royalty, dead rent etc.***

It would seem that the present exercise deliberately violates the National Mineral Policy and bypasses the rights of States to be part of the mechanism that decides rates of royalty, which obviously includes the basis of its calculation. We note that the National Mineral Policy was revised pursuant to the 2017 judgment of the Supreme Court in the Odisha illegal mining case, where the SC had said *"it is high time that the Union of India revisits the National Mineral Policy, 2008 and announces a fresh and more effective, meaningful and implementable policy."* Clearly, the NMP is implementable but will not be implemented! <u>Institutional mechanisms should not be bypassed</u>.

<u>Disclosure requirements not met</u>

We note that this consultation is pursuant to the Pre-Legislative Consultation Policy PLCP). The PLCP requires (our bold highlights)

> "2. *The Department/Ministry concerned should publish/place in public domain the draft legislation or at least the information that may inter alia include brief justification for such legislation, essential elements of the proposed legislation,* ***its broad financial implications****, and an estimated assessment of the impact of such legislation on environment, fundamental rights, lives and livelihoods of the concerned/affected people, etc.*"

Further, Section 4(1)(c) of the Right to Information Act, 2005 provides that:

> "***Every Public Authority shall publish all relevant facts while formulating policies or announcing decisions which affect public***."

<u>Relevant facts like the Committee reports, number of requests for this change, instances where such systems of calculating base price for royalty have been implemented, why the earlier amendment proposal was dropped and what responses were received, and much else, have not been published or placed in the public domain</u>.

It should be clear from the calculations above that the broad financial implications have not been considered, let alone disclosed. Had they been considered carefully, this proposal would not have wasted so much national time.

<u>Agreement with FIMI</u>

In our response to the Ministry's consultation on the National Mineral Index, we were in agreement with the position of the Federation of Indian Mineral Industries (FIMI). In that instance, we quoted FIMI from newspaper reports as saying:

> “*We request you to continue with the system of Average Sale Price published by IBM, which we feel is the most transparent and effective price discovery mechanism.*”

We continue to agree with FIMI. We do have strong reservations on the existing ASP system managed by IBM, set out in our response on the National Mineral Index.

<u>Conclusion</u>

It is difficult to make recommendations in the light of the lack of any proper examination of the current ASP system of price discovery, any proper rationale for the proposed change, and its impacts in confusing the overall situation with mining even further. Why the present IBM ASP is ***not appropriate way to collect revenue*** and how it *leads to* ***cascading effect on both royalty and auction premium*** has not been explained. If we look at the rationale provided in the previous consultation, it seems more likely that that certainty of the fiscal regime would drop; participation in future auctions reduce, leading to lower payments to States as mineral owners and further set back the sector. And changing royalty rates in future would become even more difficult. <u>All in all, the proposal does not meet its own justification.</u>

In summary, this proposal would create unnecessary complexity without any commensurate improvement. In fact, this would arguably worsen matters. It is economically illiterate. It bypasses the National Mineral Policy and the rights of states. It is done in a particularly opaque manner. The simple option to redefine average sale price in the Second Schedule isn’t availed of, and the earlier proposal to enshrine matters through an amendment has been dropped without a word. We would request the Ministry to meet the various procedural requirements

We would strongly recommend that (a) the inter-ministerial mechanism as stated in the National Mineral Policy be institutionalized as soon as possible, and (b) a joint team of the Comptroller & Auditor General (CAG) and the Commodity Derivatives Market Regulation Department (CDMRD) of SEBI be tasked with examining the basis of the ASP calculated by IBM, with their report to be considered by the inter-ministerial body.

And finally, while IBM may be tasked with gathering the information and calculating the IBM ASP, SEBI may be tasked with regulating the IBM ASP so produced in order to ensure separation of powers and adequate checks and balances.

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Director
28.06.2023