

# Mineral Royalty Act: Royalty Guideline – RG-MRA-006: Capital Recognition Deduction

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## Purpose

1. This Guideline explains how capital recognition deduction (CRD) is to be determined for the purpose of calculating net value under the Mineral Royalty Act 1982 (NT) (the MRA).
2. This Guideline is issued by the Secretary under section 4E of the MRA.

## Introduction

3. 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.
4. Under section 10(2), 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.
5. Based on this formula the net value of production in a royalty year is established by deducting all allowable deductions (including CRD) from a production unit's gross realisation in that royalty year.
6. CRD gives full recognition to all capital assets that are eligible capital assets expenditure (ECAE) and replaces the 1982 regime which allowed for depreciation of assets over a maximum of 15 years and full interest deductibility.
7. Under the CRD scheme, interest (2 per cent above the 10 year bond rate for Australian Federal Government securities) is built into the CRD calculation. The interest component has application to all royalty payers, irrespective of the particular structure of financing they enter into in relation to capital expenditure.
8. As a consequence, actual depreciation/amortisation and interest expenses incurred by a royalty payer in a royalty year are not deductible as ECAE or as an operating cost.

## What is CRD

9. CRD is the fraction of the value of each item representing an amount of ECAE and used on the production unit, for the purposes of the operations of the production unit, during the whole or part of each six month period of a royalty year.

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10. The amount of CRD able to be deducted each six months is calculated by:
- (1) allocating all items of ECAE (defined in paragraphs 11 to 19) on the basis of the period of years over which CRD can be claimed, in accordance with the capital deduction life schedule set out in paragraphs 37 and 38
  - (2) utilising the CRD factors announced by the Secretary (refer to paragraphs 45 to 51)
  - (3) multiplying the principal sum (refer to paragraphs 31 to 34) of each item of ECAE by the appropriate CRD factor (depending on the period of years over which CRD can be claimed) in (2).

The above calculation is best illustrated by way of example:

### Example 1

Assume an item of ECAE has a principal sum of \$100 000. The CRD for the period from 1 July 2017 to 31 December 2017 for this item is calculated by:

- (1) allocating the item of ECAE on the basis of the period of years over which CRD can be claimed in accordance with the capital deduction life schedule = *three years*
- (2) using the three year CRD factor announced by the Secretary for the relevant six month period from 1 July 2017 to 31 December 2017 = *0.18048*
- (3) multiplying the principal sum by the CRD factor =  $\$100\,000 \times 0.18048$ .

The CRD for the item of ECAE for the six month period is \$18 048.

## What is ECAE

11. ECAE is an amount expended which was absolutely necessary for the setting up and operation of the production unit (refer to paragraphs 28 to 30), in respect of:
- (1) feasibility studies
  - (2) studies and investigations required by a law in force in the Territory
  - (3) site clearing and overburden removal activities up to the date of the commencement of the active operation of the production unit
  - (4) mine design and shaft sinking and tunnelling
  - (5) design, acquisition, installation and construction of facilities essential to the operation of the production unit:
    - i. mining plant
    - ii. treatment plant necessary for the production of a saleable mineral commodity
    - iii. storage facilities
    - iv. structures
    - v. electricity generation and reticulation
    - vi. water storage and reticulation
    - vii. communication facilities
    - viii. transport facilities
    - ix. town and accommodation facilities
    - x. other facilities absolutely necessary for the production of a saleable mineral commodity

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- (6) amounts required by Northern Territory or Commonwealth legislation to be expended in negotiation with landowners prior to the operation of the production unit (for example, pursuant to native title, land rights or sacred sites legislation). It is restricted to negotiation costs and does not cover compensation payments.
12. Repair and maintenance work to an eligible capital asset used in the production of a saleable mineral commodity is often classified as an operating cost for royalty purposes. However, a capital improvement may be made to an asset. When this occurs, the capital improvement may constitute a new item of ECAE.
13. A capital improvement is something that substantially and permanently enhances the value of the asset. It is not work that merely rectifies defects or is undertaken in anticipation of forthcoming defects (preventative repairs and maintenance). Similarly, it does not include work undertaken to keep the asset in a suitable condition to allow it to serve the purpose for which it exists.

### Example 1

If a bulldozer that a miner is claiming CRD for has damaged hydraulics replaced, this is classified as repair and maintenance and is deductible as an operating cost. However, if the same bulldozer has its engine and transmission that were in good working order replaced with a new engine and transmission that are substantially more powerful, for the purpose of increasing the amount of work the bulldozer was able to perform, this is a capital improvement and deductible as ECAE. A separate CRD life, based on the depreciation period allowed for income tax purposes, is allocated to this item of ECAE.

14. In addition to the above forms of expenditure, the MRA deems certain forms of social infrastructure and resident workers accommodation to be ECAE.

### Eligible social infrastructure expenditure

15. Eligible social infrastructure expenditure is an amount expended in respect of design, installation or construction of a building or other physical structure in the Territory that provides social or economic benefits to a community directly affected by a production unit.
16. Although expenditure for eligible social infrastructure (as outlined in paragraph 15) is subject to a capital recognition deduction, ongoing repair and maintenance costs for such infrastructure are not eligible for either a capital recognition or operating cost deduction under the MRA.

### Example 1

A miner has built a recreation centre in a Territory community close to the production unit to provide increased amenities for workers and residents of the community. The construction cost of the recreation centre, including its design, is eligible social infrastructure expenditure and taken under section 4AB(3) of the MRA to be ECAE.

### Capital Expenditure for resident worker accommodation

17. Capital expenditure for resident worker accommodation is an amount expended in respect of design, installation, acquisition or construction of accommodation in the Territory, whether on or outside the boundaries of the production unit. To be eligible, the expenditure must relate to accommodation for employees, contractors and other workers who work in the Territory and whose principal place of residence is in the Territory.

## **Expenditure excluded as ECAE**

18. The recording of an amount as a capital item in the accounts of the production unit is not conclusive evidence that the item is an item of ECAE for the purposes of the MRA. The following are examples of expenditure not considered to be ECAE, including:
  - (1) subject to paragraph 11(6), amounts expended in negotiation with landowners prior to the operation of the production unit
  - (2) tenement acquisition costs (refer to paragraphs 55 to 57)
  - (3) any expenditure in relation to an activity in the nature of exploration.
19. In addition, certain expenditure is expressly excluded as being eligible social infrastructure expenditure and resident worker accommodation in the MRA. This includes compensation to landholders for use and disturbance of the land. The costs of negotiating with land holders are also expressly excluded unless the amounts are required to be expended in accordance with a law in force in the Territory.

### **Example 1**

A miner has an access agreement in place with landowners that includes a compensation package comprising both cash payments and a commitment by the miner to construct a swimming pool for use by members of the local community. Design and construction costs of the swimming pool form part of the compensation payment. Consequently, the design and construction costs do not constitute eligible social infrastructure expenditure.

## **ECAE eligibility criteria**

20. An item of ECAE must be used on the production unit and be absolutely necessary to the setting up and operation of the production unit in the Territory. Where an item of ECAE is not used during the whole or part of a six month period, the CRD should be proportionately reduced.
21. “Use” means use normal to the kind of asset in question, which depends on the nature and character of the ECAE. Normal use does not cease because the asset is out of action at times and for reasons incidental to ownership and normal use. However, a royalty payer who deliberately chooses not to use an asset cannot be said to be using it.
22. In relation to eligible social infrastructure expenditure that provides social or economic benefits to a community in the Territory directly affected by a production unit, the expenditure is taken to be used in relation to the operation of a production unit.
23. Capital expenditure for resident worker accommodation must be provided for use by employees, contractors and other workers who work in the Territory in respect of the production unit and whose principal place of residence is in the Territory. Generally, a break in residence as part of normal business operations (for example, vacancy due to workers being on leave) will not affect the CRD, provided that the accommodation is not used for a purpose other than for the use by employees, contractors and other workers of the production unit whose principal place of residence is in the Territory.
24. If a production unit is temporarily shut down due to cessation or suspension of mining operations, this may affect the CRD for the ECAE. However, if a production unit is shut down to allow a royalty payer to carry out periodic maintenance, or as a result of a natural disaster, the temporary break in the operation would generally not affect the CRD for the relevant items of ECAE because the Secretary would consider that there has been a continuous use of these assets.
25. If an item of ECAE is not used solely for the operations of the production unit, CRD should be apportioned accordingly. For example, if a vehicle is used between the

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production unit and an exploration licence outside the production unit, CRD can only be claimed for the portion of vehicle costs associated with the operations of the production unit to which the royalty return relates. Appropriate records must be maintained to substantiate the apportionment.

26. There is no requirement that an asset be owned by the royalty payer. CRD may be applied to an asset to which the royalty payer has an immediate right of use under a finance lease, or other arrangement where the title is retained by the lessor and may not eventually be transferred to the royalty payer.
27. Equipment provided and used by a contractor to provide services to the royalty payer would not be eligible for CRD. Payment for services provided by the contractor would include costs associated with the equipment which may be claimable as Operating Costs if they meet the eligibility criteria. Guideline [RG-MRA-005](#): Operating Costs provides further information.

### What is a production unit

28. An eligible capital asset must form part of a production unit or be used on the production unit for a relevant or requisite purpose. The term “production unit” means either a mining tenement, or two or more mining tenements being operated as part of an integrated operation, together with any facilities in the Territory that are absolutely necessary for the production of a saleable mineral commodity from the mining tenement(s).
29. A facility only forms part of the production unit if two requirements are satisfied:
  - (1) the facility is situated within the Territory
  - (2) the facility is absolutely necessary for the production of a saleable mineral commodity from minerals obtained from that production unit.
30. Guideline RG-MRA-002: Production Unit provides further information on the key concept of a production unit.

### What is the value of an item of ECAE

31. Subject to paragraph 32, the value of an item of ECAE, called the principal sum, is generally the acquisition cost of the item (irrespective of whether the asset is new or used) where acquired under an arm’s length transaction. Where an asset is transferred within a group of companies, the written down value (derived from an arm’s length value less accumulated depreciation) may be used to value the asset for CRD purposes.
32. Where the item of ECAE was not purchased at arm’s length, the market value should be used.
33. In line with generally accepted accounting principles, the principal sum may include:<sup>1</sup>
  - (1) purchase price
  - (2) construction cost
  - (3) import duties
  - (4) non-refundable purchase taxes (including stamp duty)
  - (5) delivery and handling costs
  - (6) site preparation costs

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<sup>1</sup> See Accounting Standard AASB 116 (or successor Accounting Standard).

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- (7) installation and assembly costs.
34. The principal sum of an asset does not include any subsequent costs incurred on maintenance, repairs or consumables as these costs are generally considered to be operating costs and are treated as such under the MRA.

### Revaluation of an asset

35. The assets of a production unit may be subject to revaluation which can result in either an increase or decrease of the asset's value. For CRD purposes, the value of an item of ECAE (the principal sum) is not affected by revaluation (whether upward or downward).
36. Once the principal sum of an item of ECAE is determined and CRD claimed, the same principal sum continues for the duration of the allocated CRD life notwithstanding any revaluations.

### Capital deduction life schedule

37. Under section 4C(5) of the MRA, CRD may be claimed over a period of 3, 5 or 10 years depending on the period over which depreciation for the particular expenditure is allowed for income tax purposes.
38. The table below sets out the period over which a capital recognition deduction may be claimed for items representing ECAE.

Period over which depreciation allowed for income tax purposes	Corresponding period allowed for purposes of capital recognition deduction (CRD life)
4 years or less	3 years
Over 4 years but less than 10 years	5 years
10 years and over and all other assets	10 years

### Special arrangements for certain eligible capital assets

39. Under section 4C(7) of the MRA, the Secretary may make special arrangements for the treatment of items representing ECAE. The discretion is designed to deal with assets that are non-depreciating for income tax purposes.
40. Where an item of ECAE is non-depreciating for income tax purposes, it is categorised as having a 10-year CRD life on the basis that it falls into the "all other assets" category.
41. In some cases, the application of a 10-year CRD life may not produce a fair and equitable outcome. For example, the life of mine is substantially less than 10 years and the miner has no ability to recover any of the unclaimed portion of the expenditure.
42. Section 4C(7) permits the Secretary to determine a more reasonable period over which CRD can be made for non-depreciating assets where this is justified. In general, the Secretary will consider the period over which these assets are claimed for income tax purposes in determining a corresponding CRD period.
43. For a special arrangement to be considered, a royalty payer must submit a written application, detailing a statement of reasons together with supporting information which substantiates the claim.
44. As a general rule, the following factors may be considered for a special arrangement:

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- (1) the nature and character of the asset
- (2) the income tax treatment of the asset
- (3) the residual value at the end of the mine life
- (4) transferability of the asset (for example, whether it can be sold separately from the production unit)
- (5) the life of the mine
- (6) the treatment of other comparable assets
- (7) whether the asset has previously been claimed for royalty purposes
- (8) any other relevant information.

### CRD factors

45. CRD is a fraction of the value of each item representing an amount of ECAE actually used on the production unit, for the purposes of operations of the production unit, during the whole or part of the six-month period of a royalty year.
46. The fraction, known as the CRD factor, is published or announced from time to time by the Secretary, and applies retrospectively for the period specified in the announcement (being six months before the announcement).
47. The CRD factor is determined by the Secretary converting the principal sum (refer to paragraph 10) into a series of semi-annual annuities at an assumed rate of interest.
48. Each item of ECAE is to be allocated a period of years over which the CRD will be allowable (refer to paragraphs 37 and 38).
49. CRD in respect of each item of ECAE is an allowable deduction for a period not exceeding the period allowed for it, whether that period is a period of uninterrupted use or the sum of fractional periods of use.
50. The announcement of the factors to be used in calculating CRD and the period during which the factors will apply is generally made soon after the end of each 6 month period to allow royalty payers sufficient time to determine their royalty liabilities. Where the Secretary does not make an announcement within 12 months of the most recent announcement, the latest factors announced will apply until the Secretary announces new factors.
51. The Secretary has announced and issued the CRD factors to be used in calculating CRD and the period during which the factors will apply, in the form of a Guideline (see [RG-MRA-007](#): CRD Factors).

## Calculation of CRD

52. The calculation of CRD is best illustrated by way of example.

ABC Mining Pty Ltd (ABC) operates a production unit within the Territory. ABC elects to prepare its royalty returns on an accrual basis and its royalty year commences on 1 January each year. ABC needs a water tank for its production unit and purchases a suitable tank at arm's length for \$100 000 on 1 July 2017. The delivery and installation costs for the water tank are \$20 000. On 1 July 2017, \$120 000 (the principal sum) is brought to ABC's account. The water tank has an effective depreciation life of 25 years and is being depreciated at 4 per cent prime cost method, for income tax purposes. The water tank is put into use on the production unit on 1 September 2017.

As the water tank is an item of ECAE, the CRD that may be claimed by ABC is calculated as follows.

For the 6-month royalty period 1 January 2017 to 30 June 2017, no CRD may be claimed as the water tank was not used on the production unit.

For the 6-month royalty period 1 July 2017 to 31 December 2017, a CRD may be claimed for the period 1 September 2017 to 31 December 2017 (122 out of a possible 184 days of actual usage on the production unit for the period). Because the water tank is depreciated over 25 years for income tax purposes, the corresponding CRD life is 10 years (refer to paragraphs 37 and 38). The 10 year CRD factor announced by the Secretary for this period is 0.06308 (refer to paragraphs 45 to 51 and [RG-MRA-007](#): CRD Factors).

The allowable CRD for the period is calculated by multiplying the principal sum by the CRD factor by the proportion of days in the period that the item was in use:

$$\$120\,000 \times 0.06308 \times 122/184 = \$5\,018.97$$

## Rule against double deductions

53. Where an amount expended in respect of a production unit is capable of falling under more than one deduction category or being reflected in the financial accounts of the production unit in more than one form (for example, certain capitalised expenditure could be an operating cost or qualify for a CRD), the royalty payer must classify the expenditure under the most appropriate category, as only one deduction is allowed, whether in the same royalty year or over a different royalty year.
54. Any expenditure relating to activities in the nature of mine development (where the expenditure is more appropriately to be treated as ECAE) should be claimed as a CRD.

## Sale or transfer of a production unit

55. When a production unit together with the eligible capital assets is sold or transferred to a new miner or a new royalty payer, the cost of acquiring the mining tenement or production unit is not deductible for royalty purposes either as operating costs or as ECAE. However, when a production unit is sold or transferred and the purchaser continues to operate the production unit as a going concern, any CRD in relation to ECAE for that production unit continues in the same manner and to the same extent as if the production unit or ECAE had not been sold or transferred.
56. For example, if an asset with two years remaining CRD life is transferred with the production unit to a new owner, the new owner is only entitled to claim CRD on the asset for the remaining two years of CRD life, based on the same value that applied to the previous deductions for the asset, irrespective of the actual consideration (if any) paid for the asset. The new owner cannot commence a new CRD life for the asset.



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57. If eligible capital assets are sold or transferred independently from the production unit, the new owner of the second hand assets is able to commence a new CRD life based on:
- (1) if it is an arm's length sale or transfer (Guideline [RG-MRA-004](#): Gross Realisation and Gross Production Revenue provides further information on arm's length sales at paragraph 23), the purchase price paid by the new owner
  - (2) or if it is a related party sale or transfer, the written down value (derived from an arm's length value less accumulated depreciation).

## Assets sold, scrapped or removed from the production unit

58. If an asset is sold, scrapped or removed from a production unit, CRD in respect of that asset ceases as soon as the asset is no longer used for the operations of the production unit. The CRD claimed for the relevant royalty period usually needs to be apportioned accordingly.
59. Any gain or loss resulting from the sale of an asset sold independently from a production unit must be included in gross realisation for the royalty return for the relevant period. Guideline [RG-MRA-004](#): Gross Realisation and Gross Production Revenue provides further information on the inclusion of a gain or loss on sale of assets.

## GST

60. An amount of ECAE is the amount exclusive of the GST (if any) payable in relation to that expenditure. Where an item of ECAE is input taxed, the amount claimable is inclusive of GST.

## Record keeping requirements

61. For general record keeping requirements, refer to MRA Overview.
62. In respect of CRD, the royalty payer must maintain proper records relating to all assets which have been included as ECAE. Relevant supporting documentation includes, but is not limited to:
- (1) fixed asset register, including a schedule of acquisitions, transfers and disposals for the relevant royalty period
  - (2) taxation depreciation schedule
  - (3) trial balance and detailed general ledger reports
  - (4) invoices and capital expenditure approvals.

## MRA publications

63. 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.



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