RG-MRA-004: Gross Realisation and Gross Production Revenue

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# Purpose

1. This Guideline explains the accepted methods for determining gross realisation and gross production revenue, for the purpose of calculating royalty liability under the *Mineral Royalty Act* *1982* (NT) (the MRA).
2. This Guideline is issued by the Secretary under section 4E of the MRA.

# Introduction

1. Under the MRA, royalties are calculated on the net value derived from the production of a saleable mineral commodity within the boundaries of a production unit, subject to a minimum royalty (as calculated in paragraph 4(b)) that applies for royalty years commencing on or after 1 July 2019.
2. The royalty payable under section 9 of the MRA is **the greater of**:
	1. 20 per cent of the net value, less $10 000
	2. the percentage of the gross production revenue applying to the royalty year as follows:
3. 1 per cent for the royalty payer’s first royalty year that begins on or after 1 July 2019
4. 2 per cent for the royalty year that follows the royalty year mentioned in subparagraph (i)
5. 2.5 per cent for each royalty year that follows the royalty year mentioned in subparagraph (ii).
6. Generally, when calculating the net value, only those expenditures necessary to produce that commodity are allowable as deductions against the value of the saleable mineral commodity.
7. Section 10 of the MRA sets out the formula for calculating the net value of a saleable mineral commodity sold or removed without sale from a production unit.
8. Net value is calculated in accordance with the formula:

**NV = GR - (OC + CRD + EEE + 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.

1. When calculating the minimum royalty for a particular royalty year, only the gross values of saleable mineral commodities produced from the boundaries of a production unit should be included. There is no recognition or deduction of any costs incurred in respect of the operation of the production unit in the minimum royalty calculation.

# Trigger for royalty liability

1. The concept of a production unit is a key feature of the MRA. The concept fixes the boundary, that is the geographical area, where the production of an identified saleable mineral commodity for any available market occurs and the precise time at which the gross value of that commodity is to be fixed. The boundary does not extend beyond the production stage to downstream activities such as manufacturing. This means that value adding to products through downstream processes is not taken into account for the purposes of calculating royalty.
2. As it is difficult to provide an exhaustive and technical definition of the mineral commodities likely to be marketed from a production unit, the MRA defines the point at which mineral commodities become saleable or marketable in general terms recognising that the point may vary from production unit to production unit, and even, over time, within the same production unit.
3. The MRA requires that royalty is to be paid on a saleable mineral commodity at the time the first of either of these events occurs:
4. the saleable mineral commodity is sold in accordance with an enforceable sale contract or, as a consequence of a Ministerial declaration, a deemed sale by virtue of section 4AA of the MRA, prior to removal from the production unit
5. the saleable mineral commodity is removed from the production unit without sale.
6. Guideline RG-MRA-002: Production Unitprovides further information on the key concept of production unit.

# What is gross realisation

1. In order to calculate the net value, the royalty payer must, among other things, determine the gross realisation from the production unit in a royalty year.
2. The term “gross realisation” is defined in sections 4 and 4A of the MRA and is comprised of a range of elements or variables. Gross realisation is calculated as follows:

GR = (GPR + GOS) – LOS – NNV

where:

GPR is the gross production revenue from the production unit (as described in paragraph 16)

GOS is the gain realised on the sale of assets of the production unit

LOS is any loss incurred on the sale of assets of the production unit

NNV is any negative net value approved to be brought forward.

1. Any interest earned which is referable to the operations of the production unit is not to be included in either the gross production revenue or gross realisation amount (see paragraphs 71 to 72).

## What is gross production revenue

1. The term “gross production revenue” is defined in sections 4 and 4A(1) of the MRA and is determined based on the sum of:
2. subject to paragraphs 71 and 72, the gross values of saleable mineral commodities produced by the production unit in a royalty year that have been sold or removed without sale from that production unit
3. any amount received by way of insurance, indemnity or guarantee for the loss of a saleable mineral commodity from the production unit which value would otherwise have been taken into account in calculating gross production revenue
4. any amount received as the price or compensation for a saleable mineral commodity where sale or disposition of the saleable mineral commodity is not permitted or authorised by law.

## Determining gross value of the saleable mineral commodity

1. The two triggers, outlined in paragraph 11, fix the precise time at which the gross value of saleable mineral commodities must be determined. That is, the valuation of the commodities has to occur when they are either sold (or deemed to be sold) from the production unit or when they are removed from the production unit without sale (whichever triggering event occurs first).
2. As a general rule, a saleable mineral commodity is considered to have been produced when the mineral commodity is at a stage in processing where it is first capable of being sold into any available market, whether or not the royalty payer chooses to sell it. The subsequent processing and enhancement of the saleable mineral commodity is considered to be a downstream process that is not relevant in determining the gross value of the saleable mineral commodity.
3. Generally, the Secretary considers that a reasonable valuation basis is the free on board (FOB) arm’s length price obtained on the sale of the saleable mineral commodities. Exceptions are where the sale or transaction is between related parties or where the sale or transaction is not conducted at arm’s length. In such situations, a value, other than the FOB price, that the royalty payer can establish and substantiate to be an appropriate gross value, may be accepted as the gross value.
4. The Secretary 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.

Sale prior to removal

1. The words “sale” and “sold” in section 4A of the MRA are considered to have the same meaning as they have in the *Sale of Goods Act 1972* (NT). A contract of sale of a mineral commodity is a contract where the seller transfers the property in the mineral commodity to the buyer for a price (or monetary consideration). That is, a sale occurs when the ownership of the mineral commodity is transferred to the buyer at the time of the contract.
2. A sale does not include an “agreement to sell”. An agreement to sell arises when ownership of the mineral commodity is to be transferred at a future time, or subject to some condition. An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled.

#### Arm’s length sales

1. In determining whether there is an arm’s length sale, the substance of the dealing and the relationship between the parties are considered. An arm’s length transaction is taken to have occurred where the parties to a transaction have acted severally and independently to form their bargain.
2. Where the royalty is triggered by a sale and the transaction is at arm's length, generally the FOB price obtained for the saleable mineral commodities is taken as the gross value for gross production revenue purposes.
3. Where the sale contract is negotiated on a cost, insurance and freight (CIF) basis, amounts relating to insurance and freight should be deducted from the CIF price to obtain the gross value for royalty purposes. Therefore, the insurance and freight amounts cannot be claimed as operating costs for the purposes of calculating the net value. Guideline RG‑MRA-005: Operating Costs provides further information.
4. In some instances, the final price and/or quantity of saleable mineral commodities is not known at the time the sale contract is executed. When this occurs, in conformity with current administrative practice, the initial or provisional arm’s length price or quantity may be accepted but with adjustments to be made once the price and/or quantity is confirmed.
5. Where the final price and/or quantity is ascertained in a subsequent royalty year, any difference between the provisional invoice (that has been included in the previous royalty year) and the final invoice is included in the gross production revenue for the year in which the final price and/or quantity is determined.

Example 1

A provisional invoice of $100 000 is issued for the sale of 2000 tonnes of manganese. The $100 000 amount is to be included for royalty purposes at the time the manganese is sold pursuant to a sales contract. In the same royalty year, a final invoice of $90 000 is issued, with the change in final price due to quantity and grade differences. The $100 000 amount is to be adjusted in the same royalty year to reflect the final amount (being $90 000) received or receivable for royalty purposes.

Example 2

In year 1, a provisional invoice of $100 000 is issued for the sale of 2000 tonnes of manganese. The $100 000 amount is to be included for royalty purposes at the time the manganese is sold pursuant to a sales contract. In year 2, a final invoice of $90 000 is issued, with the change in final price due to quantity and grade differences. Because the provisional invoice amount of $100 000 has already been included in the gross production revenue for year 1, the $10 000 difference may be offset against the gross production revenue for year 2.

#### Non-arm’s length sales

1. A royalty regime’s effectiveness can be compromised without rules dealing with the transfer pricing transactions that are a consequence of the globalisation of business. Simply put, a transfer price is the price for which an entity transfers goods or provides services to a related or associated party. Relevant to mineral royalties, transfer pricing arrangements may arise where a royalty payer that is a member of a multinational corporate group sells a mineral commodity to an overseas related party, prior to the eventual sale of the mineral commodity to an unrelated party. Further information on the concept of “transfer pricing” can be found in the Organisation for Economic Co-Operation and Development (OECD) Report – Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017) (or successor reports).

Example 1



In this diagram, ABC Mining and ABC Sales are engaging in international cross‑border transfer pricing. This is because ABC Mining sells goods to ABC Sales, an overseas related party. The price for which ABC Mining transfers the saleable mineral commodity to ABC Sales is a transfer price, whether that price is commercially realistic or not.

1. For this reason, where a non-arm’s length sale of a mineral commodity has taken place (prior to removal from a production unit), the value of the sale for royalty purposes may be determined on the following basis:
	1. the open market value (see paragraphs 36 and 37)

or

* 1. where there is no ascertainable open market value, or the application of the open market value will not result in a fair and equitable outcome, the royalty payer may establish and substantiate an amount as being the value to the royalty payer, which may include, but is not limited to, one of the following methods:
		1. in circumstances that involve transfer pricing, in accordance with the alternative value transfer pricing rules described in paragraphs 44 to 55

or

* + 1. in circumstances that do not involve transfer pricing, using an alternative value, subject to the procedural requirements described in paragraphs 40 to 43.
1. To avoid uncertainty, a royalty payer that has entered into, or is intending to enter into, a non‑arm’s length arrangement can obtain confirmation of an acceptable valuation arrangement, from the Secretary. To seek such confirmation, detailed and cogent written information must be provided to the Secretary.

Removal without sale from the production unit

1. Subject to a contrary Guideline or Advance Opinion, where liability for royalty is triggered by the removal of saleable mineral commodities without sale (for example, removal to a stockpile facility outside the production unit or removal for further downstream processing), the value is generally determined as follows:
	1. the open market value for the mineral commodities (see paragraphs 36 and 37)

or

* 1. an amount that the royalty payer may establish and substantiate as being the value to the royalty payer, which is labelled as the “alternative value” in the MRA (see paragraphs 38 to 43). If the royalty payer does not establish such a value, the open market value will be used.
1. Irrespective of which valuation method is adopted, saleable mineral commodities must be valued at the precise time they are removed without sale from the production unit. However, if the removal and subsequent sale of the saleable mineral commodity occurs within a short timeframe (for example, one month or a reasonable period accepted by the Secretary), in conformity with current administrative practice, the arm’s length sale price may be accepted as the gross value of the saleable mineral commodity.
2. In most cases the alternative value is no more or less than the value the mineral commodity will yield in the open (or wide and general) market.
3. Unless the royalty payer establishes that another method of determining the value of the mineral commodity should be adopted, the generally accepted approach is to apply the open market value approach or process described in Walker Corporation Pty Ltd v Sydney Harbour Foreshore Authority (2008) 233 CLR 259 at [51] (see paragraph 36).
4. Where a claim for the value to be set at the alternative value is made, the royalty payer must establish and substantiate that value (see paragraphs 38 to 43).

#### Open market value

1. The open market value is the price that would be negotiated for the commodity at the trigger date for valuation in an open and unrestricted market (if offered openly and under competition in ordinary circumstances) between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller, acting at arm’s length (severally and independently).
2. The following valuation methods will be accepted as a fair representation of the open market value:
	1. the value published by a recognised commodities exchange (for example, the London Metals Exchange, Perth Mint)

or

* 1. the price received from comparable arm’s length sales made by the royalty payer of the same or substantially similar saleable mineral commodity (including quantity and quality) at the time of removal of the saleable mineral commodity to be valued.

#### Alternative value

1. In certain instances, application of the open market value for a saleable mineral commodity may not result in a fair and equitable outcome, in that it results in the gross value being determined solely by reference to the prices obtained for the end product in its ultimate refined state without allowing all of the direct costs incurred to be deducted. This may be the case where a saleable mineral commodity (such as gold and silver) is subject to further treatment outside of the production unit but the further treatment costs are not deductible for royalty purposes.
2. Section 4AAA(2)(b) of the MRA permits a royalty payer to establish and substantiate another amount as being the gross value of the saleable mineral commodity (labelled in the MRA as the alternative value). The onus rests on the royalty payer to establish and substantiate the alternative value. Where the saleable mineral commodity is dealt with by the royalty payer in circumstances that involve a transfer pricing arrangement, the alternative value is determined in accordance with the alternative value transfer pricing rules (see paragraphs 44 to 55).
3. A written application or claim should be made to the Secretary setting out a statement of reasons to establish and substantiate the value to the royalty payer. The reasons should be sufficiently explicit to identify and direct the Secretary’s attention to the particular aspects upon which it is contended that the amount should be determined as the gross value of the saleable mineral commodity for the purposes of the MRA.
4. In support of the application, clear and cogent information must be provided to the Secretary.This information must include:
5. any forward selling contracts relating to the saleable mineral commodity
6. identification and description of the actual condition of the saleable mineral commodity at the precise time it was removed from the production unit with all its existing advantages and possibilities
7. in relation to dore (being an alloy, amalgam or mixture of gold and silver as well as other impurities), the amount or price the royalty payer receives from the subsequent sale of the saleable mineral commodities (being the end product in its refined state, that is gold and silver) and the direct costs incurred (outside the production unit) in processing dore into the refined saleable mineral commodities
8. any other relevant information or documentation supporting the claim.
9. Upon receipt of the application or claim coupled with supporting information, the Secretary will determine, as soon as practicable, whether, in his or her opinion, the royalty payer has established and substantiated the claim.
10. As a general rule, an amount that closely approximates the price that would be received for the mineral commodity in an arm’s length transaction will be accepted.

Example 1

Removal for Further Processing – Gold and Silver

The effect of section 4AAA(2)(b) is best outlined by way of brief explanation and specific example.

Under normal circumstances, gold or silver is removed from a production unit in a concentrated state known as dore (being an alloy, amalgam or mixture of gold and silver as well as other impurities) for treatment and processing in a refinery that is usually some distance away from the production unit.

Dore is taken to be partially processed gold, gold ore, gold nuggets, gold concentrates, gold contained as part of a concentrate, or gold extracted from a mining lease in any form whatsoever. The relevant minerals for the purposes of determining the gross value amount are the gold and silver content in the dore.

When dore 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. Accordingly, they are to be valued at the precise time of removal from the production unit.

The quantity of gold and silver removed can be confirmed from the refinery’s Memorandum of Outturn statement. The gold and silver is valued at the spot price of gold and silver prevailing on the date the dore is removed from the production unit less any dore refining and transport charges incurred by the royalty payer.

The daily 8 am gold or silver spot buying prices as published by the Australian Gold Refineries (Perth Mint) are acceptable for valuing gold and silver for royalty purposes. The 8 am price will be accepted on any given day, regardless of any intraday fluctuations in price. If dore is removed from the production unit on a public holiday or weekend the next available published spot rate is to be used.

All costs, such as refining and transportation, incurred subsequent to the removal without sale from a production unit of the saleable mineral commodity cannot be claimed as operating costs for the purposes of calculating the royalty payable because the connection between the item of expenditure and the production unit is not sufficient. However, as shown by the calculation below, these costs can be taken into account when determining the gross value of the gold and silver.

Assume that a production unit produces 500oz of dore. The dore was removed without sale from the production unit on 1 July 2017 to Perth Mint for refining. The dore was received at the refinery on 3 July 2017. Transportation and refining costs amounted to $2000 and the 8 am gold and silver spot buying prices (per ounce) quoted by Perth Mint for 1 July 2017 were $1460.02 for gold and $20.54 for silver. The Memorandum of Outturn from the Perth Mint indicated 430oz of gold and 20oz of silver were refined from the dore.

The gross value for gold and silver is equal to:

(430 x $1 460.02) + (20 x $20.54) - $2000 = $626 219.40

#### Alternative value – transfer pricing

1. Where a saleable mineral commodity is removed without sale in circumstances that involve a transfer pricing arrangement, calculation of the gross value based on the arm’s length sale price received by a related party from an unrelated party customer for that mineral commodity may not result in a fair and equitable outcome. This is because the arm’s length sale price to an unrelated party may include sales and marketing costs incurred by, and the appropriate profit margin of, the related party of the royalty payer.
2. Where the final sale price (paid by an unrelated party acting at arm’s length) achieved by a related party of the royalty payer under a transfer pricing arrangement is discounted to reflect sales and marketing costs incurred by, and the profit margin of, that related party, this margin is expressed as a percentage of the final sale price and known as a transfer pricing factor or margin.
3. The maximum transfer pricing factor allowable under the MRA is 5.5 per cent, unless the transfer pricing methodology, figures and resulting factor for a particular period:
	1. have been accepted by the Australian Taxation Office (ATO) (see sections 4AAA(3)(a) and (4) of the MRA). A methodology, figures and resulting factor are acceptable to the ATO if an audit of the royalty payer has been undertaken by the ATO for that period and there has been no substitution of a condition with an arm’s length condition pursuant to Subdivision 815-B of the *Income Tax Assessment Act 1997* (Cth), or subsequent issuance of an assessment or amended assessment to give effect to the substitution of a condition with an arm’s length condition

or

* 1. have been agreed with the ATO (see section 4AAA(3)(b) of the MRA). A methodology, figures and resulting factor have been agreed with the ATO if they are in accordance with the terms of an Advance Pricing Arrangement (whether unilateral, bilateral or multilateral) whereby the future transfer pricing methodology to be used to determine the arm’s length price is agreed between the relevant parties (see the ATO’s Law Administration Practice Statement PS LA 2015/4 (or successor practice statement)).

The ATO generally follows the OECD Report “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations” (as amended from time to time), which was a revision of the OECD Report “Transfer Pricing and Multinational Enterprises” (1979), in applying transfer pricing methodologies (see paragraphs 1.13, 1.14 and 3.1 of the Taxation Ruling TR 97/20: Arm’s Length Transfer Pricing Methodologies for International Dealings).

1. Where a transfer pricing methodology and figures used by the royalty payer have been accepted by or agreed with the ATO for a particular period, in order to minimise red tape the methodology and figures used should be applied to determine the gross value of the saleable mineral commodity over that period. In circumstances where a royalty assessment has already been issued for a royalty year during that period, it may be necessary for the Secretary to amend the assessment to align it with the methodology and figures accepted by or agreed with the ATO.
2. Where a transfer pricing methodology has not been accepted by or agreed with the ATO, the onus rests upon the royalty payer to establish and substantiate that a transfer pricing factor claimed fairly reflects reasonable sales and marketing costs and profit margin that would ordinarily be incurred or achieved by an unrelated party acting at arm’s length.
3. A written application should be made to the Secretary, to establish and substantiate the transfer pricing factor claimed. If a royalty payer has established and substantiated to the Secretary that a transfer pricing factor (or methodology by which the factor is determined) applies for the purposes of the MRA, the factor may be applied up until a time when there is a material change in the underlying circumstances upon which the factor was based. At such a time, the suitability of the factor may be reviewed.
4. To support such an application, certain documentation must also be provided to the Secretary. If an application to establish and substantiate the transfer pricing factor claimed is not lodged, any assessment issued by the Secretary may apply the open market value to any saleable mineral commodity removed without sale from the production unit.

##### Transfer pricing factor up to 3 per cent

1. Where a transfer pricing factor of up to 3 per cent is claimed, generally, the royalty payer only needs to provide the following documentation:

(1) a description of the arrangements, transactions and risks undertaken by different parties that result in the saleable mineral commodity eventually being sold to an unrelated party and identification of all parties involved

(2) sales contracts and invoices substantiating the arm’s length prices to an unrelated party achieved for the saleable mineral commodity

(3) information to substantiate that the sales to unrelated parties are at arm’s length

(4) confirmation as to whether any transfer pricing reviews or audits have been (or are being) conducted by the ATO or of any Advance Pricing Arrangement with the ATO to which the royalty payer is/was a party.

##### Transfer pricing factor above 3 per cent

1. Where a transfer pricing factor above 3 per cent and up to the maximum of 5.5 per cent is claimed, the following documentation must be provided:

(1) an independent expert valuation report that assesses the reasonableness of the transfer pricing arrangement and includes a valuation of the saleable mineral commodity for the relevant period, coupled with the terms of reference (or letter of engagement) for that report

(2) sales contracts and invoices between the royalty payer and related parties, as well as between the related parties and unrelated parties

(3) sales and marketing agreements, agency agreements and umbrella agreements between the royalty payer and related parties, as well as between the related parties and unrelated parties

(4) information to substantiate that the sales to unrelated parties are at arm’s length

(5) documentation establishing the structure and nature of the royalty payer and its related entities

(6) a detailed description of the arrangements, transactions and risks undertaken by different parties that result in the saleable mineral commodity eventually being sold to an unrelated party and identification of all parties involved

(7) financial statements and reports of the royalty payer and any related entities that are selling the saleable mineral commodity

(8) a report or summary including a description of the transfer pricing methodology, data and analysis used by the royalty payer to calculate the transfer pricing factor claimed

(9) documentation relating to product profitability, relevant market information and profit contributions of each party

(10) confirmation as to whether any transfer pricing reviews or audits have been (or are being) conducted by the ATO or of any Advance Pricing Arrangement with the ATO to which the royalty payer is/was a party

(11) any other relevant information.

##### Section 4AAB formula

1. Once a transfer pricing factor has been established and substantiated by the royalty payer and approved by the Secretary, the gross value of the saleable mineral commodity removed without sale during the relevant period is calculated pursuant to the formula set out in section 4AAB of the MRA which provides:

**A = V x (1 – T)**

where:

**A** is the alternative value for the saleable mineral commodity (the gross value)

**V** is the final value for the saleable mineral commodity (the FOB sale price for which it was sold to an unrelated party, acting at arm’s length), subject to paragraphs 54 and 55

**T** is the transfer pricing factor (capped at 5.5 per cent) expressed as a decimal number.

Example 1

ABC Mining sells 10 000 tonnes of ore (a saleable mineral commodity) it produces from a Northern Territory production unit to a related party, ABC Mineral Sales, who subsequently sells the ore at arm’s length to unrelated parties. The final price achieved by these arm’s length sales is $1000 per tonne and a transfer pricing factor of 3.5 per cent (0.035) has been negotiated between the related parties.

In this instance, a transfer pricing factor (whether 3.5 per cent or otherwise) has **not** been accepted by or agreed with the ATO, or approved by the Secretary. To claim a factor of 3.5 per cent for the purposes of the MRA, ABC Mining needs to establish and substantiate that such a factor fairly reflects the reasonable sales and marketing costs and profit margin that would ordinarily be incurred or achieved by an unrelated party, and provide comprehensive documentation (see paragraph 52) to substantiate their claim. Alternatively, ABC Mining may be able to provide a lesser amount of documentation and claim a factor of up to 3 per cent (see paragraph 51).

If the Secretary approved a transfer pricing factor of 3.5 per cent for ABC Mining, the gross value would be calculated in accordance with the section 4AAB formula as follows:

Alternative value: $1 000 per tonne x (1 – 0.035) = $965 per tonne

 $965 x 10 000t = $9 650 000

1. There may be circumstances where a saleable mineral commodity is removed without sale and subsequently sold to a related party under a transfer pricing arrangement but is never on-sold to an unrelated party. Depending on the particular circumstances, the value of the saleable mineral commodity may be determined by reference to the open market value (see paragraphs 36 and 37) or an amount that the royalty payer may establish and substantiate as being the alternative value (see paragraphs 38 to 43).
2. Generally, where a royalty payer has made comparable arm’s length sales to unrelated parties of the same or substantially similar mineral commodity (including quantity and quality), the mineral commodity may be valued using the weighted average FOB arm’s length price obtained for the same or substantially similar mineral commodity for the purposes of determining the final value for the section 4AAB formula (see paragraph 53). This methodology will only be approved by the Secretary where the quantity and quality of mineral commodity sold to unrelated parties in arm’s length transactions is comparable to the mineral commodity being valued. This methodology is best illustrated by the following example where the related party uses the saleable mineral commodity for its own consumption.

Example 1



As represented by this diagram, ABC Mining removed 1000 tonnes of ore from the production unit and sold it to a related party, ABC Mineral Sales. ABC Mineral Sales then sold 700 tonnes of that ore to Buyer No 1, an unrelated party, and the remaining 300 tonnes to a related party, ABC Smelting. ABC Smelting then sold 100 tonnes of that ore to Buyer No 2, an unrelated party (without having smelted or otherwise treated that 100 tonnes), and consumed the other 200 tonnes in its smelting business.

ABC Mining has established and substantiated to the Secretary that a transfer pricing factor of 3.5 per cent applies.

The section 4AAB formula applies to the 700 tonnes sold to Buyer No 1 as follows:

Alternative value: $600 per tonne x (1 – 0.035) = $579 per tonne

 $579 x 700t = $405 300

The section 4AAB formula applies to the 100 tonnes sold to Buyer No 2 as follows:

Alternative value: $700 per tonne x (1 – 0.035) = $675.50 per tonne

 $675.50 x 100t = $67 550

If the Secretary accepts that the quantity and quality of mineral commodities sold to Buyers No 1 and 2 are comparable to what was used by ABC Smelting for own consumption, the section 4AAB formula may be applied to the 200 tonnes used for its own consumption by ABC Smelting as follows:

Alternative value = Weighted average arm’s length price x (1 – 0.035) x 200t

Step 1

Weighted average = ($420 000 + $70 000) / (700t + 100t)

 = $490 000 / 800t

 = $612.50 per tonne

Step 2

Alternative value: $612.50 per tonne x (1 – 0.035) = $591.0625

 $591.0625 x 200t = $118 212.50

ABC Mining’s total gross value in respect of the 1 000 tonnes of ore removed from the production unit is: $405 300 + $67 550 + $118 212.50 = $591 062.50.

#### Removal without sale to stockpile

1. Saleable mineral commodities removed without sale to a stockpile outside the production unit at the end of a royalty year (closing inventory) shall be included in gross production revenue in the year the saleable mineral commodities are removed without sale. While saleable mineral commodities removed without sale must be valued at the precise time they are removed from the production unit, the Secretary may, in conformity with current administrative practice, accept the closing inventory being valued using the weighted average price obtained for the same or substantially similar saleable mineral commodities (including quantity and quality) removed and sold during the royalty year.
2. The treatment of closing inventory is illustrated in the following example:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Quantity (Unit)** | Year1 |   | Year 2 |   | Year 3 |
| Opening inventory | 0 |  | 50 |  | 100 |
| Add: Production | 100 |  | 250 |  | 60 |
| Less: Quantity sold | (50) |  | (200) |  | (100) |
| Closing inventory | 50 |   | 100 |   | 60 |
|  |  |  |  |  |  |
| **Weighted Average Value** |   |   |   |   |   |
| Invoice price |  $ 5  |   |  $ 10  |   |  $ 15  |
| Weighted average value of closing inventory (closing inventory invoice price) |  $ 250  |   |  $ 1 000  |   |  $ 900  |
|  |  |  |  |  |  |
| **For Royalty Calculations** |   |   |   |   |   |
| Value of sales |  $ 250  |  |  $ 2 000  |  |  $ 1 500  |
| Less: Weighted average value of opening inventory |  $ 0  |  |  $ (250)  |  |  $ (1 000)  |
| Add: Weighted average value of closing inventory |  $ 250  |  |  $ 1 000  |  |  $ 900  |
| Gross value |  $ 500  |   |  $ 2 750  |   |  $ 1 400  |

1. The closing inventory is likely to be sold in the following year. To eliminate double counting, an adjustment needs to be made to reverse the value of closing inventory included for royalty in the preceding royalty year. No reversal may be made in respect of any closing inventory not sold but utilised for internal processing.

Example 1

A royalty payer removed a total of 70 000 tonnes of mineral commodity to a stockpile located outside the production unit. During the year, the royalty payer sold 50 000 tonnes of the same product by way of consignment at an average price of $110 per tonne yielding $5 500 000. All sales throughout the year were at arm's length. A total of 20 000 tonnes remained on hand at the end of the royalty year. There was no opening inventory at the commencement of the royalty year.

In the following year 70 000 tonnes of product was removed from the production unit, of which 30 000 tonnes was sold at an average price of $100 per tonne yielding $3 000 000. A total of 60 000 tonnes of product remained on hand at the stockpile at the end of the royalty year.

Year 1:

Actual sales – 50 000t @ $110 $5 500 000

Less opening stock ( $0)

 $5 500 000

Add closing stock – 20 000t @ $110 $2 200 000

Gross value $7 700 000

Year 2:

Actual sales – 30 000t @ $100 $3 000 000

Less opening stock – 20 000t @ $110 ($2 200 000)

 $800 000

Add closing stock – 60 000t @ $100 $6 000 000

Gross value $6 800 000

#### Conversion of saleable mineral commodity before sale or removal without sale from a production unit

1. Where a saleable mineral commodity produced on a production unit is further processed to a stage where, by virtue of the Minister’s declaration, it ceases to be a saleable mineral commodity, the saleable mineral commodity used in that further process shall be taken to have been sold immediately before the further process commenced and liability for royalty is triggered.
2. The saleable mineral commodity may be valued using the valuation methods applicable for a mineral commodity removed without sale to estimate or approximate the value of the saleable mineral commodity deemed to be sold from the production unit.
3. Any costs or capital assets incurred or used in the further processing cannot be recognised for royalty purposes. Guidelines RG-MRA-005: Operating Costs and RG MRA‑006: Capital Recognition Deduction provide further information.

Example 1

Iron ore produced by a production unit is used on the production unit to produce pig iron. The Minister has issued a written declaration to the royalty payer stating that the iron ore at the commencement of the process to convert it into pig iron ceases to be a saleable mineral commodity. As pig iron is no longer a saleable mineral commodity, the iron ore (being the saleable mineral commodity) is deemed to have been sold immediately before it was used to produce pig iron. Accordingly, the iron ore shall be valued at this point to determine the gross value.

## Payments for loss of saleable mineral commodities or disposition where sale is not permitted

1. Any payments received by way of insurance, indemnity or guarantee in respect of the loss of a saleable mineral commodity must be included in the calculation of gross production revenue.
2. Similarly, payments received for a saleable mineral commodity where its sale or disposition is not permitted or authorised by a law in force in the Territory must be included in the calculation of gross production revenue.

## Gain/loss on sale of assets

1. The gain or loss incurred on the sale of all eligible capital assets used in relation to the production unit must be included in gross realisation (but not in the calculation of gross production revenue) in the royalty year during which they are sold.
2. To determine the profit or loss on sale amount, the standard accounting practice of comparing the assets’ original cost less accumulated depreciation to the sale proceeds to give a figure representing a gain or loss on sale is acceptable.

## Negative net value

1. The net value calculation is based on the formula provided in section 10(2) of the MRA (refer to paragraph 7). The net value calculation can result in a negative value being established, which is commonly known as a negative net value (NNV).
2. To establish the gross realisation from the production unit, any NNV approved to be brought forward into a later royalty year can be deducted.
3. The right to bring forward NNV is dependent on the Secretary's approval.
4. NNV is not to be taken into account in the calculation of gross production revenue.
5. Guideline RG-MRA-003: Negative Net Value provides further information on NNV.

## Interest income and prepaid revenue

1. Subject to paragraph 72, any interest earned that is referable to the operations of the production unit is not to be included in gross realisation.
2. An exception to paragraph 71 is where the sale price for saleable mineral commodities under an arm’s length sales contract has been partially or fully paid more than 180 days before the purchaser takes physical delivery of the mineral commodities. Where there has been prepayment of an amount under these circumstances, the value of those mineral commodities shall be the sale price received increased by a prescribed amount of interest based on the sale price received.
3. The interest amount is to be calculated based on:
	1. a rate equivalent to the arithmetic mean of the 10 year bond rate for Australian Federal Government securities plus 2 per cent
	2. the period commencing with the receipt of the payment and ending with the delivery of the mineral commodities.

# Conversion of foreign currency to Australian currency

1. Where the proceeds from the sale of mineral commodities 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 of sale or removal without sale.
2. Similarly, where the value is the price published by a recognised commodities exchange, the price in foreign currency must be converted to an Australian dollar equivalent at the exchange rate current at the time of sale or removal without sale.
3. Where there is an adjustment to an invoice and the adjustment is in a foreign currency (for example, by way of a final invoice or the issue of a credit note), the adjustment amount may be converted at the exchange rate current at the time the adjustment is made. In conformity with administrative practice, the adjustment is to be included in the royalty year in which the adjustment is made.
4. Acceptable currency exchange rates include the closing exchange rate for the day as published in the Australian Financial Review, the notes/cash buy rate of a major Australian bank or such other rate as approved by the Secretary.

## Foreign exchange gains/losses

1. Foreign exchange transactions usually occur where:
2. sales of product are made in foreign currency
3. purchases of equipment are made in foreign currency

or

1. money is borrowed in foreign currency.
2. Foreign exchange and hedging transactions are treated as business decisions or risks independent from the profitability or operation of the production unit. Any gains or losses arising from these transactions are not to be taken into account for the purposes of determining gross realisation.

# GST

1. Generally, an amount or value included in the calculation of gross realisation is the amount or value exclusive of the GST (if any) payable in relation to that amount or value. Where an amount or value included in the calculation of gross realisation is input taxed, the amount or value to be included is inclusive of GST.

# Record keeping requirements

1. For general record keeping requirements, refer to MRA Overview.
2. In respect of gross production revenue, the royalty payer must maintain proper records detailing:
	1. the mass and grade of a mineral commodity recovered from the production unit and of sales, shipments, transfers and other disposals of a mineral commodity from the production unit, including the time, destination, value and basis of valuation and mass and grade of each sale, shipment, transfer or other disposal
	2. any other relevant information.
3. For gross realisation, the royalty payer must also maintain records for all sales, transfers and other disposal of assets, being assets the costs of which have been included in calculating eligible capital assets expenditure.
4. Where a saleable mineral commodity is removed without sale and subsequently sold under a transfer pricing arrangement, a royalty payer must retain all documents that they have in their possession, create, or that come into their possession, which are relevant for determining the gross value of that mineral commodity. Such records may include:
	1. documentation evidencing a transfer pricing arrangement
	2. records of an audit by the ATO that included consideration of the transfer pricing methodology used in dealing with the mineral commodity for the purposes of the *Income Tax Assessment Act 1936* (Cth) or the *Income Tax Assessment Act 1997* (Cth) (see paragraph 46(1))
	3. an Advance Pricing Arrangement with the ATO (see paragraph 46(2))
	4. documentation evidencing the pricing and terms by which that saleable mineral commodity was sold by a related party to an unrelated party.

# MRA publications

1. 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.



Michael Butler

Secretary

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