Senate Select Committee of Inquiry into New Taxes
Inquiry into a National Mining Tax

Submission by Bryan Pape*

The difficulty with the Federal Parliament is that it has never understood federalism. .....The supremacy of the law over the legislature is the foundation of federalism.[1]

Nothing useful will be tried out, so long as the Commonwealth continues to sit like a cuckoo in the nest claiming an excessive proportion of the national income.[2]

As all deposits of material in the earth are in the last resort limited, mining is an industry which is perpetually committing suicide.[3]

Economists are familiar with the concept of economic rent, but non economists often view it with some suspicion.[4]

1. The Committee asks whether the proposed Minerals Resource Rent Tax (MRRT) would:
   (i) be a tax on the property of a State so that it infringed s.114 of the *Constitution*, and;
   (ii) if not, would it discriminate or give a preference between States or parts of States as referred to in ss.51(ii) and 99 of the *Constitution* respectively?

2. Relevantly, ss. 114, 51 (ii), and 99 and of the *Constitution* provide as follows:

   S.114
   .....(T)he Commonwealth [shall not] impose any tax on property of any kind belonging to a State.

   S. 51(ii)

   The Parliament, shall subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to taxation; but so as not to discriminate between States or parts of States.

   S. 99

   The Commonwealth shall not, by any law or regulation of ……revenue, give preference to one State or any part thereof over another State or any part thereof.

3. First, I turn to the application of s. 114 of the *Constitution*. What falls for decision is whether the MRRT answers the description of a tax on the property of a State. The purpose of the MRRT:

> *(I)s to set a **value** on the resource extracted by a mining company. That **value** should be independent of an entity's choices about the way it finances its mining operations. The required return to capital invested in a mining operation is recognised through the interest allowance for activities upstream of the taxing point and through arm's length pricing of downstream activities where the first arm's length sale is beyond the taxing point.* [5] (Emphasis added)

4. It is instructive to establish what economists generally accept to be the meaning of *economic rent*. Professor Joan Robinson defined it in the following way:

> *The essence of the conception of **rent** is the conception of a surplus earned by a particular factor of production over and above the minimum earnings necessary to do its work.* [6]

How does this idea work with respect to a mine which is a depleting, exhaustible asset or non-renewable asset?

> *In the case of mines, for instance, it is impossible to separate the value of the exhausted properties from the value of the inexhaustible properties. It is easy to determine how much the capital value of a coal mine is reduced by the process of use. But this capital value is nothing more than the present value of the surplus income from the mine during a period of time, - that is, the present value of the total rent which it will yield, - and this rent consists of two indistinguishable elements: the return for the coal used up and the return for the site value of that coal.*[7]

Next is there any relevant difference between *economic rent* and a *royalty*? An American economist, L.C. Gray in a 1914 paper seemed to be of the view that economic rent included royalty. He concluded:

> *(T)he traditional division of the net return from exhaustible natural resources into a rent and a royalty is justified only as a method of capitalization. The real economic rent of such resources comprises the net return from the rent bearer-, including the so called royalty.*[8]

If there is no royalty as such in addition to rent, then it would seem to be the case that the concepts are not mutually exclusive. In short they are no more than different methods of measuring the value of the mineral mined.

5. The proposed MRRT is a tax to be levied with respect to iron ore and coal. For present purposes the MRRT is considered with respect to:

- Iron ore under the mining laws of Western Australia; and
- Coal under the mining laws of Queensland.

6. Western Australian Iron Ore.

Mining in Western Australia is governed by the *Mining Act 1978* (WA). The property in all minerals is vested in the Crown and under s. 109(1)(a), the Governor is authorised to make regulations prescribing *how, by whom at what rate or differentiating rates, royalties shall be paid in respect of minerals…. obtained from land that is subject to a mining lease.* It is instructive to refer to s. 9(1) which relevantly provides:

> *Subject to this Act —*
> *(a) ……*
> *(b) all other minerals existing in their natural condition on or below the surface of any land in the State that was not alienated in fee simple from the Crown before 1 January 1899 are the property of the Crown.*

The rights of a holder of a mining lease are provided for in s. 85. Relevantly they provide as follows:

> *(1) Subject to this Act and to any conditions to which the mining lease is subject, a mining lease authorises the lessee thereof and his agents and employees on his behalf to —*
> *(a) work and mine the land in respect of which the lease was granted for any minerals;*
> *(b) take and remove from the land any minerals and dispose of them;*
> *(c) ……*
> *(d) do all acts and things that are necessary to effectually carry out mining operations in, on or under the land.*
>
> *(2) Subject to this Act* ***and to any conditions to which the mining lease is subject,*** *the lessee of a mining lease —*
> *(a) is entitled to use, occupy, and enjoy the land in respect of which the mining lease was granted for mining purposes; and*
> *(b****) owns all minerals lawfully mined from the land under the mining lease.***
> *(3) The rights conferred by this section are exclusive rights for mining purposes in relation to the land in respect of which the mining lease was granted.* (Emphasis added)

The point at which royalties are imposed is when the property in the mineral passes from the Crown to the holder of the mining lease. In short when the mineral is ***extracted*** from the land. Regulations 85 and 86 of the *Mining Regulations 1981 (WA)* impose royalties for the 5 years commencing on 1 July 2010 with respect to iron ore at rates ranging from 5% for beneficiated ore, 5.625% for fine ore and 7% for lump ore. The royalty is imposed on the ***royalty value*** which in the case of iron ore is the gross invoice value less allowable deductions.

7. Queensland Coal.

Mining in Queensland is administered under the *Mineral Resources Act 1989* (Qld). Coal is the property of the Crown in right of the State of Queensland as provided by s 8(2) of the Act. The property in the mineral passes to the miner when it is mined subject to the rights of royalty payments in accordance with ss. 310, 311, 321 and at the rates prescribed by the *Mineral Resources Regulations 2003* (Qld). S.310 provides that:

> *All minerals lawfully mined under the authority of a mining lease cease to be the property of the Crown or a person who had property therein and become the property of the holder of the mining lease* ***subject however to the rights to royalty payments under this Act of the Crown or any other person***.
>
> (Emphasis added)

The royalty rate for coal is the higher of 7% of the value of the coal and the rate calculated in accordance with a formula prescribed in paragraph 3 of Schedule 4 of the Regulations. The threshold amount for the royalty to cut in is $100,000 under Reg. 34(2).

8. The MRRT is to be imposed at a rate of 30% on a ***taxable profit or value*** at the ***mine gate***. This is computed by reference to the value of the ore when the property passes from the Crown in right of the State to the miner. It seems to be calculated by reference to the sales value to produce a lesser ***mine gate value*** less the direct costs of mining and a deduction and for the cost of capital to produce an economic rent. The MRRT liability will apparently be subject to a 25% rebate as an ***extraction allowance***, resulting in an effective tax rate of 22.5%. At the ***mine gate*** the property in the minerals will have passed to the miner. This is said to be the ***taxing point*** for the MRRT. It is here that all of the extraction costs in winning the State owned ore, are to be collected and deducted against the ***mine gate value*** of the ore to determine the taxable profit. (See Policy Transition Group Issues Paper at note 5 for further explanation of the words italicised in bold print).

9. In *Queensland v Commonwealth*, [9] the issue which arose for decision was whether the State of Queensland was liable to fringe benefits tax in respect of the motor vehicles and houses it allowed its employees to use for private purposes. Four Justices held that the Commonwealth's fringe benefits tax was not a tax on the property of the State. It was a tax on the benefit provided to the employee. Mason, Deane and Brennan JJ. in explaining the meaning of s.114 said:

> *In its context in s.114 of the Constitution, a "tax on property", is neither a term of art nor a concept with a clearly settled legal meaning. Nor, in that context, do the words express a concept susceptible of elucidation by means of a formula reflecting precise criteria. Rather, the section refers to a "tax on property" as that expression is ordinarily understood..... It is the "substance of the operation of the statute, rather than merely its form" which is "definitive of the relevant nature of the tax it imposes or exacts".* [10]

On the other hand Dawson J. in holding that the fringe benefits tax was a 'transaction tax rather than a property tax' observed that:

> *(W)hilst in some circumstances a tax upon a transaction may be substantially the equivalent of a tax upon the ownership of property, ordinarily the distinction between a tax on a transaction and a tax upon property is a valid and necessary one.*[11]

He went on to refer with approval to what Menzies J. had said in an earlier case, that "s. 114 is not an exhaustive statement of the protection of the Commonwealth or of a State from the taxation laws of the other."[12]

Gibbs C.J. dissented saying that "the expression 'tax on property' is of course ambiguous and elliptical".[13] He observed:

> *It is clear that s.114 gives to a State immunity from taxation which is sought to be imposed on the State with respect to its property. The relation between a State and its property which is sufficient to invoke the immunity would, if the words of s. 114 are given its full meaning of which they are capable, include not only ownership, but also use, of the property.*[14]

10. An example of an Australian rent resource tax is the *Mineral Royalty Act 1982* (NT). Royalties are imposed by reference to a concept of economic rent. S. 9(1) provides:

> *There is payable under this Act to the Crown in right of the Territory a royalty in respect of all minerals vested in the Crown in right of the Territory obtained from a production unit in a royalty year.*

The amount of the royalty is determined by s.10 and relevantly provides as follows:

> (1) *The royalty payable under section 9 is 20% of the net value of a saleable mineral commodity sold or removed without sale from a production unit in a royalty year, but where that net value is:*
> *(a) $50,000 or less, the royalty payable is nil; or*
> *(b) more than $50,000, the royalty otherwise payable is reduced by $10,000.*
>
> *(2) For the purposes of subsection (1), the net value in a royalty year is calculated in accordance with the following formula:*
> *GR– (OC + CRD + EEE + AD)*
> *Where:*
> *GR is the gross realization from the production unit in the royalty year; and*
> *OC is the operating costs of the production unit for the royalty year; and*
> *CRD is the capital recognition deduction; and*
> *EEE is any eligible exploration expenditure, if any; and*

AD is the additional deduction, if any, under section 4CA

.

(3) – (11)……..

In determining the operating costs OC under s. 4B(1), paragraph (u) excludes a deduction for ***interest payments*** *or payments in the nature of interest or any amount representing depreciation*.

11. Relevantly the property in the iron ore and coal is vested in the Crown in right of the State where the mining leases are located. On extracting the minerals the property in them passes to the miner. The miner is working on a Crown lease to extract the property of the State and it is this fact which in my view is decisive of the issue.

12. The Commonwealth in exacting the MRRT from the miner would be essentially, 'standing in the shoes' of the State, to superimpose the MRRT, ***as if*** the minerals belonged to it. It would be tantamount to expropriation. Like the economist Colin Clark's metaphorical parasitic cuckoo bird, the Commonwealth could be seen to be sitting on the States' nest eggs of coal and iron ore. In truth the MRRT can be characterised as a Commonwealth royalty based on the legal fiction that the Commonwealth is the owner of the minerals. Alternatively, the MRRT might be characterised as in the nature of a surcharge triggered and payable to the Commonwealth when the property in the ore passes from the State to the miner. In short the MRRT would be a tax on property owned by a State rather than a transaction tax of the kind lawfully held to be imposed like Commonwealth payroll and fringe benefits taxes. In my opinion the MRRT would be invalid as beyond the power of the Parliament because it would infringe s. 114 of the *Constitution*.

13. An important collateral matter is the right of a State to carry out its constitutional functions of government without impermissible interference by the Commonwealth. It is also consistent with the *object of s.114 [in protecting] the financial integrity of the Commonwealth and the States by exempting each from taxation on its property by the other*.[15] Here the Commonwealth is seeking to gather taxes for itself in what it perceives to be are the States unused taxable capacities in failing to impose rent resource taxes. Gleeson C.J. in *Austin v Commonwealth* observed that *it is the impairment of constitutional status, and interference with capacity to function as a government, that is at the heart of the matter.*[16] He referred to the relevant principles as formulated by Starke J. in *Melbourne Corporation:*

> *It is a practical question, whether legislation... on the part of [the] Commonwealth...destroys, curtails or interferes with the operations of [a State], depending upon the character and operation of the legislation...No doubt the nature and extent of the activity affected must be considered and also whether the interference is or is not discriminatory but in the end the question must be whether the legislation...curtails or interferes in a substantial manner with the exercise of constitutional power by [the State]. The management and control by the States and by local governing authorities of their revenues and funds is a constitutional power of vital importance to*

> *them. Their operations depend upon control of those revenues and funds. And to curtail or interfere with the management of them interferes with their constitutional power.*[17]

If s. 114 is not infringed, then in my view it is strongly arguable that the MRRT would substantially interfere with the control by a State of its revenue and its capacity to govern. For this reason it would also be invalid.

14. If the MRRT is held not to infringe s. 114 or does not impermissibly interfere with the exercise of a State's constitutional powers, then the second question needs to be considered. In my view an allowance made for royalties in computing a liability to the MRRT would not be discriminatory within the meaning of s. 51(ii) or as a preference under s. 99. By way of illustration, the liability to State payroll tax may vary between the States but that of itself doesn't make it discriminatory in computing a corporation's income tax liability. An allowance by way of rebate for a royalty either in computing the MRRT or by a credit in discharging the liability would not be discriminatory because it would be of general application. Any inequality would only arise because of differing royalty rates imposed by the States and not from anything done by the Commonwealth Parliament.[18] S.51(ii) prohibits discrimination but does not afford protection against inequality of burden as between States in the incidence of taxation.[19]

15. Without a Bill for the MRRT having as yet been prepared, it is sufficient to say that my opinion, is obviously premature and should be treated as provisional. Subject to this qualification, the answers to the questions asked are as follows:

    (i) Yes; or alternatively the MRRT would be invalid on the grounds that it would be an impermissible interference with the exercise of a State's constitutional powers.
    (ii) Does not arise; but if it did, the answer is No.

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[3248] words

[1] Owen Dixon, 'The Law and the Constitution', Z. Woinarski (ed), *Jesting Pilate and Other Papers and Addresses*, (1965), at p. 53.

[2] Colin Clark, 'Principles of Public Finance and Taxation', *Arthur Capper Moore Research Lecture to the Federal Institute of Accountants*, (1950), at p. 30.

[3] Kenneth E. Boulding, *Economic Analysis*, (1941) at p. 207.

[4] Kenneth J. McKenzie, 'Fiscal Federalism and the Taxation of Non-renewable Resources' in Richard M. Birch and Francois Vaillancourt (eds), *Perspectives on Fiscal Federalism*, (2006), Chp 12 at p. 247.

[5] Australian Government – Policy Transition Group, *Issues Paper - Technical design of the Minerals Resource Rent Tax etc*, (1 October 2010) at para. 182. <http://www.futuretax.gov.au/documents/attachments/PTGIssuesPaper.pdf> accessed 4/11/2010.

[6] Joan Robinson, *Economics of Imperfect Competition*, (2nd ed, 1969), at p. 102.

[7] L. C. Gray,'Rent Under the Assumption of Exhaustibility', *The Quarterly Journal of Economics*, (1914),Vol. 28(3), at p. 468.

[8] Ibid. at p.489. See too T. J. C. Robinson, *Economic Theories of Exhaustible Resources*,(1989), Chp.12, L.C.Gray. At p. 148. *Gray thus concludes that although rent and royalty may be differentiated conceptually, they are one and the same thing – a surplus over extraction cost which should preferably be called 'rent' (or 'true rent').*

[9] (1987) 162 CLR 74.

[10] Ibid. at p.96.

[11] Ibid. at p.108.

[12] Loc.cit.

[13] Ibid. at p.86.

[14] Ibid. at pp.87-88.

[15] Ibid. at p.96.

[16] (2003) 215 CLR 185 at para [24]

[17] (1947) 74 CLR 31 at p.75.

[18] *Colonial Sugar Refining Co. Ltd. v Irving* [1906] A.C. 360 at p.367; cf *R v Barger*, *Commonwealth v McKay* (1908) 6 CLR 41 and similarity of s. 51(ii) and s. 99 at pp. 82, 105-111.

[19] *W.R. Moran Pty. Ltd v Deputy Federal Commissioner of Taxation (NSW)* (1940) 63 CLR 338, affirming (1939) 61 CLR 735.