Determination of Coal Royalty

MIN 140

Queensland Government

Version history

Version	Date	Comments
1	04 December 2001	Endorsed
1.1	27 October 2005	Conversion Project - New Word XML
2	20 June 2007	Replaces Version 1 – Updated to reflect changes to the *Mineral Resources Regulation*.
3	13 July 2008	Replaces Version 2 – Updated to reflect changes to the *Mineral Resources Regulation*. This policy is effective from 1 July 2008.
4	9 September 2012	Replaces Version 3 – Updated to reflect legislative references in the *Mineral Resources Regulation*. This policy is effective from 1 July 2012.
5	13 November 2012	Replaces Version 4 – Updated to reflect legislative changes to the *Mineral Resources Regulation*. This policy is effective from the date of approval.

Purpose | Scope

The purpose of this policy is to provide clarification of the determination of both royalty rate and the value of coal for royalty purposes.

This policy summarises the key components which comprise the calculation of the value for coal on which coal royalty is applied. In particular, the policy expands further on section 42(1)(c)(iii) *Mineral Resources Regulation* 2003 (MRR) which provides for a deduction of "any other cost the Minister has decided, on reasonable grounds, is a type of cost that should be subtracted from the gross value."

Policy

Determination of Royalty Rate

Schedule 4, Part 2, section 3 MRR specifies that the royalty rate for a return period is determined by reference to the average price per tonne of the coal sold, disposed of or used in that period (average price, or AP), as follows:

- If the average price is $100 or less – the rate is 7% of the value of the coal.

- If the average price is more than $100 but not more than $150 – the rate, applied to the value of the coal, is the result of the following formula (rounded down to two decimal places and expressed as a percentage):

$$7 + \left(\frac{(AP - 100)}{AP} \times 5.5\right)$$

- If the average price is more than $150 – the rate, applied to the value of the coal, is the result of the following formula (rounded down to two decimal places and expressed as a percentage):

$$7 + \left(\frac{(AP - 100)}{AP} \times 5.5\right) + \left(\frac{(AP - 150)}{AP} \times 2.5\right)$$

Expressed differently, the rates to be applied to the value of the coal sold, disposed of or used in a period are as follows:

Average price per tonne for period	Rate
Up to and including $100	7%
Over $100 and up to and including $150	First $100: 7% Balance: 12.5%
More than $150	First $100: 7% Next $50: 12.5% Balance: 15%

The following items are to be taken into account in the calculation of the average price for the quarter, determined in A$, which in turn determines the rate of royalty that will be applied to the value of coal as described below.

- the total revenue billed during the relevant quarter (except as noted below), translated into A$ at the rate of exchange at the bill of lading date less any associated ocean freight incurred during the quarter (net revenue billed). Unless a gross value royalty decision applies to particular coal, this should accord with the initial credit entries in the sales account and debit entries in the ocean freight account; and
- the total invoiced payable tonnes (after penalties) for the relevant quarter from which the revenue above was derived.

Where particular coal sold, disposed of or used during a period is the subject of a gross value royalty decision made under section 43F MRR (discussed below), the net revenue billed for that coal should be calculated by reference to the gross value of the coal under that decision rather than any revenue actually billed.

The average price is derived by dividing net revenue billed by the total invoiced payable tonnes. Exchange rate variations between the date of shipment and the date of receipt are ignored in the calculation of total revenue billed. However, such adjustments are factored into the calculation of the value of coal to which the royalty rate is applied.

The calculation of average price, and consequently royalty rate, is to be determined separately for coal consumed within Queensland and coal consumed outside Queensland.

<u>Example 1</u>

The net revenue billed during a quarter for coal consumed outside Queensland is A$123,500,000. Invoiced payable tonnes were 650,000 tonnes. No gross value royalty decision applies to any of the coal sold during the quarter. The average price is therefore A$190 per tonne. The royalty rate applied to the value of coal is therefore 10.13%:

Average price = A$123,500,000 ÷ 650,000 = A$190

Royalty rate $= 7 + \left(\frac{(190-100)}{190} \times 5.5\right) + \left(\frac{(190-150)}{190} \times 2.5\right)$

$= 7 + \left(\frac{90}{190} \times 5.5\right) + \left(\frac{40}{190} \times 2.5\right)$

$= 7 + 2.6053 + 0.5263$

= 10.13% (ie 10.1316 rounded down to two decimal places)

Value of Coal

Sections 42 to 43K MRR describe some of the items that are included in the calculation of coal and more generally for various minerals. The following items are specifically provided for:

- subject to the adjustments set out below, the gross value is the amount set out in the following table:

Scenario	Description	Gross Value
1	• Coal is sold or disposed of to, or used by, a related party. • The related party is involved in the marketing or reselling of the coal, or in the production of a commodity using the coal. For example: • Company A sells coal to Company B (a subsidiary of Company A), and Company B uses the coal to produce electricity in a power station. • Company A sells coal to Company B (a subsidiary of Company A), and Company B markets the coal to arms-length third parties.	The amount decided by the Minister in a gross value royalty decision
2	• Coal is sold or disposed of to, or used by, a person (whether related or not). • The seller receives a non-financial benefit from the sale, disposal or use (whether or not a financial benefit is also received). For example, Company A sells coal to Company B (an arms-length third party) in exchange for a cash payment and a transfer of some of Company B's port entitlements to Company A.	The amount decided by the Minister in a gross value royalty decision
3	• Scenarios 1 and 2 do not apply. • Coal is sold in an arms-length transaction to a non-related party. • The seller has sold coal in an arms-length transaction to a non-related party in the previous two years.	The amount for which the coal is sold
4	• Scenarios 1, 2 and 3 do not apply. • The seller entered into an agreement (before or as soon as practicable after	The amount for which the coal is sold

Scenario	Description	Gross Value
	the coal was mined) to sell the coal in an arms-length transaction to a non-related party.	
5	None of scenarios 1,2,3 or 4 apply.	The amount decided by the Minister in a gross value royalty decision

- the gross value shall also include, where applicable, an amount that represents a recovery of royalty from the customer;
- despatch income is to be added to the gross value;
- demurrage charges are deductible;
- marine costs, essentially ocean freight and insurance relating to the transport of coal by water to a port outside Queensland, are to be subtracted;
- exchange gains and losses between the time of sale and time of payment are to be added or subtracted; and
- other costs as reasonably determined by the Minister may be subtracted ("other costs").

Other Costs

Other costs that may be taken into account pursuant to section 42(1)(c)(iii) MRR in the determination of the value of coal include the following:

- margins (profit or loss) relating to intermine purchase/sale transactions;
- port operating costs which are paid by the producer of coal directly to operators of port facilities where the facilities are actually used by the producer of coal for the coal in respect of which the deduction is claimed. (For example, port access charges under take or pay contracts, harbour dues and coal loading charges.);
- port operating costs paid to another coal producer as reimbursal for expenses actually paid to a port operator when port entitlement is swapped or sold. Conversely, the amounts received for such costs by a coal producer are to be offset against any port operating costs claimed as deductions by that coal producer;
- assay costs that are incurred directly in relation to the sale of coal, for exampling train sampling and port stockpile sampling;
- allowance for port infrastructure where provided for by the coal producer on a non refundable capital contribution basis;
- coal research levy;
- COAL21 levy;

- Commonwealth levy for long service leave paid in respect of employees directly employed by the coal producer (excluding contractors);
- counter trade costs;
- bank commissions incurred in relation to the issuing of letters of credit for export shipments; and
- such other charges as may be determined reasonable by the Minister from time to time.

The following items shall not be taken into account in determining allowable costs:

- rail and road haulage costs and capital contributions;
- marketing costs and sales commissions, other than counter trade costs referred to above;
- premiums paid to other coal producers when acquiring port capacity entitlement are not deductible. ("Premiums" are costs paid to another coal producer above the cost that the other coal producer is liable to pay to the operator of the port facility.);
- coal royalty;
- amounts relating to the sale of coal that are deemed to be irrecoverable, ie. bad and doubtful debts;
- any gains or losses arising from currency hedging activities, and
- such other charges as may be determined as not being reasonable by the Minister from time to time.

All items comprising the value of coal are to be determined on a GST exclusive basis.

Other Factors in the Determination of Value

The gross value of coal shall exclude any amounts representing interest received where the coal is sold on an extended credit basis.

Where a gross value royalty decision is required, section 43G MRR sets out a non-exhaustive list of matters which the Minister may consider in making the decision. Applications for gross value royalty decisions must be made to the Minister and lodged at the office of the Under Treasurer (or such other place as gazetted from time to time).

Further information in relation to some of the above items is provided below.

Exchange Adjustments

In determination of the value of coal, differences attributed to exchange rate movements between the bill of lading date and the date of receipt are to be brought to account, that is, realised exchange gains and losses only.

Often the proceeds of sale are not translated into A$, but rather retained in a foreign currency account. In these circumstances, similar principles of assessable revenue determination apply.

However, the hedge settlement exchange rate applicable on the date of invoice payment should be used to translate the US$ into A$.

In relation to other items such as ocean freight, despatch income and demurrage charges, exchange gains and losses between the time of sale and time of payment are to be added or subtracted.

Intermine Transactions

It is not uncommon for coal companies to sell coal to one another for the purposes of blending etc. or fulfilling a particular contract.

Where such transactions take place it is the final value of the coal that is relevant for royalty purposes. Thus if company B earns a "margin" on the sale of coal originating from company A, such margin will be brought to account in company B's royalty return. Similarly, any small loss made on the final sale will reduce the revenue earned by company B for the period.

Where such transactions occur, the relevant companies should ensure that a definite agreement has been reached as to the method of accounting for the payment of royalty on the transaction so as to avoid any confusion in relation to liability.

<u>Example 2</u>

Mine A sells coal to Mine B for A$200 at the port. Mine B exports the coal to its customer overseas for a gross realised value of A$210. If Mine A records A$200 on its return and pays the royalty based on its calculated rate for the quarter, then Mine B should record A$210 as revenue and deduct the purchase price of A$200. Mine B will include the revenue of A$210 per tonne to determine the royalty rate for the quarter. In turn the calculation of the value of coal will include a deduction for the purchased coal at A$200 per tonne.

Capital Contributions & Capital Expenditure

Where companies have made non-refundable capital contributions for the building of port infrastructure the Queensland Treasury has determined an annuity formula for establishing a notional quarterly deduction as follows:

$$\mathrm{QCD} = 0.50 \times \mathrm{TCC} \times \frac{\mathrm{i}}{1 - ((1 + \mathrm{i}) - \mathrm{n})}$$

where QCD = quarterly capital deduction;

TCC = total capital contribution;

n = 20, representing 20 semi-annual periods; and

i = 0.04, representing 8% compounded semi-annually.

As *i* and *n* above are constant, it can be seen that the product equates to 0.03679088 x TCC. Thus if a company had contributed $10m for port facilities, the quarterly deduction that would be allowed for a period of 10 years is $367,909.

The above formula will also apply to the amortisation of capital expenditure items at ports where the total expenditure, or expected expenditure, exceeds $50,000. Where such expenditure is

less than $50,000 the expenditure may be written off (expensed) in the period in which it has been incurred.

Example 3

Mine C has a 30% interest in a port facility. In one quarter it contributes $21,000 and $6,000 respectively for 2 separate items of equipment at the port. As the grossed up cost of the first item is $70,000, Mine C must amortise its contribution of $21,000 and claim $773 per quarter over 10 years. However, the grossed up cost of the second item is $20,000, and accordingly the expenditure of $6,000 may be written off in the quarter in which it is incurred.

Counter Trade Costs

In order to expand sales into certain countries, some coal producers have been required to acquire produce of those countries as a form of barter arrangement in exchange. This arrangement is commonly termed "counter trade". An agent is normally utilised to sell the relevant product in order to generate proceeds for the coal company. The agent's commission in this case has been allowed as a deduction. However, other sales commissions and marketing type costs are not allowable.

Recoupment of Royalty

Some domestic coal contracts have provided for the recovery of Government charges and imposts in order that the mine's revenues are not disadvantaged in the event that certain costs beyond its control are increased during the term of the contract. Where this is the case the recoupment of royalty, being merely a form of additional revenue, in the same manner in which all revenues should allow for the recovery of costs and yield a profit, is to be included as assessable revenue.

In order that the correct amount of royalty is both recovered and paid, the simplest way of calculating the royalty to be paid is to multiply the value by $R/_{1-R}$, where *R* is the determined royalty rate.

Example 4

Mine D sells coal domestically in terms of a contract that allows for the recovery of State royalty. The current year's contract price for the coal is $23.50, and the mine delivers 1m tonnes, incurring allowable deductions of $250,000. The determined royalty rate in this example is 7%. If the royalty was calculated at 7% of $23,250,000, and the resultant royalty of $1,627,500 invoiced to the customer, the value of the coal for royalty purposes would be $24,877,500. Multiplying this by 7% would mean that the coal mine would not have recovered, or paid, the full royalty.

However, multiplying the $23,250,000 by 7/93 yields a royalty of $1,750,000 to be invoiced to the customer and paid to the State. It can be seen that adding these two figures gives a total value of coal for royalty purposes of $25,000,000 on which the royalty rate of 7% yields the correct royalty of $1,750,000.

Comprehensive Example

The following example illustrates how royalty would be calculated in a particular quarter based on various assumptions of revenues and costs.

Details	Export	Domestic	Comment
Average quarterly A$ per tonne	190.00	25.00	Net revenue billed divided by invoiced payable tonnes
Quarterly royalty rate	10.13%	7.00%	Rate determined by formula and rounded down to two decimal places
Invoiced payable tonnes	650,000	100,000	
Total revenue billed A$	121,500,000	2,500,000	
Ocean freight A$	2,000,000		
Net revenue billed	123,500,000	2,500,000	
Net exchange gain/(loss)	250,000		Realised gains and losses in the quarter
Net revenue	123,750,000	2,500,000	
Deductions			
Port costs	1,560,000		
Harbour dues	130,000		
Sampling and analysis	32,500	650	
Despatch	(250)		
Demurrage	750,000		
Coal purchases	3,000,000		
Coal research levy	292,500	45,000	
COAL21 levy	130,000	20,000	
Long service levy	136,500	21,000	
Total deductions	6,031,250	86,650	
Value of coal	117,718,750	2,413,350	
Royalty payable	11,924,909.38	168,934.50	
Total quarterly royalty payable	12,093,843.88		

Rights of Appeal

Persons aggrieved by an administrative decision made under an enactment may, within 28 days of notification of the decision, apply in writing to the decision-maker for a statement of reasons under Part 4 of the *Judicial Review Act 1991*.

Legislation

Mineral Resources Act 1989

Mineral Resources Regulation 2003

Approval

Approving Authority:	Treasurer and Minister for Trade
Date Approved:	13 November 2012