NORTHERN TERRITORY PETROLEUM ROYALTY

OVERVIEW

Purpose

1. This Overview outlines the administrative arrangements relating to the establishment, calculation and collection of royalties under the *Petroleum Act 1984* (NT) (the Act)*.*
2. This Overview is for general guidance purposes only.

Introduction

1. Royalties are payments made to the Northern Territory Government (the Territory), as the owner of the petroleum, in consideration of a right granted to extract and remove petroleum and are calculated at the rate of 10 per cent of gross value at the wellhead on petroleum production. They are not a tax.
2. Royalties are collected under the Act.
3. The Territory’s royalty regime encourages present and future exploration and development of petroleum resources. At the same time, it compensates the Northern Territory community for allowing the private extraction of the Northern Territory’s non-renewable resources.
4. The Department of Mines and Energy issues titles under Territory petroleum legislation for the right to produce petroleum within the territorial boundary of the Northern Territory (including coastal waters). When titleholders (commonly known as licence holders or licensees) obtain a title, they undertake to pay royalties. This Overview outlines the royalty requirements and sets out the obligations of the licensees in this regard.
5. The payment of royalties is governed by Division 5 of Part III of the Act,[[1]](#footnote-1) coupled with a legally enforceable written agreement between a licensee and the Treasurer (as the responsible Minister for administering the royalty provisions of the Act) on behalf of the Territory or, in the absence of a legally enforceable agreement, a binding determination made by the Treasurer. A failure to pay royalties can result in cancellation of a retention licence or production licence.

8. The annual royalty return required to be lodged provides the Commissioner of Territory Revenue with information to enable calculation of the royalty, including the gross value of the petroleum and any applicable allowable deductions.

Substances subject to the Act

1. Subject to the terms of the Act, royalties are payable on all petroleum (in the sense described in the Act) except for a substance which, in its naturally occurring state, is not recoverable from a well by conventional means.
2. “Petroleum” is defined as:
3. any naturally occurring hydrocarbon, whether in gaseous, liquid or solid state;
   1. any naturally occurring mixture of hydrocarbons, whether in gaseous, liquid or solid state;
   2. any naturally occurring mixture of one or more hydrocarbons, whether in gaseous, liquid or solid state, and one or more of the following: hydrogen-sulphide, nitrogen, helium and carbon dioxide or any combination thereof; and
   3. any petroleum as defined in (i), (ii) or (iii) that has been returned to a natural reservoir.

Royalties

1. Royalties on petroleum within the scope of the Act are charged on an *ad valorem* basis (not a profit-based or net value approach) which is applied to the recovery of all petroleum within the boundary of the geographical area of the Northern Territory (including coastal waters) that is subject to a retention licence or production licence (described as the “licence area” in the Act).
2. The inherent nature of the Territory’s petroleum royalty scheme is that petroleum products (“petroleum”) have a value at the wellhead and that a royalty will always be payable on petroleum production under the ad valorem scheme.
3. Under the Act, royalty applies to petroleum derived from the licence area. Ring-fencing principles apply and each of the licensee’s operations are treated independently, for royalty purposes, from all of the licensee’s other operations (including operations on distinct and separate licence areas). Accordingly, the accounts from the individual field or project the subject of a retention licence or production licence may not be mixed with the accounts for activities outside the field or project. There is no ability to aggregate income or revenue and expenses from all operations carried on by the licensee within the Northern Territory.
4. The licensee(s) is/are the royalty payer for the purposes of the Act. Accordingly, the licensee is responsible for the lodgement of royalty returns and payment of royalties.

Ad valorem royalty

1. The imposition and assessment of royalty on petroleum recovered in the Northern Territory is governed by the Act coupled with a legally enforceable written agreement or, in the absence of a legally enforceable agreement, a binding determination made by the Treasurer.
2. Under section 84 of the Act, royalty is payable to the Territory and liability for royalty is a joint and several liability of the licensee(s).
3. Under section 84, the royalty rate is 10 per cent of gross value at the wellhead.[[2]](#footnote-2) The term “wellhead” has a well-established common business usage or practice in the Australian (and, indeed the world) petroleum recovery industry.[[3]](#footnote-3) The term refers to the top of the well casing and/or equipment at the top of the well casing, including outlets and values, designed to control the production of petroleum (commonly known in the industry as the “Christmas tree” being an assembly of valves mounted on the casing head through which petroleum is produced. The Christmas tree also contains valves for testing the well and for shutting it down if necessary).
4. The point at which a licensee is required to bring to account the gross value of the petroleum for the purposes of calculating the royalty in respect of, or determining the consequent royalty implications arising from the recovery of the petroleum from, the relevant area of the retention licence or production licence is fixed by the terms of section 84(1) of the Act (see also section 84(5) of the Act). The precise time at which the gross value of the petroleum has to be determined is at the wellhead (see also sections 5(1) (definition of “well”) and 6(2) of the Act).
5. For the purposes of calculating the amount of royalty payable, petroleum is deemed not to have been produced in the period to which the royalty calculation relates if, during that period, that petroleum is unavoidably lost, returned to the natural reservoir, flared or vented in accordance with good oilfield practice or used by the licensee for the purposes of approved mining operations or any incidental purposes (including the heating and lighting of the dwellings of employees engaged by the licensee in connection with the work of production and the heating and lighting of buildings maintained to provide social amenities for those employees, workers and their families).

*Methods for determining gross value*

1. There are generally three methods used to determine “gross value at the wellhead”. First, the most desirable method is to refer to the actual arm’s length sales to unrelated parties of the petroleum at the wellhead. The second method, used only when there is no actual sales of petroleum at the wellhead, is comparable sales (i.e. sales comparable in time, quality, quantity and availability of market outlets). The third method, used only when actual sales or comparable sales are not available, is the net-back or work-back method;[[4]](#footnote-4) i.e. subject to one qualification or limitation (refer to paragraph 26), the subtraction of reasonable post-wellhead costs from the actual sales price/market value (i.e. the arm’s length price achieved or achievable between unrelated parties) at the first point of sale.
2. Where there is no sale of petroleum at the wellhead or comparable sales, to enhance administrative simplicity and to negate or minimise the potential for difficulties and uncertainties in valuing the petroleum at that precise point of time, a general practice has been adopted to determine the gross value of the recovered petroleum by taking the value at the point where the value of the petroleum can be independently established (this is generally the first point of sale) and deducting from this value, post-wellhead costs directly attributable to the production of petroleum from the licence area.
3. Depending on the specific circumstances, an alternative method or formula (other than the methodologies stated above), the application of which results in an amount that fairly reflects the gross value concept and simplifies royalty calculations, may also be considered.
4. To allow for an alternative method to be considered as part of the agreement process, a written application or claim should be made to the Commissioner of Territory Revenue setting out a statement of reasons to establish and substantiate to the Commissioner that the alternative method accurately represents the gross value of the petroleum produced (or to be produced) from a licence area. The reasons should be sufficiently explicit to identify and direct the Commissioner’s attention to the particular aspects upon which it is contended that the amount should be determined as the gross value of petroleum for the purposes of the Act.
5. In circumstances where the sale or transaction involves a transfer pricing arrangement between related parties, the licensee must establish and substantiate an alternate value for petroleum royalty purposes. Generally, the alternate value should be determined in conformity with the concepts, principles and rules identified and described in the *Mineral Royalty Act 1982* (NT).
6. The Commissioner of Territory Revenue considers parties to be related where they are “related bodies corporate”, as defined in section 50 of the *Corporations Act 2001* (Cth). This includes companies in a parent/subsidiary relationship and subsidiaries of the same parent company.

*Deductible post-wellhead costs under a net-back method*

1. As the royalties on petroleum within the scope of the Act are charged on an *ad valorem* basis (not a profit-based or net value approach), where a net-back method is used, generally a limit on post-wellhead costs up to 50 per cent of the gross value for petroleum production will be incorporated into the written agreement or determination. Any deduction in excess of this limit may be carried forward to the next royalty period without adjustment for inflation. This limitation acknowledges the inherent nature of the petroleum royalty scheme and ensures that deductions will never exceed sales value and that the Territory will always receive a royalty on production under the *ad valorem* scheme.
2. While revenue and costs are calculated on a field by field basis, depending on its specific circumstances, “post-wellhead costs” are normal operating costs which are reasonable in amount and are directly attributable to the production, maintenance for the purpose of production or the marketing or sale of petroleum products from the licence area. These will generally include field gathering costs (i.e. costs of running the petroleum from the well(s) into processing facilities), processing, storage and pipeline tariffs or transportation costs (i.e. costs of transporting the petroleum to the refinery or the first point of sale).
3. Labour, office and management costs are generally deductible if the work was performed solely in the Northern Territory and was directly attributable to the petroleum operations conducted on the licence area.
4. In relation to field production assets (i.e. assets located on the licence area) used for petroleum production, deductions will generally be allowed for depreciation in conformity with the income tax treatment of the asset and any gain or loss on the sale of eligible field assets will be included as part of the allowable deduction calculation.

*Non-deductible costs under a net-back method*

1. The concept or notion of “gross value” clearly prohibits the deduction of pre-wellhead costs such as exploration costs (i.e. costs incurred in exploring and prospecting for petroleum and outlays on plant and other items of capital equipment required to develop petroleum from a well), lifting costs (being the costs of bringing petroleum to the surface), reservoir maintenance costs and overhead costs relating to pre-wellhead activities.
2. Where a field or project ceases production as a result of a permanent shut down or a field or project ceases production and its operation is placed in care and maintenance for an indefinite period (as a result of a temporary shut down), mothballing costs (however described such as care and maintenance or abandonment costs) - even if mothballing costs may be required to maintain plant and gathering systems to facilitate the safe re‑commencement of production at some future period of time - are considered not to be directly attributable to the production of petroleum from the field. Consequently, that expenditure is not eligible to be claimed as post-wellhead costs.
3. Similarly, deferred or post-production rehabilitation expenditure (i.e. expenditure incurred subsequent to the cessation of production and, accordingly, not directly attributable to the production of petroleum from the field) is not eligible to be claimed as post-wellhead costs.
4. In addition, any gains/losses from foreign exchange dealings and asset revaluation adjustments will not be recognised for royalty purposes.

*Royalty agreements with the Treasurer*

1. For the purposes of entering into a written agreement with the Treasurer under section 84 of the Act and to ensure that any future royalty (in relation to petroleum produced from an area that is subject to a retention licence or production licence) is correctly accounted for and paid in a timely manner, it is important that a prospective licensee notifies, and commences discussions with, the Territory Revenue Office (being the office responsible for administration and enforcement of the royalty provisions of the Act), when an application for a retention licence or a production licence is submitted to the Department of Mines and Energy.
2. Subject to all of the particular circumstances of the prospective field or project and the ultimate views and consent of the Treasurer, the terms of any legally enforceable written agreement between a licensee and the Treasurer will generally align with the principles set out in this Overview and may include:

(1) an appropriate or reliable net-back method or approach to determine the gross value of all the petroleum recovered at the wellhead from the actual downstream sales value of petroleum or, in the alternative, value added products such as LNG; and

(2) relevant deductible post-wellhead costs (including capital costs) directly attributable to the production of petroleum from the field or project - which are reasonable in amount (i.e. the amount expended must represent the fair and realistic value of the activities carried out).

Lodgement of royalty returns

1. Annual royalty returns are required to be lodged in circumstances where the production of petroleum has commenced. The returns are to be lodged within three months after the expiration of a royalty year or such longer period as the Commissioner of Territory Revenue permits.
2. The licensee must ensure that:
   1. information relating to its field or project is accurate and up to date; and
   2. completed and signed returns are lodged with the Commissioner of Territory Revenue covering all details set out in the return together with working papers supporting the royalty calculations.
3. For convenience, a template royalty return will shortly be made available by the Territory Revenue Office.

***Records required when royalty return lodged***

1. To facilitate the audit and assessment process, the following is a list of some of the information required to be submitted with the royalty return:

(1) a statement showing -

1. the quantity; and
2. gross value as determined in accordance with section 84 of the Act;

of all petroleum produced from the licence area and in respect of which royalty is payable under the Act;

(2) the licensee’s method of determining the quantity and gross value;

(3) a list of expenditure claimed (if applicable);

(4) an explanation for any increase/decrease in revenue or expenditure in comparison with the amounts declared in the previous royalty return; and

(5) any other relevant information which may facilitate the audit of the royalty return.

Audit and assessment of royalty

1. The terms of the Act coupled with the agreement or Treasurer’s determination depend upon the issuance and delivery of an assessment by the Commissioner of Territory Revenue stating the amount of royalty payable by the licensee.
2. An assessment is made of the royalty payable. A licensee’s liability for royalty is not determined until an assessment has been issued.
3. To make an assessment, an audit may be conducted to verify information disclosed in the royalty return.
4. The audit may be carried out on the licensee’s licence area or premises, or the licensee may be requested to provide further information to substantiate the royalty return. To facilitate the audit process, licensees need to ensure that all records requested by the Commissioner of Territory Revenue or a person appointed or authorised by the Commissioner (“authorised officer”) are submitted and available for examination in a timely manner.
5. Once the audit is completed, an assessment is issued incorporating any necessary adjustments arising from the audit.
6. The Commissioner of Territory Revenue has the ability to issue amended assessments in certain circumstances.

***Authorised officer’s powers in conducting an audit***

1. Under the Act and the terms of an agreement, for the purposes of the administration and enforcement, an authorised officer is permitted to, amongst other things:

(1) gain access to the licence area or premises where records are kept;

(2) inspect, examine, make and retain copies of documents or records;

(3) test a device referred to in section 84(5) of theAct and make and retain records associated with or produced by the device;

(4) require a person to produce records; and

(5) require a person to answer questions and provide information.

***Your rights in respect of an audit***

1. In relation to the audit process you should expect:

(1) the authorised officer to be professional and courteous;

(2) the audit to be completed in a timely manner;

(3) your affairs to be treated with strict confidentiality;

(4) to be given a receipt for records or other materials the authorised officer removes from your premises;

(5) to be given an opportunity to discuss any aspect of the findings with the authorised officer;

(6) to be given the opportunity to explain the reasons for any irregularities and discrepancies; and

(7) to receive an explanation of the results or findings.

***Your obligations in respect of an audit***

1. Throughout the audit, you are obliged to:

(1) disclose any discrepancies, errors and undeclared royalty liabilities;

(2) provide the authorised officer reasonable assistance and facilities;

(3) provide complete and honest answers and explanations to questions;

(4) provide prompt, full and free access to all relevant information, records, documents, data and systems as required; and

(5) ensure accounting records and books of accounts are properly kept and complete.

Payment of royalty

1. Provisional royalty payments are generally made monthly. However, further payments may be made at the end of the royalty year.
2. Payment of royalty is generally required to be made:

(1) in the case of **monthly provisional payments** (which are to be accompanied by a statement), not later than 15 days after the commencement of each month;

(2) in the case of a **residual payment** (i.e. the difference between the sum of the monthly payments and the total amount calculated as payable in the royalty return) for a royalty year, at the same time the royalty return is lodged, which must be within three months of the end of the royalty year; and

(3) in the case of any **shortfall** between royalty assessed in an assessment and the sum of the **monthly provisional payments** and **residual payment**, on the date specified in the notice of assessment (generally within 30 days of the issue of the assessment).

***Unpaid royalties and interest charges***

1. Royalties not paid by the due date incur an interest charge. The interest rate is fixed at 0.33 per cent per day.
2. Interest charges apply in all cases upon the amount of royalty from time to time remaining unpaid, to be computed from the time such royalty became payable until it is paid. In exceptional circumstances, some or all of the interest may be remitted.

Record keeping requirements

1. Licensees are required to maintain proper and accurate records relating to petroleum recovered and which substantiate details contained in royalty returns. The records are to be kept at the licence area or at some other place in Australia as agreed between the licensee and the Commissioner of Territory Revenue.
2. The Commissioner of Territory Revenue or any authorised officer is to have access to accounts, books, documents and other records relating to the field or project.

Confidentiality

1. Information collected by the Commissioner of Territory Revenue or any authorised officer for the purposes of royalty is used only for the purpose of administering and enforcing the royalty provisions of the Act*.*
2. The confidentiality of this information is strictly maintained and any disclosure will only be made if consistent with the confidentiality requirements, or when required or authorised by law.



Grant Parsons

Commissioner of Territory Revenue

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1. Section 119(2) of the *Petroleum Act* (being a transitional or savings provision) expressly ensures that Division 5 of Part III of the *Petroleum Act* applies to a lease granted or renewed under the now repealed *Petroleum (Prospecting and Mining) Act* *1954* (NT) which is continued in force (as if the law remained the same as it was at the time immediately before the *Petroleum* *Act* commenced operation on 15 October 1984). [↑](#footnote-ref-1)
2. There is provision to reduce the royalty in exceptional circumstances such as if the production becomes uneconomic at the fixed rate (section 86). [↑](#footnote-ref-2)
3. See *BHP* *Petroleum Pty Ltd v Balfour* (Unreported, Supreme Court of Victoria, Marks J, 8 February 1985); *BHP* *Petroleum* *Pty* *Ltd* *v* *Balfour* (1994) 180 CLR 474; *Schroeder v Terra Energy Ltd* 565 N.W.2d 887,890 (Mich. App. 1997). [↑](#footnote-ref-3)
4. The authorities of *Oil Basins Limited v* *BHP Petroleum Pty Limited* [1988] VicSC 247 and *Australian Energy Limited v Lennard Oil NL* (Unreported, QSC, MacPherson J, 6 February 1985); [1986] 2 Qd R 216 support that it is appropriate to ascertain the wellhead gross value by using the net-back approach; i.e. it is an appropriate method of deducing from actual downstream sales the gross value at the point of production upstream of those actual sales (see also *Bob Jane T-Marts Pty Ltd v Commissioner of Taxation* [1999] FCA 415 at [92]-[93]; *Howell v Texaco Inc* 112 P.3d 1154, 1159 (Okla. 2004); *Ramming v Natural Gas Pipeline Company of America* 390 F.3d 366, 372 (5th, Cir. 2004)). [↑](#footnote-ref-4)