

# Mineral royalty rate analysis stakeholder consultation paper

## What is a royalty?

A royalty is a payment made to the Government to compensate for the extraction of a resource owned by the community.<sup>1</sup>

In Western Australia, all minerals in their natural form located within Crown Land are owned by the State Government, which holds the minerals on behalf of the community. When a project owner gains title to these resources, the State Government requires it to make a royalty payment to compensate the community for the loss of its asset. A Royalty is therefore a purchase price, not a tax. To the project owner, the royalty is a cost of production.

Royalties are paid by the holder of a mining tenement. This may be an exploration license, mining lease or prospecting license.

## Who collects royalty?

In Western Australia, the Crown owns most minerals and producers must pay royalties for their extraction. This applies throughout the State, except where private freehold land was alienated before 1899. At that stage, freehold title included rights to subsurface minerals. The definition of minerals in the Mining Act 1978 also excludes certain resources obtained from the land by private landowners. These are limestone, rock, gravel, shale (other than oil shale), sand (other than mineral sands, silica sand or garnet sand), clay (other than kaolin, bentonite, attapulgite, or montmorillonite).

## Royalty system design

These core principles should guide the design of an effective royalty system:

- **Equity:** the royalty system should return fair and appropriate compensation to the community for the loss of its resources, and treat producers equitably so that similar projects are required to make similar royalty payments.
- **Efficiency:** the royalty system should not reduce the productive capacity of the economy, or unduly deter or distort employment and investment decisions.
- **Adequacy:** the royalty system should return sufficient revenue to support Government spending on services and investment.
- **Stability and predictability:** the royalty system should provide stable and predictable revenue to allow Government to plan and deliver services sustainably, and to provide proponents with a stable and competitive royalty framework when planning projects.
- **Transparency and simplicity:** the royalty system should be simple for Government to administer, and for proponents to comply with, and understand.

<sup>1</sup> A glossary of terms is included at the back of the discussion paper

## The Western Australian royalties system

Royalties levied under the *Mining Act 1904* and *Mining Act 1978*, as well as under State Agreements, have generally been levied as a specific rate (rate per tonne of production) or through *ad valorem* systems (a percentage of the resource's value).

In 1981, the Western Australian Government completed a detailed review of mineral royalties, and adopted the following principles and rates reflected in current royalties.

1. The basis for determining royalties is to return approximately 10 per cent of the mine-head value of the ore. The mine-head value is the value of the ore at the first point at which the ore could be stockpiled once extracted from the mine, and excludes generally transport or processing costs.
2. Royalties are applied to the minerals in their first saleable form, whether as a bulk material subjected to limited treatment, mineral concentrate, highly processed or finished form.
3. The following three-tier royalty rates apply to the various stages of processing:
  - a. Bulk materials (crushed and screened), 7.5 per cent of free-on-board value, i.e. the value on a ship for export.
  - b. Mineral concentrates, 5 per cent of the value.
  - c. Metallic form, 2.5 per cent of the value.
4. Royalties apply to each material across an industry rather than on a mine-by-mine basis.

Many royalties are set under Agreement Acts negotiated between proponents and Government. Over the years, these have included a variety of different royalty rates. Agreement Acts are varied with the agreement of all parties to the Agreement Act.

The benchmark of 10 per cent of the mine-head value of minerals is similar to petroleum royalties, where a royalty of 10 per cent of the well-head value applies generally in Western Australia.

Petroleum royalties reflect the well-head value of the resource and are calculated as a percentage of the true well-head value. Alternatively, mineral royalties, set under the Mining Act Regulations, are subject to the fixed three-tier *ad valorem* royalty system. The *ad valorem* royalty system uses a percentage of the mineral sale value; and the full cost deductions to calculate a true mine-head value are not considered. Because of this, the actual royalty receipts can differ substantially from the notional 10 per cent mine-head. Although actual royalty rates can differ from the notional 10 per cent benchmark, it delivers a more predictable and stable revenue stream than one in which rates are adjusted frequently.

Very few mines sell raw ore at the mine-head, but the mine-head value of the raw ore can, in principle, be calculated at any point along the downstream process by deducting the costs of processing and transporting the mineral from the mineral sales value.

## Western Australia's royalty legislation

Mineral royalty rates are applied through three separate legislative mechanisms – the *Mining Act 1978 (and Mining Regulations 1981)*, in State Agreements that refer to the rates in the *Mining Act 1978 (and Mining Regulations 1981)*, or in State Agreements with specified royalty rates.

In 2011-12:

- 77 per cent of royalties were collected through rates specified in State Agreements (primarily iron ore royalties).
- 9 per cent of royalties were collected in accordance with reference to the *Mining Act 1978* rates referred to in State Agreements.
- 14 per cent of royalties were collected in accordance with the *Mining Act 1978*.

2011-12 \$ Million	Mining Act	State Agreements referring to Mining Act rates	State Agreement Act rates
Iron Ore	\$234.3	\$324.1	\$3,128.7
ALR (Iron Ore)	\$0.7		\$59.0
Gold	\$230.1		
Alumina			\$66.2
Nickel	\$70.8	\$20.2	
Base Metals (Copper, Lead, Zinc)	\$40.8	\$17.4	
Mineral Sands	\$6.4	\$17.0	
Diamonds	\$5.4		\$11.2

A table of royalty rates is provided in Attachment 1.

## Western Australia's royalty systems

### 1. Rate Per Tonne (Specific Rate Royalty)

The fixed rate system applies generally to low value, bulk minerals. The royalty is calculated by applying a rate to each tonne produced. In Western Australia, two rates apply currently: 62 cents and \$1.00 per tonne.

### 2. Percentage of Sale Value (ad valorem royalty)

An ad valorem royalty applies to major mining projects in Western Australia. Royalty rates reflect varying levels of processing costs incurred post-mine-head - a rate of 7.5 per cent applies to bulk material, 5 per cent for mineral concentrates and 2.5 per cent for minerals in metallic form. This approximates roughly the 10 per cent mine-head value benchmark.

The nickel royalty is calculated as a percentage of the contained metal value. The gold royalty is based on the total amount of gold produced during a month multiplied by the average of gold spot prices for that month.

### 3. Percentage of Mine head Value or Well-head Value (Netback royalty)

This royalty is calculated by applying a percentage to the value of the resources when they are first extracted from the ground. It is based on the net value after deducting costs incurred by the project owner between the mine-head or well-head and the point of sale.

This royalty system applies currently to petroleum (both oil and gas) produced onshore and in offshore areas within the State's jurisdiction, based on the value of petroleum at the well head.

## Royalties and the Commonwealth Grants Commission

The Commonwealth Grants Commission process distributes Goods and Services Tax (GST) revenue among the States according to the principle of horizontal fiscal equalisation, defined as follows:

"State governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standards."<sup>2</sup>

The Commission takes into account States' relative costs of providing services and relative capacity to raise revenues. There has been a long-term decline in Western Australia's grant share reflecting the growth in the State's royalty revenues.

For more information about the Commonwealth Grants Commission and the State's share of GST revenue see <http://www.treasury.wa.gov.au/cms/content.aspx?id=3654>

## Royalties elsewhere

The resource industry varies across the Australian States and the Northern Territory in its size and make-up. Each jurisdiction developed its royalty arrangements independently, so there is no common royalty regime. A mix of specific, *ad valorem*, hybrid *ad valorem* and profit based royalties applies.

Internationally, a wide range of mining taxes and mining revenue raising measures apply in countries producing minerals.

Mining revenues include not only royalties, but also export licences, withholding taxes, dividend payments to Government, sales and consumption taxes, import duties, provincial royalties and private landowner royalties.

Some arrangements are intended to attract investment and offer concessions and rebates to developing mines. Others are designed to extract a maximum of revenue without impeding investment. Most mining jurisdictions use a combination of specific rate and ad valorem royalty systems, but some countries are moving towards hybrid ad valorem or profit based systems.

Many other minerals-producing jurisdictions, both overseas and interstate, have reviewed their royalty systems in recent years. Some of these evaluated the efficacy of royalty frameworks under a range of commodity market conditions.

<sup>2</sup> Commonwealth Grants Commission, *Report on State Revenue Sharing Relativities 2002 Update*, p. 5.

## Suggested issues for consideration by stakeholders

Stakeholders are invited to comment on the Terms of Reference and issues raised in this paper, including:

- Is the current royalties system, based on 10 per cent of the mine-head value, effective and appropriate, and consistent with system design principles such as adequacy and equity over a range of commodity market conditions?
- If not, how can the system be improved, bearing in mind the Government's stated objective of maintaining an *ad valorem* royalty system?
- Are there any anomalies in the current system that should be addressed?
- Is the current application of the three-tier royalty rate system equitable between producers and across a broad range of mineral commodities?

### Glossary of Terms

**Ad valorem:** Latin for "based on value". *Ad valorem* royalties apply as a percentage of the value of the mineral.

**Commonwealth Grants Commission:** An independent statutory authority that recommends how to allocate general revenue assistance between the States and Territories. The commission presents recommendations to the Australian Government.

**Free-on-board:** The value of the mineral when placed on the ship for export at the company's wharf.

**Mine-head value:** The value of the ore at the first point at which the ore could be stockpiled once extracted from the mine.

**Netback royalty:** A royalty calculated as a percentage of a value derived by deducting from the sale value of the resource, the costs incurred between the point of sale, and a point earlier in the process.

**Royalty:** A payment made to the owner of a resource to compensate for the extraction of the resource.

**State Agreement:** A a contract between the Government of Western Australia and a proponent of a major resources project, ratified by an Act of the State Parliament. These agreements specify the rights, obligations, terms and conditions for development of the project and establish a framework for ongoing relations and cooperation between the State and the project proponent.

**Well-head value:** The value of petroleum at the first point of extraction from the ground.

## Western Australian royalties rates

(Please refer to the relevant legislation for actual royalty rates and arrangements)

### MINING REGULATIONS 1981/AGREEMENT ACTS

Royalty Rate	Royalty System	Commodities
\$0.62 per tonne	Specific Rate	Limestone-Lime Earth <sup>8</sup> , Salt, Clay, Dolomite, Gypsum, Construction Materials
\$1.00 per tonne	Specific Rate	Silica, Limestone-Lime Earth <sup>9</sup> , Talc
\$1.50 per tonne	Specific Rate	limenite <sup>1</sup>
2.50%	Ad valorem	Gold <sup>5</sup> , Silver, Copper <sup>7</sup> , Lead <sup>7</sup> , Zinc <sup>7</sup> , Nickel, Tin, Cobalt <sup>7</sup> , Platinoids
5%	Ad valorem	Copper <sup>6</sup> , Lead <sup>6</sup> , Zinc <sup>6</sup> , Mineral Sands, limenite <sup>2</sup> , Kaolin, Magnetite, Chromite, Cobalt <sup>6</sup> , Manganese Ore <sup>10</sup> , Spodumene, Tantalum, Uranium Oxide
7.50%	Ad valorem	Export Coal, Bauxite, Gemstone, Iron Ore-Iron Stone, Manganese Ore, Diamonds
10%	Ad valorem	(Crude oil petroleum, condensate, LPG & LNG ) <sup>3</sup>
12.50%	Ad valorem	(Crude oil petroleum, condensate, LPG & LNG ) <sup>4</sup>
Any other mineral not specifically listed in the Mining Regulations Table -if sold as crushed or screened material, 7.5% of the royalty value or if sold as a concentrate, 5% of the royalty value	Ad valorem	

#### Note

- 1 Feedstock that is not of a marketable quality
- 2 Feedstock that is of a marketable quality
- 3 Primary production licences
- 4 Secondary production licences
- 5 First 2,500 oz are exempt from royalty.

- 6 if sold as a concentrate
- 7 if sold in metallic form
- 8 Used for agricultural or construction purposes
- 9 Used for metallurgical purposes
- 10 benefited by the producer in Western Australia

## Other agreement acts

Royalty Rate	Royalty System	Commodity	Agreement Act Title
1.65%	Specific Rate	Alumina	<i>Alumina Refinery Agreement Act 1961</i>
5%	Specific Rate	Diamonds	<i>Diamond (Argyle Diamond Mines Joint Venture) Agreement Act 1981</i>
Esc \$1.90/tonne	Specific Rate	Coal	<i>Collie Coal (Griffin) Agreement Act 1979 Collie Coal (Western Collieries) Agreement Act 1979</i>

## Salt - specific rates

Tonnes	Rate/Tonne	Commodity	Agreement Act Title
1-508,024	\$0.144430	Dampier Salt (Dampier)	<i>Dampier Solar Salt Industry Agreement Act 1967</i>
508,025-1,000,000	\$0.180530		
1,016,048 & over	\$0.216640		
Tonnes	Rate/Tonnes	Dampier Salt (Lake MacLeod)	<i>Evaporites (Lake MacLeod) Agreement Act 1967</i>
1-508,024	\$0.389030		
508,025-1,000,000	\$0.486290		
1,016,048 & over	\$0.583550		
Tonnes	Rate/Tonnes	Dampier Salt (Port Hedland)	<i>Leslie Solar Salt Industry Agreement Act 1966</i>
1-508,024	\$0.254703		
508,025-1,000,000	\$0.318379		
1,016,048 & over	\$0.382055		
Tonnes	Rate/Tonnes	Onslow Salt	<i>Onslow Solar Salt Agreement Act 1992</i>
1-500,000	\$0.317978		
500,001-1,000,000	\$0.397472		
1,000,001 & over	\$0.476967		
Tonnes	Rate/Tonnes	Shark Bay Salt	<i>Shark Bay Solar Salt Industry Agreement Act 1983</i>
1-500,000	\$0.339150		
500,001-1,000,000	\$0.423940		
1,000,001 & over	\$0.508730		

## Submission process

Submissions will be accepted until 31 October 2013 and can be emailed, or mailed to:

Nicky Cusworth  
Deputy Director General Strategic Policy  
Department of State Development  
1 Adelaide Terrace  
East Perth WA 6004

royalties@dsd.wa.gov.au

Enquiries can be directed to the Director: State Development Policy  
(Department of State Development) at (08) 9222 0555, or to the email above.

For more information visit [www.dsd.wa.gov.au/royaltyrates](http://www.dsd.wa.gov.au/royaltyrates)