United States Department of the Interior

GEOLOGICAL SURVEY
RESTON, VIRGINIA 22092

In Reply Refer To:
EGS-MS600

JAN 13 1977

Memorandum

To: Assistant Secretary--Energy and Minerals

From: Director, Geological Survey

Subject: Guidelines for determining value for computing royalty on Federal potassium and sodium leases

Enclosed are guidelines to the Mining Supervisors that we have prepared to implement the Secretary's decision on subject matter.

The guidelines were prepared with the assistance of our field and headquarters personnel, the office of Audit and Investigation, and the Solicitor's office. Draft guidelines were circulated within the Department. Views and comments submitted thereon were taken into consideration in preparation of the final guidelines.

If you agree that these guidelines implement the Secretarial decision, please concur below.

W. A. Radlinski
Acting Director

Enclosure

Rolland R. Reid
I Concur

JAN 19 1977

Guidelines for Determining the Value to be Used to Compute the Royalty Due on Production from Federal Potassium and Sodium Leases

I. Introduction

The purpose of these guidelines is to implement a recent Secretarial decision on determining the gross value of potassium and sodium for royalty purposes. Through the years, various policies have been established by the Department of the Interior to assure that royalties from Federal potassium and sodium leases are computed in accordance with the governing laws, regulations, and lease terms and that the royalty payment represents the Government's fair share from leasehold production. These guidelines incorporate appropriate instructions and explanations which have been issued to determine the gross value to be used to compute the royalty payable to the United States on production from Federal potassium and sodium leases.

The Secretary's decision determined that royalty payments shall be based on the contract price established in a bona fide transaction between independent parties, a procedure which has been used over the years but not specifically set out in previous guidelines. That decision also stated that if the transaction is not bona fide, if the parties are not bargaining independently, or if some or all of the commodity produced is consumed or transferred internally by the producer, then the Mining Supervisor may establish appropriate values for such products which approximate actual market values and which will be used for royalty purposes.

II. General

Royalty value is computed on the gross value of lease production at the point of shipment to market. Unless otherwise provided for in the lease, royalty is due and payable on the last day of the calendar month following the calendar month in which said production is sold, consumed, or transferred for internal use. The point of shipment to market is defined as the loading dock or similar facility at the processing plant. When circumstances warrant, the Mining Supervisor may approve another facility as the point of shipment of leasehold products to market. The gross value for royalty purposes will normally be the sales price of bulk products resulting from prices received by arm's-length contract at the customary point of shipment to market.

III. Gross Value on Which Royalty Is Based

The prices received by the lessee, in bona fide arm's-length contract transactions not involving considerations other than the sale of the products, represent the gross value for royalty purposes. Gross value is normally based on the sales price of bulk products at the customary point of shipment to market.

Lessees using part of the products internally or selling to an affiliate shall use the monthly weighted average price realized from its sales by arm's-length contracts and apply such value to the products used internally, transferred to an affiliate, or sold through a non-arm's-length transaction. However, in no event will the royalty be based on value less than the gross proceeds accruing to the lessee less allowable deductions.

A lessee having no bona fide sales will be provided a value by the Mining Supervisor, calculated by taking a weighted average of all bona fide sales for each product of similar quality from production of other lessees within the area for the previous month.

IV. Production on Which Royalty is Due

Royalty is generally due on the value of primary products resulting from production from the leased lands whether such primary products are sold, transferred, or used in the production of secondary products.

Primary products are generally considered to be the first marketable products recovered through the processing of raw or brine. When untreated ore or brine is sold, the royalty will be based on the value of the theoretical primary product equivalent.

In those cases when primary products are used to make other products (i.e., primary products are extracted from leased lands), royalty attaches on the value of the resulting products which are actually sold or transferred from the point of shipment to market.

Secondary products are regarded as those products resulting from the application of extensive chemical processing, usually involving the use of purchased reagents that become chemically combined with the primary products. Therefore, royalty is due on the value of the primary products consumed to produce the secondary product.

In those cases where:

1. only a secondary product is actually produced or,

2. the primary product is not marketable as produced and is therefore processed to a secondary product,

the royalty will be based on the value of the secondary product less the cost of any purchased reageats that become chemically combined with the primary product.

V. Deductible and Nondeductible Items

Royalty is normally due on the value of the products sold in bulk at the customary point of shipment to market, and any incremental value added by bagging, packaging, transportation, or other similar services is generally not subject to royalty. Some of the more frequently encountered items which may be deducted if justified are:

1. Freight and handling costs, from the point of shipment to market to the point of delivery to the customer, are deductible if included in the sales price. These costs shall be verified by documentation from the transportation company. Transportation and handling costs to company warehouses located extraneous to the market area may be deducted from the gross sales value at the warehouse, but under no circumstances may the accepted gross value be less than the gross value F.O.B. mine or processing plant.

2. Freight equalization is deductible, provided this allowance is publicized and is required to meet competition.

3. Bagging and tagging charges are deductible where the sales price of the product sold in bags has been increased over the bulk product price to cover the cost of bagging. Normally, the deduction entitlement is equivalent to the difference in prices of bagged product and bulk product. However, under no circumstances shall the royalty base be less than the price received for like quality products sold in bulk quantity.

Items of expense occasionally encountered in the sale, transportation, and handling of lease production from the point of shipment to market which are specifically nondeductible in the computation of royalty gross value are:

COST ITEMS NOT DEDUCTIBLE

1. Analysis charges.
2. Demurrage, car, at point of shipment.
3. Demurrage, car, at destination.
4. Expenses in connection with product donated for experimental purposes.
5. Insurance, on product in storage warehouses.
6. Materials used to mix with product (to maintain product consistency).
7. Reconditioning cargo shipments sent to warehouses for storage where the additional expense is due to the hardening of the material while in transit.
8. Reconditioning product removed from storage.

9. Retesting of product.
10. Sales commissions and sales costs of every other nature.
11. Storage charges on product stored in warehouses.
12. Survey charges.
13. Tariffs, freight, cost of.

ITEMS WHICH MAY BE DEDUCTED WHEN THE COST OF C.I.F. (COST, INSURANCE & FREIGHT) IS ADDED TO THE SALES PRICE BUT NOT OTHERWISE

1. Bagging and tagging charges.
2. Forwarding charges from storage warehouses.
3. Handling charges from storage warehouses.
4. Weighing and handling out of storage.
5. Wharfage and handling out of storage.

VI. Authority

A. 30 USC 282 Feb. 7, 1927 C.66,2,44 Stat. 1057

" * * * at a royalty of not less than 2 per centum of the quantity or gross value of the output of potassium compounds and other related products, except sodium, at the point of shipment to market, * * *."

B. 30 USC 262 Feb. 25, 1920 c. 85, 24, 41 Stat. 447; Dec. 11, 1928, c. 19, 45 Stat. 1019

" * * * at a royalty of not less than 2 per centum of the quantity or gross value of the output of sodium compounds and other related products at the point of shipment to market; * * *."

C. 30 CFR 231 (37 F.R. 11041, June 1, 1972)

(1) 231.3(4) Manner and form of records, and notices "Prescribe * * * the manner and form in which records of operations, reports, and notices shall be made."

(2) 231.61 Value basis for royalty computation.

(a) The gross value for royalty purposes shall be the sale or contract unit price times the number of units sold, provided, however, that where the Mining Supervisor determines:

(1) That a contract of sale or other business arrangement between the lessee and a purchase of some or all of the commodities produced from the lease is not a bona fide transaction between independent parties because it is based in whole or in part upon considerations other than the value of the commodities; or

(2) That no bona fide sales price is received for some or all of such commodities because the lessee is consuming them, the Mining Supervisor shall determine their gross value, taking into account: (i) all prices received by the lessee in all bona fide transactions, (ii) prices paid for commodities of like quality produced from the same general area, and (iii) such other relevant factors as the Mining Supervisor may deem appropriate; and provided further that in a situation where an estimated value is used, the Mining Supervisor shall require the payment of such additional royalties, or allow such credits or refunds as may be necessary to adjust royalty payment to reflect the actual gross value.

(b) The lessee is required to certify that the values reported for royalty purposes are bona fide sales not involving considerations other than the sale of the mineral, and he may be required by the Mining Supervisor to supply supporting information.

(3) 231.62 Audits

An audit of the lessee's accounts and books may be made annually or at such other times as may be directed by the Mining Supervisor by certified public accountants, and at the expense of the lessee. The lessee shall furnish free of cost duplicate copies of such annual or other audits to the Mining Supervisor within 30 days after the completion of each audit.

D. Potassium and Sodium Leases - Public Domain

(1) Form 10-43 (prior to 1966)

sec. 2 (c) Royalty "It is expressly agreed that the Secretary of the Interior may establish reasonable minimum values for purposes of computing royalty on any of the leased deposits, due consideration being given to the highest price paid for a part or a majority of the production of like quality products from the same general area."

(2) Form 3520-2 (Jan. 1971)

Potassium Lease Sec. 2(b) Royalty "It is expressly agreed * * * to the highest price paid for a part or a majority of the production of like quality products from the same general area, the price received by the lessee, the posted price, and other relevant matters."

(3) Form 3520-3 (August 1970)

Sodium Lease Sec. 2(b) Royalty "It is expressly understood * * * to the highest price paid for a part or a majority of the production of like quality products from the same general area, the price received by the lessee, posted prices, and other relevant matters."