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Dr Sarah Rummery
Executive Director Revenue and Mineral Royalty Secretary
Territory Revenue Office
Level 14, Charles Darwin Centre
19 Smith Street
Darwin NT 0801

By email: royaltiesandassurance.dtf@nt.gov.au

Dear Dr Rummery,

Designing an ad valorum mineral royalty scheme for the Northern Territory

The Minerals Council of Australia – Northern Territory Division (MCA NT) welcomes the opportunity to provide a submission to the Territory Revenue Office on the Mineral Royalty Scheme Review Consultation Paper.

As the peak industry organisation representing Australia's exploration, mining and minerals processing industry, nationally and internationally, the MCA advocates policies and practices to deliver a safe, profitable, innovative, environmentally responsible industry that is attuned to community needs and expectations. MCA NT represents the interests of member companies operating, exploring and providing services to the minerals industry in the NT.

The NT's minerals sector contributed $367 million in royalty payments in 2022-23, this is just over a third of the NT's own source revenue.[1] The sector is also one of the Territory's largest long term job creators, directly employing approximately 3,500 people.[2]

The Minerals Development Taskforce (MDT) Final Report identified barriers currently limiting investment in the minerals sector and made a series of recommendations to ensure the NT can become a leading supplier of the minerals the world needs for the clean energy transition. The headline recommendation was the need to reform the current hybrid profits based and minimum royalty regime. The report noted that the current scheme places the NT at a competitive disadvantage and is detrimental to mineral project development relative to other jurisdictions in Australia and internationally.

The NT Government have accepted the MDT's recommendations in principle. The MCA NT also support these recommendations and welcome the opportunity to work collaboratively with the NT Government towards implementation. The MCA NT are looking forward to seeing a detailed implementation plan with prioritised specific actions and clearly defined timeframes.

[1] Northern Territory Government, *Northern Territory Government Budget 2023-34, Budget Paper No 2. Budget Strategy and Outlook*, Northern Territory Government, Darwin, 2023.
[2] Mineral Development Taskforce, *Mineral Development Taskforce Final Report*, Darwin, 2022, viewed 25 July 2023.

Importantly, the MDT found that:

- The effective headline royalty rate of 6.5% to 13.1% is the highest in Australia, aside from the draconian Queensland step rate royalty on coal
- Over 20% of pre-tax cashflows are paid in royalties compared to 10-12% in most other Australian regimes
- Projects with a relatively long project life will pay more in royalties once the deduction on capital assets is exhausted, typically after 10 years
- The NT regime captures a significant share of the upside value but maintains a minimum royalty when cashflow is weak
- Investors view the current system as complex, high risk and a deterrent to investment.

It should also be noted that the MDT found significant problems with the existing capability and capacity in government to administer the existing complex royalty regime. It recommended actions to address these concerns.

The consultation paper notes that the NT Government has accepted that the current royalty regime will be replaced with an ad valorem regime that is simple, competitive and incorporates modern and contemporary design features. The MCA NT supports that decision and is pleased to provide the following information regarding design features to assist the government.

Type of royalty rate

MCA NT provide the following comments in relation to the type of royalty and specifically in relation to questions one to five.

The MDT Final Report concluded that the current NT royalty regime results in high effective royalty rates that are uncompetitive and deter investment. To address this major defect, the royalty regimes in Western Australia (WA) and South Australia (SA) are considered, particularly because of proximity and therefore competition for investment.

The WA royalty regime has a fixed rate ad valorem royalty system with three tiers:

- Bulk materials (subject to limited treatment) – 7.5% of the royalty value
- Concentrate material (subject to substantial enrichment through a concentration plant) – 5% of the royalty value
- Metal – 2.5% of the royalty value.

The SA royalty regime also has a fixed rate system with four tiers:

- Mine ores and concentrates – 5.0% of the royalty value
- Refined mineral products – 3.5% of the royalty value
- Industrial mineral products – 3.5% of the royalty value
- Minerals for a prescribed purpose – 3.5% of the royalty value.

Both mineral royalty systems are simple and competitive regimes that have attracted significant levels of investment and mining related activity (technical services, contractors, professional firms and mining subject matters experts) whilst generating fair returns to the states. The models are simple and transparent with clear regulations and guidelines as to the minerals included in each tier.

The WA model is understood by mining companies and the WA State Tax administration and has been subject to review and improvement in recent years. In addition, the WA royalty regime has not been subject to material changes and thus has the added benefit of stability which provides certainty for mining companies to make large, long term investments. In this regard, it should be noted that the

NT Government has a history of making adverse legislative changes to the royalty regime and applying the changes to existing investments (refer the increase in the rate from 18% to 20% and the introduction of the flat rate minimum ad valorem royalty).

The SA model is a simplified version of the WA model that is also easily understood by mining companies and easily administered by the SA Government. In addition to the simplified four tier model, the SA Government developed a reduced royalty rate for new mines of 2.0% for a five year period, a discount of 50%. The royalty discount was a highly successful incentive in SA, converting known deposits into operating mines.[3,4] Importantly, the incentive attracted both long term mining projects as well as short term mining projects than otherwise would not have been commercially viable.

In our view, the NT Government cannot afford to implement a royalty regime that is materially adverse when benchmarked against WA or SA.

As acknowledged in the consultation paper, the WA system of having different royalty rates applied to different levels of processing could be seen as reducing the simplicity of the system. However, each mining operation typically remains within the same royalty rate for the entirety of its life and therefore any complexity is only relevant at the outset when determining the appropriate characterisation for the mining operation. Disputes on characterisation are also limited.

Having different royalty rates for the different degrees of processing also ensures a fair return for the State. In this system, higher royalty rates are applied to those commodities that require less processing and hence the underlying mineral in its natural state comprises a bigger proportion of the profit margins made by the mining company.

Additionally, the NT Government could consider a new and contemporary tier for mine rehabilitation and secondary processing of tailings. This is a relatively new practice that requires miners to enter legacy mine sites and undertake additional processing and manufacturing to convert mine waste into a saleable commodity, leaving the legacy mine in a rehabilitated state on completion. A reduced rate tier for this circular economy practice could incentivise this new industry in the NT with the additional bonus of reducing the legacy mine tailings held by the NT Government. The MCA NT regard a tier for secondary processing and remediation to be a modern and contemporary design feature aligned with the objective of the Territory's new royalty regime as noted in the consultation paper.

Royalty rate

MCA NT provide the following comments in relation to the royalty rate and specifically in relation to questions six to nine.

Determining the correct royalty rate should not be viewed in isolation, but considered holistically alongside the approach to deductions in addition to the value on which the royalty rate is to be applied. As noted above, to ensure the NT regime is competitive, we consider the WA and SA royalty rates as relevant benchmarks.

To reduce complexity for the royalty payer and the government, the MCA NT recommend that the royalty be applied to the realised sale price of the material/metal. In other words, the royalty value be determined based on the gross invoice value of the mineral less allowable deductions. This can avoid the need to determine via a netback or other means the value of the ore/metal at the point in time that it is extracted and improve the simplicity of the system.

Where the above approaches are adopted to improve the simplicity of the system, it should be recognised that the royalty base would be higher than in other models where either the product is valued as it leaves the production unit or additional deductions (such as marketing and refining costs) are allowed. As a result, the royalty rate should be lower than would otherwise be the case to ensure

[3] Geoscience Australia, *Australian Operating Mines Map 2022*, prepared by H Colclough and J Pheeney, GA, Canberra, 2022.
[4] Geoscience Australia, *Australian Operating Mines Map 2019*, prepared by A Hughes, GA, Canberra, 2020.

the overall royalty charge remains competitive. This is the approach adopted in WA in relation to the main commodity, iron ore.

The MCA NT also support the SA scheme with a competitive reduced royalty rate for new mines of 2.0% of the net value of minerals over a five year period to accelerate mining development in the state. As noted above, this approach has been highly successful in SA in converting known deposits into operating mines.

Deductions and thresholds

MCA NT provide the following comments in relation to deductions and thresholds and specifically in relation to questions 10 to 13. The current hybrid scheme accommodates for deductions for production costs and logistical costs. The consultation paper notes that an ad valorum scheme generally does not include deductions or may have minimal deductions.

The MDT Final Report noted that there is an infrastructure gap in the NT that results in high transportation costs. Arguably the single largest cost for bulk mining activity (including iron ore, manganese, copper) is logistics. Regional and remote mining projects often do not eventuate owing to these prohibitively expensive costs that can be 50% greater in NT compared with WA.

The MCA NT recommends that existing deductions for transportation must be maintained if the NT Government are committed to converting the pipeline of mineral projects from exploration to production. This approach is in line with allowable deductions (prescribed costs) in SA and WA.

Appropriate mineral quantity thresholds should be included in the royalty regime to exclude small scale mining operations from being subject to royalty.

Other matters

MCA NT provide the following comments in relation to questions 14 to 19.

The MDT Final Report provided five options for alternative arrangements based on a multi criteria analysis by ACIL Allen[2]. Although the taskforce did not provide a recommendation on the preferred arrangement, the top option was ad valorem with early holiday and repayment. The purpose of the early holiday being to reflect the importance of early free cash flow in mineral investment decision making economics. In this scheme, the first five years royalties are deferred but must be repaid in later years. The deferred royalties should be tracked and uplifted annually to reflect interest charges and be repaid over a set period after year five. Care needs to be taken in designing the repayment mechanism to ensure no adverse cash flow impact upon the project.

The MCA NT agree with the independent analysis and recommend the royalty holiday policy approach as the top modern and contemporary design feature aligned with the objective of the Territory's new royalty regime.

The second ranked option for a competitive ad valorem regime aligns with the SA model of a discounted rate of royalty being applied during the start-up phase of the mining project. As mentioned above, the MCA NT also supports a competitive reduced royalty rate for new mines of 2.0% over a five year period to accelerate mining development.

Although slightly more complex to administer, a graduating competitive ad valorum royalty rate over the early stages of operation could be beneficial. The period of duration could correspond with the initial project risk and capital payback for projects of this scale. For example:

- 25% of the full royalty rate during the initial 12 month period
- 50% of the full royalty rate during months 13-24
- 75% of the full royalty rate during months 25-36
- 100% of royalty rate thereafter.

The MCA NT also support a quantity based royalty regime for certain extractive mineral types as this is industry standard in most jurisdictions across Australia.

Grandfathering

The MDT Final Report noted widespread feedback outlining the significant problems with the existing hybrid minerals royalty regime and recommended reform through:

> Recommendation 2.a.1: Fundamentally reform the Territory royalty scheme- replace with an ad valorem scheme which is simple, competitive, delivers appropriate returns for non-renewable resources and delivers investment certainty.[2]

As the NT Government has accepted the recommendations in principle, the MCA NT question how the existing regime and new simple and competitive regime will apply to existing mining projects.

The MCA NT's view is that it is unacceptable to continue to apply the existing uncompetitive hybrid regime with its known defects alongside a new ad valorem system. Such an approach would only raise complexity, increase administrative burden to the Territory Revenue Office and ultimately would do nothing to encourage existing operators to continue to invest in existing operations or prevent early closure.

Any grandfathering of the existing profit-based system to existing operations will raise important questions and additional complexity (as well as areas of dispute) as to how a new royalty regime applies to new investment decisions associated with existing mining projects. For example, a decision to invest in a major mine expansion to extend a mine life should be encouraged and not suffer the existing royalty regime. Furthermore, a decision to establish a new greenfield mine project adjacent to an existing mine that utilises existing infrastructure should be encouraged and not suffer the existing royalty regime. These real-world investment decisions should be made based on the application of the new royalty regime.

For these reasons, and to ensure the new system is simple and competitive, the MCA NT strongly encourages the consideration of other options to the full grandfathering of the existing profits based system to existing projects. At a bare minimum the benefits of an ad valorem system to improving the administration and calculation simplicity should be equally applied to existing operations.

To ensure mine life of existing mines is maximised, and therefore continuing benefits are received by NT residents and communities, any grandfathering should include modifications that support mines staying open for longer. This may include rate reductions toward the end of mine life or bringing forward deductions for closure costs.

MCA NT would also encourage any differences between the treatment of existing and new operations to be phased out progressively over time to reduce the disincentive to extend mine life at existing operations.

Administration

MCA NT provide the following comments in relation to administration of the mineral royalty scheme and specifically in relation to questions 21 and 22.

The MDT recognised the significant administrative problems associated with the existing royalty regime. This related to the complexity of the calculation for the 20% profits based royalty and the drawn-out process associated with the Territory Revenue Office finalising the royalty return, paying refunds and providing certainty to royalty payers that the return is closed.

The basis on which the profit is calculated in the NT is highly restricted and allows substantially fewer deductions for operating costs incurred in mining and has complex capital allowance calculations, which involve maintaining a separate asset register to those already in existence for accounting and income tax purposes. The Territory Revenue Office has also tended to disallow costs clearly associated with mining operations, such as labour and travel costs as well as mining fees, levies and other charges payable to the NT Government and Land Councils. Under current rules only staff physically present in the NT can be included in operating costs and significant restrictions are placed on deductibility of FIFO worker costs, notwithstanding the inability of mining companies to source sufficient levels of local labour.

Further, legislative responses to limit deductions that the Court considered appropriate and referable to mining operations just add to the perception that the profit calculation is artificially biased towards revenue maximization rather than good policy. If the existing profits based royalty is to continue to apply to existing mines, then the following improvements to administration of the regime should include:

- Profit be calculated directly from company accounts applying commercial principles that allocate costs to operations
- Removal of the requirement for an independent audit of the royalty calculation as it creates a redundant additional cost, an additional level of compliance and is not required by other revenue authorities such as the Australian Taxation Office
- A clear and simple set of rules to determine the profit should be determined after consultation with the small number of existing mining companies. This will improve the existing regime and send a message that the NT is intent on being an attractive location to carry on business. It will also remove the risk of ongoing adverse changes to the method of

Frequency of returns and payments

MCA NT provide the following comments in relation to the frequency of returns and payments specifically in relation to questions 23 to 25.

The current NT regime has a six monthly royalty payment cycle. Most Australian jurisdictions have quarterly or monthly royalty payments.

The MCA NT supports a more frequent payment cycle for an ad valorum scheme to allow for simpler cashflow management and improve cash flow to the state. A quarterly royalty return aligns with other remittance schedules including private royalties and other tax obligations.

Finally, many members in the NT maintain a fiscal year end of 30 June. However, many multinational companies operate with a 31 December fiscal year. If possible, these variations should be accommodated or recognised. Ultimately, any changes to the frequency or administration of the NT mineral royalty scheme should be determined by the NT Government's ability to administer payments.

The MCA NT is available to further discuss the development of this policy at any time. Should you need further information please do not hesitate to contact either myself on 08 8981 4486, or Amber Jarrett, Principal Policy Adviser MCA NT on 0424886662 and Amber.Jarrett@minerals.org.au.

Yours sincerely

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