

Mineral Royalty Act: Royalty Guideline

- RG-MRA-005: Operating costs

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Acronyms	Full form
AD	Additional deduction
CRD	Capital recognition deduction
EEE	Eligible exploration expenditure
GR	Gross realisation
GST	Goods and services tax
MRA	<i>Mineral Royalty Act 1982</i>
NV	Net value
OC	Operating cost

Contents

Purpose	4
Introduction	4
What are operating costs?	5
Meaning of 'in relation to' the production unit.....	5
Meaning of 'reasonable in amount'	5
Meaning of 'directly attributable'	5
Meaning of 'production, maintenance for the purposes of production, sales and marketing'	6
Allowable operating costs – specific items.....	7
Allowable operating costs - rehabilitation	12
Allowable operating costs - pre-production.....	13
Excluded operating costs - specific items	13
Excluded operating costs - foreign exchange losses	16
Excluded operating costs - revaluation	16
Methods of costs allocation - office expenses or management fees.....	16
Adjustment to amount of operating costs - recoverable costs	17
Rule against double deductions.....	17
Conversion of foreign currency to Australian currency	18
GST	18
Record keeping requirements.....	18
MRA publications	18

Purpose

1. This Guideline outlines allowable and excluded operating costs (OCs) for the purpose of calculating net value (NV) under the *Mineral Royalty Act 1982* (MRA).
2. This Guideline is issued by the Secretary under section 4E of the MRA.

Introduction

3. Section 10 of the MRA sets out the formula for calculating the NV of a saleable mineral commodity sold or removed without sale from a production unit.
4. Under section 10(2), net value is calculated in accordance with the formula:

$$\text{NV} = \text{GR} - (\text{OC} + \text{CRD} + \text{EEE} + \text{AD})$$

where:

- **NV** is the net value from a production unit in a royalty year
 - **GR** is the gross realisation from the production unit in the royalty year
 - **OC** is the operating costs of the production unit for the royalty year
 - **CRD** is the capital recognition deduction
 - **EEE** is any eligible exploration expenditure
 - **AD** is any additional deduction under section 4CA.
5. Based on this formula, the NV of production in a royalty year is established by deducting all allowable deductions (including OCs) from a production unit's GR in that royalty year.
 6. The Northern Territory's mineral royalty regime applies on an individual mine or project basis. The regime does not apply on a company, business or enterprise basis. Accordingly, expenditure of a particular production unit is only to be taken into account for the purposes of calculating OCs and expenditures relating to the business or enterprise of which the production unit forms part.
 7. Ring-fencing principles apply where each of the royalty payer's operations are treated independently, for royalty purposes, from all the royalty payer's other operations and the accounts from the individual production unit may not be mixed with the accounts for activities outside the production unit. There is no ability to aggregate income or revenue and expenses from all operations carried on by the royalty payer within the Territory.
 8. For the purposes of calculating the NV, OCs are items of expenditure - reasonable in amount - in relation to a production unit. These items of expenditure must also be directly attributable to:
 - (1) the production of the saleable mineral commodity
 - (2) maintenance for the purposes of production
 - (3) the sale or marketing of the saleable mineral commodity.
 9. OCs do not cover exploration activity, tenement acquisition costs, capital improvements to the production unit, deferred rehabilitation and various specified items (refer to paragraphs 53 to 74). Further information on exploration expenditure and capital expenditure can be found in Guidelines RG-MRA-008: Eligible Exploration Expenditure and RG-MRA-006: Capital Recognition Deduction, respectively.

What are operating costs?

10. Operating costs are defined in the MRA. To be eligible as an OC, the expenditure must meet these criteria:
- (1) the cost must be incurred in relation to the production unit
 - (2) the cost must be reasonable in amount
 - (3) the cost must be directly attributable to the production, maintenance for the purposes of production, or the sale or marketing of the saleable mineral commodity of a production unit.

Meaning of 'in relation to' the production unit

11. The expression 'in relation to' requires that there is a sufficient nexus between the expenditure and the production unit from which the saleable mineral commodity is produced. Expenditure arising from a connection which is insubstantial, tenuous or distant is not an allowable OC in relation to the production unit.
12. This means that the expenditure must result from the carrying on of mining activities on the specific production unit. Guideline RG-MRA-002: Production Unit provides further information on the definition and scope of a production unit.

Meaning of 'reasonable in amount'

13. To be 'reasonable in amount', an amount expended must represent the fair and realistic value of the activities carried out. Expenditure resulting from an arm's-length commercial transaction or arrangement will generally be accepted as reasonable in amount. A royalty payer is not entitled to recover any cost to the extent that it is extravagant or artificially inflated.
14. For related party transactions, the royalty payer must substantiate the amount expended for each claim and establish the reasonableness of the amount expended.
15. A royalty payer may be requested to provide a written explanation and supporting documentary evidence of:
- (1) the nature and extent of the expenditure, including the link between the expenditure and production, maintenance for the purposes of production, or sale and marketing of the saleable mineral commodity
 - (2) the character of the expenditure in the context of the arm's-length principle
 - (3) why the expenditure is an acceptable approximation of an arm's-length price.

Meaning of 'directly attributable'

16. To be an allowable OC, the expenditure must be 'directly attributable' to the production, maintenance for the purposes of production, or sale and marketing of the saleable mineral commodity of the production unit.
17. The connection between the expenditure and production, maintenance for the purposes of production, or sale and marketing must be material and close. This degree of necessary connection is determined using a common sense approach, where a reasonable person would conclude that the expenditure was necessarily incurred in the production, maintenance for the purposes of production, or sale and marketing of a saleable mineral commodity of the specific production unit.

18. An expenditure that is only remotely, tenuously or insubstantially connected with the requisite activity is not an allowable OC of the production unit.

Meaning of 'production, maintenance for the purposes of production, sales and marketing'

19. The expression 'production, maintenance for the purposes of production, or sale and marketing of a saleable mineral commodity' generally covers:
- (1) production of a saleable mineral commodity, such as:
 - (a) work done on a production unit in preparation for, or ancillary to, the extraction of the mineral commodity or saleable mineral commodity
 - (b) extraction of the mineral from the soil
 - (c) work done on the production unit subsequent to the extraction for the purpose of production of the end product (that is, the mineral in a state suitable for sale into any market).
 - (2) maintenance for the purposes of production of a saleable mineral commodity, such as:
 - (a) repairs and maintenance (including preventative repairs and maintenance) and work undertaken to keep the production unit in good working order
 - (b) periods of temporary closedown for such purposes.
 - (3) sales and marketing of a saleable mineral commodity, such as:
 - (a) expenditure incurred under any agreement with a third party to arrange or effect the sale or undertake the marketing of the saleable mineral commodity
 - (b) expenditure incurred in respect of transportation of the saleable mineral commodity from the production unit to the first point of sale, port or storage facility in the Territory (whichever is the earlier).
20. The expression 'production, maintenance for the purposes of production, or sale and marketing of a saleable mineral commodity' does not cover:
- (1) exploration activity - Guideline RG-MRA-008: Eligible Exploration Expenditure provides further information on deductions for exploration activity under the MRA
 - (2) tenement acquisition costs which can include exploration expenditure, capital assets (which may qualify for a CRD) and assets purchased as part of a sale which do not have a direct relationship to the production unit
 - (3) ongoing maintenance costs of eligible social infrastructure expenditure Guideline RG-MRA-006: Capital Recognition Deduction provides further information on deductions for eligible social infrastructure expenditure under the MRA
 - (4) improvements - something that substantially enhances the value of a facility or the production unit (which may qualify for a CRD)
 - (5) deferred rehabilitation - MRA Overview provides further information on deductions for deferred rehabilitation under the MRA.

21. Expenditure that is not considered to be materially or closely connected to the production, maintenance for the purposes of production, or sale and marketing of the saleable mineral commodity of a production unit includes, but is not limited to:

- (1) bad debt
- (2) entertainment
- (3) exploration expenditure
- (4) fines and penalties
- (5) foreign exchange (gain)/loss
- (6) gifts/donations
- (7) hedging costs
- (8) maintenance of share registers
- (9) provision for mine rehabilitation (deferred rehabilitation)
- (10) local community or school support and activities.

Example 1

Production Unit A is situated in a remote part of the Territory. In order to maintain its workforce the mine provides mine site entertainment such as concerts, cinema and recreational magazines to its employees. While this expenditure supports onsite employees' morale, health, and wellbeing, these costs do not have a materially close connection with the production, maintenance for the purposes of production, or sale and marketing of the saleable mineral commodity of the production unit. Therefore, they are not allowable as OCs (unless the cost represents a benefit described in paragraph 31).

Example 2

Under normal circumstances, gold or silver is removed from a production unit in a concentrated state known as doré (being an alloy, amalgam or mixture of gold and silver as well as other impurities) for treatment and processing in a refinery that may be outside the Territory.

When doré is transported from the production unit for further refining, the gold and silver are considered to have been removed from the production unit without sale. Therefore, they are to be valued at the precise time of removal from the production unit.

All costs incurred after the saleable mineral commodity is removed without sale from a production unit - for example, the cost of refining or transporting - cannot be claimed as OCs for the purposes of calculating the NV. This is because the connection between the item of expenditure and the production unit is not sufficient. However, the costs may be relevant in determining the gross value of the saleable mineral commodity.

Guideline RG-MRA-004: *Gross Realisation and Gross Production Revenue* provides further information on determining the gross value of gold and silver. See the example after paragraph 43.

Allowable operating costs – specific items

22. The MRA sets out specific items that are allowable OCs provided they also satisfy all the eligibility criteria described in paragraphs 10 to 19 and are not specifically excluded in the MRA (see paragraphs 53 to 74). A discussion of each specific item is detailed in paragraphs 24 to 49.

23. For convenience, the expression 'operation of the production unit' is used in this guideline

to cover (unless a contrary intention appears):

- (1) production
- (2) maintenance for the purposes of production
- (3) sale or marketing

of the saleable mineral commodity of that production unit.

Eligible research and development expenditure

24. Eligible research and development expenditure is expenditure reasonably incurred by a royalty payer for research into and development of efficient methods of mineral extraction and processing designed to either minimise eligible capital assets expenditure and/or ongoing OCs, or improving the rate and amount of recovery of a saleable mineral commodity from the production unit. Such activities may include:

- (1) creating new or improved materials, products, devices or systems
- (2) or acquiring new knowledge which directly supports (1).

Example

ABC Mining Pty Ltd (ABC) undertakes research into a new mining technique as part of its optimisation and improvement initiatives. The mining technique is to be solely utilised for its Territory mining operation. If successful, the technique will increase production by 30% with no additional production cost. The expenditure incurred by ABC in relation to the new mining technique is eligible research and development expenditure. Given that the cost is incurred in relation to ABC's production unit in the Territory, the expenditure is allowable as an OC.

25. Expenditure incurred in research and development activities such as market research, market development, exploration or management studies is not deductible as an OC unless it meets the criteria set out in paragraph 24.

Accounting and auditing fees

26. Accounting and auditing costs that are required to meet the needs of the royalty payer to maintain the operation of the production unit are allowable OCs. Where accounting and auditing costs are incurred as part of a broader business structure of the royalty payer, these costs will need to be apportioned between the activities that relate to the operation of the production unit, and costs that are related to other activities.

Legal fees (other than those directly attributable to royalty matters)

27. Legal fees that may be claimed as OCs are professional legal fees that are necessary, appropriate, and have a sufficiently close connection to the operation of the production unit.

Example

The tenement holder of Production Unit A incurs legal fees as a consequence of commencing legal action against a supplier for breach of contract for failure to supply materials used by Production Unit A in the production of a saleable mineral commodity. The legal fees are allowable as OCs given there is a sufficiently close connection with the operation of the production unit.

28. Legal fees incurred on royalty related matters are not deductible as an OC. For example, any fees for legal work carried out on behalf of a royalty payer, which allows the royalty payer to comply with their obligations under the MRA, are not deductible as an OC.

Insurance premiums

29. Insurance premiums (including stamp duty) covering risks directly related to the operation of the production unit are allowable OCs. Where insurance costs cover a business or enterprise that includes a production unit, an apportionment of the costs will be required. Only the costs that are materially connected with the production unit are allowable OCs.

Example

The tenement holder of Production Unit A holds an insurance policy which covers all its physical assets, including its head office building located in Western Australia. The total amount of the insurance premium (including stamp duty) is not recognised as an OC. Only the proportion materially connected with risks directly related to the operation of the production unit can be claimed.

Employee remuneration

30. Remuneration is an allowable OC provided that throughout the pay period (as distinct from a royalty year) to which a payment relates, the employee:
- (1) worked solely in the Territory
 - (2) was engaged primarily in work directly attributable to the operation of the production unit.
31. Remuneration includes salaries, wages, allowances, termination or similar payments, director's fees, worker's compensation make-up payments and employer superannuation contributions. In addition, benefits identified in a written contract of employment (which attributes a specified or ascertainable value to the benefit(s)) will generally be accepted as an allowable OC.

Example

ABC Mining Pty Ltd (ABC) owns two mines in Australia: one in the Territory and one in South Australia. ABC's employees are paid on a monthly basis. Jane Smith is an engineer and worked for ABC throughout the 2018 calendar year. Jane worked at the South Australia mine from January to April and at the Territory mine from May to December. While working at the Territory production unit, the vast majority of Jane's work was directly attributable to the operation of the production unit. However, she occasionally undertook minor tasks in relation to exploration work being performed outside the production unit.

Jane's remuneration for each of the monthly pay periods from May to December in 2018 are allowable OCs for ABC. This is because she worked solely in the Territory and, although she occasionally undertook tasks in relation to exploration work during those pay periods, Jane was primarily engaged in work directly attributable to the operation of the production unit.

Jane's remuneration for each of the monthly pay periods from January to April in 2018 is not an allowable OC because she worked outside the Territory (even if some tasks she performed were directly attributable to the Territory production unit).

Office expenses

32. Office expenses relating to the general day-to-day running of an office are allowable OCs if they:
- (1) relate to an office of the royalty payer that is located within the Territory
 - (2) are directly attributable to the operation of the production unit
 - (3) in the case of work or services, the work or services are performed solely in the Territory.
33. Office expenses are administrative and corporate expenses relating to an office of a royalty payer within the Territory. This includes a wide variety of expenditure of which it is not possible to provide a comprehensive or exhaustive list. As a general guide, the expenses that would ordinarily fall within this category include:
- (1) running costs in respect of land and buildings where an office is located (subject to paragraph 68)
 - (2) utilities expenses
 - (3) telecommunications and internet expenses
 - (4) office equipment and stationery expenses
 - (5) administrative, human resources and information technology expenses
 - (6) expenses for the in-house provision of accounting and legal services.
- For any of the above expenses to be allowable OCs, they must satisfy the criteria in paragraph 32.
34. Office expenses often include costs that are not directly attributable to the operation of a production unit. For example, an office of a royalty payer can also incur costs in respect of another mine that does not form part of the production unit, or for other activities not directly attributable to the operation of the production unit (such as exploration). In such instances, an apportionment of the costs may be required. For further information on acceptable methods of costs allocation refer to paragraphs 75 to 82.

Example 1

ABC Mining Pty Ltd (ABC) owns two mines in Australia: one in the Territory and one in South Australia. The head office is located in the Territory and provides accounting, systems and administrative support to the Territory and South Australia mines. Approximately 50% of the head office employees' time is spent on activities that are directly attributable to the Territory mining operation.

Assuming ABC select the timesheet method of costs allocation outlined in paragraph 80(1), they may claim 50% of the head office costs as office expenses directly attributable to the operation of the Territory production unit. This is because the office is within the Territory and the work or services are performed solely within the Territory.

Example 2

ABC owns two mines in Australia: one in the Territory and one in South Australia. The head office is located in Western Australia and provides accounting, systems and administrative support to the Territory and South Australia mines. Approximately 30% of the head office employees' time is spent on activities that are directly attributable to the Territory mining operation.

None of these office expenses are allowable OCs. This is because these office expenses relate to an office that is located outside the Territory and the work or services provided by the head office are not performed solely within the Territory.

Fees for management services

35. Management connotes direction or control. For example, the control that is the responsibility of the 'operator' (as defined in sections 4 and 9 of the *Mining Management Act 2001*) for a mining site.
36. Fees for management services performed or incurred solely within the Territory and directly attributable to the operation of the production unit are allowable OCs. Fees for services performed or incurred by a person not physically present in the Territory during the entire time the service was performed are not allowable OCs.
37. Fees for management services directly attributable to the operation of a production unit may include, but are not limited to, fees for services in respect of the control, direction, influence or strategic management of a production unit.
38. Fees for management services often include costs that are not incurred solely in respect of one mining operation. Also, such fees can relate to activities of a royalty payer that are not directly attributable to the operation of a production unit (for example, exploration activities). In either case, an apportionment of the costs may be required. Refer to paragraphs 75 to 82 for further information on acceptable methods of costs allocation.
39. The requirement that the fees are directly attributable to the operation of the production unit means that fees relating to strategic or higher level policy management may not be allowable.

Example 1

ABC Mining Pty Ltd (ABC) provides management support to its subsidiary which operates a production unit in the Territory. All the management services provided by ABC are performed solely by a person physically present in the Territory. The costs incurred by ABC in providing those management services are on-charged to the subsidiary as management fees. If all the management services provided by ABC are performed solely in the Territory, and are directly attributable to the operation of the production unit, fees for those services are allowable OCs.

Example 2

ABC provides management support to its subsidiary which operates two mines: one in the Territory and one in South Australia. All the management services provided by ABC are performed solely by a person physically present in the Territory. The costs incurred by ABC in providing those management services are on-charged to the subsidiary as management fees. The royalty payer must apportion the costs and the method of allocation must be approved by the Secretary (refer to paragraphs 75 to 82) because the management fees on-charged relate to both the Territory and South Australia mines.

Costs relating to the maintenance of the share registry and expenditure incurred to defend a take-over bid are included in the management fees. These costs are not allowable OCs and must be excluded from the cost base prior to allocation. This is because these costs are not directly attributable to the operation of the production unit.

Fees for management services provided by ABC that are not performed solely in the Territory are not allowable OCs. They must be excluded from the cost base prior to allocation.

Tenement rentals

40. A mineral lease is granted subject to standard conditions, such as the grantee having to pay the prescribed rent for the use of the land comprised in the mining tenement and royalties. This statutory obligation to pay prescribed tenement rent is an allowable OC.

Accommodation costs for Territory workers

41. For accommodation located outside the production unit, a deduction is available if accommodation costs (including rent, cleaning, utilities, and repairs and maintenance) are expended for employees, contractors and other workers:

- (1) who work solely in the Territory
- (2) whose principal place of residence is in the Territory.

However, the costs of maintaining workers' accommodation situated on the production unit and used in the operation of the production unit are allowable OCs, irrespective of the residence of the employees using that accommodation.

42. The costs of purchasing or making improvements to workers' accommodation (including the costs of furniture and other capital items for the accommodation) cannot be claimed as OCs. However, these may be deductible as a CRD. Guideline RG-MRA-006: *Capital Recognition Deduction* provides further information on deductions for eligible capital assets expenditure under the MRA.

Fees and charges imposed under a law in force in the Territory

43. A fee or charge imposed under a law in force in the Territory, which is materially connected with the operation of the production unit, may be claimed as an OC.

44. Such a fee or charge does not include a tax, pecuniary penalty or fine.

Fees, charges or costs as may be prescribed

45. Fees, charges and costs - which are prescribed, from time to time, by a Commonwealth or Territory law - that are materially connected with the operation of the production unit may be allowable OCs.

Payroll tax

46. Payroll tax on wages (as defined in the Territory's *Payroll Tax Act 2009*) paid or payable to employees performing functions solely within the Territory that are directly attributable to the operation of the production unit are allowable as an OC.

Other matters as necessary for the proper administration of the production unit

47. This item requires a sufficiently material connection between the activity which is absolutely necessary for the operation of the production unit and the expenditure. For example:

- (1) expenditure incurred as a consequence of work carried out to protect and keep safe the mine and mining rights
- (2) expenditure incurred as a consequence of any work done in relation to current rehabilitation, which takes place during the production phase of the mine.

Allowable operating costs - rehabilitation

48. Whether rehabilitation costs are deductible as an OC will depend upon when the expenditure takes place in relation to the life cycle of the mine.

49. Rehabilitation costs actually incurred while a production unit is producing a saleable mineral commodity are deductible as an OC in the royalty year in which they were incurred. However, these amounts are not allowable deductions where the specified accounting basis of the production unit is an accrual basis and amounts are provided for rehabilitation in a royalty year.
50. Where the entire production unit is transferred or conveyed, and the new owner intends to operate the same production unit as a going concern, any existing rehabilitation obligations attached to the production unit may be claimed by the new owner as an OC in the year in which the rehabilitation costs are actually incurred for rehabilitation work undertaken, provided that:
- (1) the rehabilitation is directly attributable to the production or maintenance for the purpose of production of a saleable mineral commodity
 - (2) the previous owner of the production unit is not entitled to any royalty adjustment in respect of the actual rehabilitation costs claimed.
51. Paragraphs 27 to 32 of MRA Overview provide further information on deferred rehabilitation costs.

Allowable operating costs - pre-production

52. To recognise the significant pre-production costs (in the nature of OCs) that can be incurred in setting up a production unit, the MRA allows for expenditure (in the nature of OCs) up to four years prior to the commencement of production of a commercial quantity of a saleable mineral commodity as an allowable OC. The costs must relate to a mining tenement that is part of the production unit. In this regard, it is noted that the definition of mining tenement excludes exploration licences and exploration retention licences (or successor titles of same or similar nature). These costs need to be claimed in the first royalty year after the commencement of production of a commercial quantity of a saleable mineral commodity.

Excluded operating costs - specific items

53. Certain types of expenditure are not recognised as OCs. The MRA sets out specific items that are excluded as OCs. A discussion of each item is detailed in paragraphs 54 to 74.

Compensation payments

54. Section 107 of the *Mineral Titles Act 2010* requires holders of exploration licences and mining tenements to compensate pastoral lessees and owners or occupiers of private land for the use, disturbance and damage to private land which has been granted under the licences or tenements. Payments made in excess of what is reasonably required under section 107 cannot be claimed as an OC.
55. Any compensation payment for the use or disturbance of land or improvements in respect of Aboriginal land is not allowable as an OC.

Taxes on income or profits

56. Payments in the form of taxes on income earned or profits generated are not able to be claimed as OCs. This includes a tax on any income earned or profit generated from the receiving (or a right to receive), holding, disposal or otherwise trading of a 'registered emissions unit' (as defined in section 420-10 of the *Income Tax Assessment Act 1997*).

Minerals resource rent tax

57. Payments of Minerals resource rent tax as defined in section 300-1 of the *Minerals Resource Rent Tax Act 2012* cannot be claimed as OCs.

Carbon tax

58. Payments of a unit shortfall charge as defined in section 5 of the *Clean Energy Act 2011* cannot be claimed as OCs.

Mineral royalties

59. Payments made in the form of mineral royalties (that are levied by Government) cannot be claimed as OCs.

Cost of negotiating with land holders

60. Unless the expenditure is of an amount required to be expended by legislation (for example, the *Aboriginal Land Rights (Northern Territory) Act 1976* or *Native Title Act 1993*) in force in the Territory, any costs associated with negotiations with land holders are not able to be claimed as OCs.

Interest and depreciation

61. Interest payments, or payments in the nature of interest, are not able to be claimed as OCs. The MRA makes provision for interest payments arising from borrowings to acquire eligible capital assets, and depreciation relating to those assets, to be captured when establishing the amount of CRD which can be claimed. Guideline RG-MRA-006: *Capital Recognition Deduction* provides further information.

Payments in the nature of royalties

62. Payments in the nature of royalties cannot be claimed as OCs. Examples of such payments include:

- (1) payments made to an owner or occupier of private land or a lessee of Crown land (such as a pastoral lease) calculated on an ad valorem or profit basis
- (2) negotiated payments calculated on an ad valorem or profit basis made to traditional Aboriginal owners or representatives of such owners.

Costs associated with mining securities

63. Associated costs (for example, bank or legal fees) incurred by miners in providing a security required by section 43(1) of the *Mining Management Act 2001* are not deductible as OCs.

Mining security levy

64. Under the *Mining Management Act 2001*, an operator who carries out mining activities under an Authorisation must pay an annual levy of 1% of the security provided by the miner. This levy is not a deductible OC for royalty purposes.

Levies on mineral output, value, profits, income or export

65. Any payments - whether or not in the nature of a levy - made on mineral output, value, profits, income, or export are not able to be claimed as OCs.
66. Such payments may be imposed through a range of different approaches including by primary legislation. Irrespective of how the obligation to make the payment is imposed or what the payment will be used for, the payment is not recognised as an OC.

Travel and ancillary costs for workers whose principal place of residence is outside the Territory

67. Travel and other ancillary costs expended in respect of transporting employees, contractors and other workers who either come to the Territory to work for temporary periods or whose principal place of residence is outside the Territory are not eligible to be claimed as OCs.

Example

ABC Mining Pty Ltd (ABC) employs numerous workers whose principal place of residence is outside the Territory. ABC incurs costs to fly these workers to Alice Springs for transit, then to the production unit via a charter flight. These costs include airfares, taxi fares and accommodation costs in Alice Springs. None of the costs incurred are eligible to be claimed as OCs.

Employee remuneration, office expenses or fees for management services where the work, services or expenses are performed or incurred outside the Territory

68. Any costs which would ordinarily be classified by the Secretary as employee remuneration, office expenses or fees for management services (in the sense described in paragraphs 30 to 39) are not eligible to be claimed as OCs if the work, services or expenses were performed or incurred outside the Territory.
69. Where a cost that may meet the description in paragraph 68 is claimed as another type of OC, sections 4B(1)(z), (za) or (zb) of the MRA require the Secretary to form an opinion as to whether the cost in question would ordinarily or usually be classified under sections 4B(1)(f) (employee remuneration), (g) (office expenses) or (h) (fees for management services) respectively (had the work, services or expenses been performed or incurred within the Territory).
70. The Secretary will take into account, among other matters, the non-exhaustive description in paragraphs 30 to 39 of expenditure ordinarily classified as employee remuneration, office expenses or fees for management services. Having considered an individual case on its merits, if the Secretary forms the opinion that the cost would ordinarily be classified under any of sections 4B(1)(f) to (h) (had the work, services or expenses been performed or incurred within the Territory), it will not be claimable as an OC.
71. A royalty payer may be requested to provide a written explanation and supporting documentary evidence of:
- (1) the nature, character and extent of the expenditure, including the reasons for claiming the expenditure as another type of allowable OC
 - (2) a detailed explanation as to why the expenditure would not ordinarily be claimable under sections 4B(1)(f) to (h) of the MRA (had the work, services or expenses been performed or incurred within the Territory).

Failure by a royalty payer to establish and substantiate that the expenditure would not ordinarily be claimable under any of sections 4B(1)(f) to (h) (had the work, services or expenses been performed or incurred within the Territory), will generally result in the expenditure not being allowed as an OC.

Excluded operating costs - foreign exchange losses

72. Losses resulting from foreign exchange, financing arrangements or capital transactions are not allowable OCs. Foreign exchange and hedging transactions are treated as business decisions or risks independent from the profitability or operation of a production unit.

Excluded operating costs - revaluation

73. Once the principal sum relating to an asset has been determined for CRD purposes (Guideline RG-MRA-006: *Capital Recognition Deduction* provides further information on the concept of principal sum), it remains unchanged for all future determinations of royalty liability. Costs associated with the revaluation of assets are not recognised as OCs.
74. If a royalty payer pays a third party to value an asset for the purposes of revaluation, this payment is not an allowable OC: Neither is any gain or loss on the revaluation.

Methods of costs allocation - office expenses or management fees

75. In respect of a royalty year, OCs are determined in relation to a specific production unit and not on a company, business or enterprise basis. Where a production unit forms part of a larger business arrangement, certain costs must be apportioned between the production unit and the other parts of the business.
76. Therefore, it is important to ensure that office expenses (refer to paragraph 32) and management fees (refer to paragraph 36) are analysed and allocated to the operations of the individual production unit. Prior to any allocation, ineligible OCs must first be excluded from the OC base.
77. Different methods of allocation may be relied upon to determine the appropriate amount of office expenses and fees for management services relating to the specific production unit.
78. The method of allocation should reflect, in all circumstances, a realistic estimation or value of those costs. Methods that do not fairly and reasonably reflect the effort or resources used in relation to the operations of the production unit are not accepted.
79. The royalty payer must disclose (in writing to the Secretary) the reasons for relying on a particular method of allocation coupled with information establishing and verifying the cost(s) claimed.
80. The methods for allocation acceptable to the Secretary are:
- (1) Timesheet method - to determine effort or resources
- This allocation method is based on the actual time spent by employees on activities materially or closely connected with operation of the production unit. To use this method, the royalty payer needs to maintain detailed timesheets for relevant employees or another reasonable system for estimating the actual time spent by employees on these activities.

(2) Proportion of direct OCs

This method allocates office expenses or fees for management services to the production unit in the same proportion as direct OCs of the production unit over the total OCs for all projects. To use this method, the royalty payer must maintain adequate records to establish and verify total OCs and the proportion of total OCs which relate to the specific production unit.

(3) Agreed percentage

A fixed percentage of total costs may be agreed between the royalty payer and the Secretary as the basis for costs allocation. The royalty payer must submit a written application requesting that the Secretary approve a fixed percentage of total costs as being the OCs attributable to that production unit, coupled with supporting information.

81. In default of a royalty payer selecting one of the above methods, any claim for office expenses or fees for management services must be substantiated and verified by relevant written records.
82. Once a method for allocation of OCs has been selected, it must be consistently applied from year to year. Where the selected method is no longer appropriate for the operation of the production unit - for example, due to changes in operating circumstances - the royalty payer is required to apply for the allocation method to be varied or substituted. The application must be made in writing, setting out in full the grounds for, and reasons in support of, such a request.

Adjustment to amount of operating costs - recoverable costs

83. Recoverable costs such as rental income or fuel rebates received in respect of OC expenditure must be offset against that expenditure. Where a timing difference results in the receipt of the recoverable cost in a royalty year which is different to the royalty year in which the related expenditure is claimed as a deduction, the recoverable cost should be recognised in the royalty year it is received as an offset to the OCs of that royalty year.

Example

A royalty payer may claim the cost of diesel fuel that is used for items of plant within the production unit as an OC for that production unit's 2017 royalty year. If the royalty payer receives a rebate towards the cost of this fuel, the rebate must be offset against the expenditure claimed. If the rebate is received in 2018 it should be used to offset the OCs of that production unit's 2018 royalty year.

Rule against double deductions

84. Where an amount expended in respect of a production unit is capable of falling under more than one deduction category, or being reflected in the financial accounts of the production unit in more than one form (for example, certain capitalised expenditure could be an OC or qualify for a CRD), the royalty payer must classify the expenditure under the most appropriate category, as only one deduction is allowed, whether in the same royalty year or over a different royalty year.
85. Any expenditure relating to activities in the nature of production (where the expenditure is more appropriately to be treated as an OC) should be claimed as an OC.

86. The specific items that are excluded as OCs in the MRA, and discussed in paragraphs 54 to 71, may only be classified as expenditures.

Conversion of foreign currency to Australian currency

87. Where an item of expenditure is in a foreign currency, the value for royalty purposes must be converted to an Australian dollar equivalent at the exchange rate current at the time that the expenditure is brought to account.

GST

88. Generally, an amount of OCs is the amount exclusive of the GST (if any) payable in relation to that expenditure. Where an item claimable as an OC is input taxed, the amount claimable is inclusive of GST.

Record keeping requirements

89. For general record keeping requirements, refer to MRA Overview.

90. In respect of OCs, the royalty payer must maintain proper records including, but not limited to:

- (1) trial balances
- (2) cost centre reports
- (3) detailed general ledger reports
- (4) invoices.

MRA publications

91. Guideline RG-MRA-001: *Guidelines and Advance Opinions*, which sets out information on the Guideline system, is incorporated into and read as one with this Guideline.



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