

Chapter 1

Background and overview of the inquiry

1.1 On 5 February 2013, the Senate passed a motion ordering the Commissioner of Taxation to provide this committee, by no later than 15 February 2013, with details of the revenue collected from the MRRT by the ATO since 1 July 2012.

1.2 This motion came about as a result of the Treasurer's persistent refusal to reveal how much or how little the MRRT had raised in revenue.

1.3 The Treasurer was putting forward the extraordinary proposition that the government could come up with a complex new tax, make predictions in budget after budget and budget update after budget update on how much it would raise, spend all the money he thought it would raise, but not be publicly accountable about whether or not it had raised the revenue predicted.

1.4 In seeking to avoid public scrutiny of the failure of the MRRT to raise the government's projected revenue, the Treasurer and other senior Ministers went as far as to suggest that the release of information about how much the MRRT had raised could be a criminal offence given it would breach confidentiality provisions in relevant tax laws.

1.5 Clearly that position was completely untenable. As the Commissioner of Taxation, Mr Chris Jordan AO, was getting himself ready to comply with the Senate's order and inform the committee that the MRRT had raised \$126 million in gross revenue in the first two quarters of 2012-13, the Treasurer finally relented and pre-empted him by finally releasing that information publicly himself..

1.6 Based on revenue raised to date, it is likely that the MRRT will come in more than 90 per cent below the Treasurer's \$4 billion net revenue forecast for 2012-13 in his July 2010 pre-election Economic Update. The MRRT revenue so far has even come in more than 90 per cent below the already halved \$2.0 billion MRRT revenue estimate in the Mid-Year Economic Fiscal Outlook (MYEFO) 2012-13, which was released on 22 October 2012.¹

1.7 The purpose of this inquiry was to consider how the Commonwealth ended up in such a fiscal mess courtesy of the government's manifestly failed MRRT. In particular, the committee sought to assess how the development and the design of the MRRT has contributed to the massive shortfall in revenue relative to government projections, when the government had already spent all the money they thought the MRRT would raise and more.

1 Australian Government, *Mid-Year Economic and Fiscal Outlook 2012-13*, 22 October 2012, p. 305.

Inquiry terms of reference

1.8 On 26 February 2013, the Senate referred to the Senate Economics References Committee for inquiry and report the question of the development and operation of the Minerals Resource Rent Tax (MRRT), with regard to revenue figures 'showing a massive shortfall in the revenue compared to government projections.'

1.9 Specifically, the Senate asked this committee to inquire into and report on:

- (a) the design of the MRRT and the extent to which the design of the tax, as opposed to other factors such as commodity prices, are responsible for the mismatch between revenue projections and actual revenue raised;
- (b) the process by which the MRRT was designed, including the extent of the involvement of the Department of the Treasury and mining corporations that would be liable to pay the tax;
- (c) the extent to which the government took into account the views of communities affected or potentially affected by iron ore and coal mining when designing the tax;
- (d) the implications for the budget; and
- (e) any other related matter.

Conduct of this inquiry

1.10 The committee advertised the inquiry on its website and in the *Australian* and wrote directly to a range of individuals and organisations inviting written submissions. The committee received 16 submissions, which are listed at Appendix 1.

1.11 The committee also held three public hearings, in Canberra on 3 April 2013, Perth on 8 April 2013 and in Melbourne on 29 April 2013. The names of the witnesses who appeared at the hearing are at Appendix 2.

1.12 The committee thanks all who contributed to this inquiry.

A short history of the MRRT

1.13 In December 2009, the final report of the Australia's Future Tax System Review (AFTS Review; otherwise known as the Henry Review) recommended that current charging arrangements for Australia's non-renewable resources should:

...be replaced with a uniform resource rent-based tax, using the allowance for corporate capital method. The tax should be imposed and administered by the Australian government.²

2 Australia's Future Tax System, *Report to the Treasurer*, part 2: detailed analysis, vol. 1, December 2009, p. 217.

1.14 In response to this recommendation, on 2 May 2010 the government, under Prime Minister Kevin Rudd, announced that it would implement the Resource Super Profits Tax (RSPT).³

1.15 Contrary to previous commitments to the industry by the Minister for Resources and Energy the government had failed to consult the industry about the design of the RSPT.

1.16 Even though the federal government sought to introduce a federal tax into an area that traditionally had been the preserve of the States and Territories, there was no consultation with State and Territory governments either.

1.17 Despite these obvious process deficiencies the Rudd government had included about \$12 billion in revenue from the RSPT in its 2010/11 Budget – with revenue projections of about \$99 billion over the first eight years.

1.18 The mining industry reacted very strongly against the government's new federal tax on mining, specifically expressing concern about the lack of consultation, the retrospective nature of the change, the unsustainability of the proposition that the Commonwealth would refund mining losses, the ongoing exposure to increases in State royalties, the implications of using the accounting book value to determine the starting base for existing operations; and the application of the RSPT to low-value commodities.

1.19 Upon becoming Prime Minister on 24 June 2010, Julia Gillard announced that Treasurer Wayne Swan and the then Minister for Resources and Energy, the Hon Martin Ferguson AM MP, would lead negotiations with the mining industry to reach consensus on the RSPT.⁴

1.20 Following the new Prime Minister's announcement, the government entered into negotiations with representatives from the three largest mining companies operating in Australia, BHP Billiton, Rio Tinto and Xstrata Coal.

1.21 On 2 July 2010, the Government announced that it would not introduce the RSPT as originally proposed, but would instead introduce the Minerals Resource Rent Tax (MRRT), along with the onshore extension of the Petroleum Resource Rent Tax (PRRT) regime. A joint media release from the Prime Minister, Treasurer and the Minister for Resources and Energy, presented the MRRT proposal, as expressed in the MRRT Heads of Agreement between the government and the mining companies, as the result of 'intense consultation and negotiation with the resources industry,' and as

3 The Hon Kevin Rudd MP and the Hon Wayne Swan MP, 'Stronger, Fairer, Simpler: A Tax Plan for Our Future,' joint media release, 2 May 2010, <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/028.htm&pageID=003&min=wms&Year=&DocType>.

4 The Hon Julia Gillard MP, the Hon Wayne Swan MP, joint press conference, 24 June 2010, <http://www.pm.gov.au/press-office/joint-press-conference-deputy-prime-minister-wayne-swan>.

'a breakthrough agreement on improved resource tax arrangements' that addressed the concerns the resource industry had expressed regarding the previously proposed RSPT.⁵

1.22 Given the government had negotiated the design of the new MRRT with just three of the more than 300 relevant mining companies across Australia, the industry as a whole continued to feel excluded from the process.

1.23 Significantly, State and Territory governments had still not been consulted and were not part of the agreement reached by the Commonwealth with the three biggest miners.

1.24 In July 2010, the Senate Fuel and Energy Committee inquiring into the MRRT (confirmed by subsequent Senate inquiries) expressed serious concern about the federal government's lack of engagement with the States and Territories as part of this process. In particular, given the federal government made an open ended commitment in the MRRT Heads of Agreement to credit all state royalties (including future increases in royalties) against any MRRT liability, the strong view was expressed very early that as a matter of process the federal government should have engaged and reached agreement with the States and Territories before signing the deal.

1.25 As part of the MRRT Heads of Agreement signed on 1 July 2010, the government agreed to the formation of an Implementation Committee which was to be: a mutually acceptable Committee comprising credible, respected industry leaders will oversee the development of more detailed technical design to ensure the agreed design principles become effective legislation. This will have the objective of ensuring the agreed principles are effected in line with their intent in a commercial, practical manner.

1.26 To make it look more like a genuine effort at consultation post the signed heads of agreement, the Gillard government renamed the MRRT Implementation Committee, the Policy Transition Group (PTG). The government asked recently retired BHP Billiton Chairman, Mr Don Argus AC, to chair the MRRT Implementation Committee/Policy Transition Group alongside Mr Ferguson, to 'consult with industry and advise the Government on the design and implementation of the MRRT and the extended PRRT'.⁶

5 The Hon Julia Gillard MP, the Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Breakthrough Agreement with Industry on Improvements to Resource Taxation,' joint media release, 2 July 2010, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/055.htm&pageID=003&min=wms&Year=&DocType=>.

6 The Hon Julia Gillard MP, the Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Breakthrough Agreement with Industry on Improvements to Resource Taxation.'

1.27 On 3 August 2010, during the Australian federal election campaign, Minister Ferguson and the Treasurer announced the membership and terms of reference for the PTG, and stated that the PTG would commence after the outcome of the election was determined.⁷

1.28 The PTG's terms of reference stated that, in order to protect the integrity of the process, the PTG would be supported by officials from Treasury, the Department of Resources, Energy and Tourism, and the Australian Taxation Office, and, as required, by representatives of the resources industry. It also indicated that the PTG would obtain advice as needed from other independent experts.⁸

1.29 The PTG's terms of reference also indicated that its recommendations should be:

...consistent with the Government's fiscal strategy as stated in the 2010/11 Budget. Any policy deviation from the Government's announcement of 2 July 2010 is to be fully offset within the recommendations in terms of impacts on revenue or costs.⁹

1.30 What the Gillard government meant by this was that the MRRT must raise the same amount of revenue as forecast (\$10.5 billion for 2012/13 & 2013/14) no matter what adjustments were made to its design.

1.31 This obviously severely limited the opportunity for genuine consultation.

1.32 On 21 December 2010, the PTG provided its final report to the Treasurer, which included 94 recommendations relating to the introduction of the MRRT and the transition arrangements for the PRRT.¹⁰

1.33 On 24 March 2011, the government announced that it had accepted all of the PTG's (revenue neutral) recommendations.¹¹

7 The Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Policy Transition Group Membership and Terms of Reference,' 3 August 2010, <http://www.alp.org.au/federal-government/news/policy-transition-group-membership-and-terms-of-re/>.

8 The Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Policy Transition Group Membership and Terms of Reference,' 3 August 2010.

9 The Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Policy Transition Group Membership and Terms of Reference,' 3 August 2010.

10 Policy Transition Group, *New Resource Taxation Arrangements* (December 2010), p. 57, http://www.futuretax.gov.au/content/Publications/downloads/New_Resource_Taxation_Arrangements_Report.pdf; and the Hon Martin Ferguson AM MP, 'Policy Transition Group Reports to Government,' media release, 21 December 2010, <http://minister.ret.gov.au/MediaCentre/MediaReleases/Pages/PolicyTransitionGroupReportsToGovernment.aspx>.

1.34 At the same time, the government announced that a Resource Tax Implementation Group (RTIG), comprising representatives of industry and the tax profession as well as government officials, would 'ensure close consultation with the resource sector continues as the legislation is finalised.'¹²

1.35 On 10 June 2011, the government released, for public comment, draft MRRT legislation, with public consultation closing on 14 July 2011.¹³ Second exposure drafts of the Bills were released on 18 September 2011 for public comment, with the consultation closing on 5 October 2011.¹⁴

1.36 Following the exposure draft process, the MRRT legislative package was introduced into Parliament on 2 November 2011.

1.37 The package was then referred to the House of Representatives Standing Committee on Economics for inquiry, which presented its report to the House on 21 November 2011.¹⁵

1.38 On 10 November 2011, the Senate referred the provisions of the package to the Senate Economics Legislation Committee for inquiry and report. The committee reported on 14 March 2012.¹⁶

1.39 Previously the Senate Select Committee on Fuel and Energy and the Senate Select Committee on the Scrutiny of New Taxes had conducted the most comprehensive inquiries into the MRRT.

11 The Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Government Accepts Resource Tax Recommendations,' joint media release, 24 March 2011, <http://minister.ret.gov.au/MediaCentre/MediaReleases/Pages/GovernmentAcceptsResourceTaxRecommendations.aspx>.

12 The Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Government Accepts Resource Tax Recommendations,' joint media release, 24 March 2011.

13 The Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Exposure Draft – Minerals Resource Rent Tax,' joint media release, 10 June 2011, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/065.htm&pageID=003&min=wms&Year=&DocType=>. The draft legislation and explanatory material is available at <http://archive.treasury.gov.au/contentitem.asp?NavId=&ContentID=2070>.

14 The Hon Wayne Swan MP and the Hon Martin Ferguson AM MP, 'Second Exposure Draft – Minerals Resource Rent Tax,' joint media release, 18 September 2011, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/111.htm&pageID=003&min=wms&Year=&DocType=>. The second exposure draft and explanatory material is available at <http://archive.treasury.gov.au/contentitem.asp?ContentID=2157&NavID=>.

15 For information on the inquiry, including the final report, see [http://www.aph.gov.au/Parliamentary_Business/Committees/House_of_Representatives_Committees?url=economics/mineralstax/subs\(2\).htm](http://www.aph.gov.au/Parliamentary_Business/Committees/House_of_Representatives_Committees?url=economics/mineralstax/subs(2).htm).

16 For information on the inquiry, including the final report, see http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=economics_ctte/completed_inquiries/2010-13/MRRT_Bill_2011/index.htm.

1.40 The Bills passed the Parliament on 19 March 2012 and received Royal Assent on 29 March 2012.

How the MRRT works

1.41 The MRRT imposes an effective 22.5 per cent tax¹⁷ on the above-normal profits earned by the mining of a **taxable resource**.¹⁸ A taxable resource is defined in the MRRT Act as any of the following:

- (a) iron ore;
- (b) coal;
- (c) anything produced from a process that results in iron ore being consumed or destroyed without extraction; and
- (d) coal seam gas extracted as a necessary incident of mining coal.¹⁹

1.42 The Revised Explanatory Memorandum for the MRRT Bills provided the following summary of the design and intended operation of the MRRT:

The MRRT is a project-based tax, so a liability is worked out separately for each project the miner has at the end of each MRRT year. The miner's liability for that year is the sum of those project liabilities.

The tax is imposed on a miner's mining profit, less its MRRT allowances, at a rate of 22.5 per cent (that is, at a nominal rate of 30 per cent, less a one quarter extraction allowance to recognise the miner's employment of specialist skills).

A project's mining profit is its mining revenue less its mining expenditure. If the expenditure exceeds the revenue, the project has a mining loss. Mining revenue is, in general, the part of what the miner sells its taxable resources for that is attributable to the resources in the condition and location they were in just after extraction (the 'valuation point'). Mining revenue also includes recoupment of some amounts that have previously been allowed as mining expenditure.

Mining expenditure is the cost a miner incurs in bringing the taxable resources to the valuation point.

Mining allowances reduce each project's mining profit. The most significant of the allowances is for mining royalties the miner pays to the States and Territories. It ensures that the royalties and the MRRT do not double tax the mining profit.

17 The nominal rate of the MRRT is 30 per cent, but this is discounted by a 25 per cent extraction allowance.

18 All **bolded** terms are defined terms in the MRRT Act and related Acts.

19 MRRT Act, s. 20-5(1).

In the early years of the MRRT, the project's starting base provides another important allowance. The starting base is an amount to recognise the value of investments the miner has made before the MRRT.

Other allowances include losses the project made in earlier years and losses transferred from the miner's other projects (or from the projects of some associated entities).

If a miner's total mining profit from all its projects comes to less than \$75 million in a year, there is a low-profit offset that reduces the miner's liability for MRRT to nil. The offset phases out for mining profits totalling more than \$75 million.²⁰

1.43 The MRRT deals with three project cases:

- (a) The project did not exist on 1 May 2010 (the time when the MRRT was first announced).
- (b) The project was invested in on 1 May 2010, and is transitioning into the MRRT.
- (c) The project is one of the multiple projects in which a miner has an interest, which usually involves considerable pre-mining expenditure.²¹

How a miner calculates their MRRT liability

1.44 The method of calculating a miner's liability under the MRRT is essentially the same, regardless of the case into which the mining project fits.

1.45 The following steps are used to work out the amount a miner (that is, the holder of a **mining project interest**) should pay under the MRRT:

- (a) calculate the miner's **mining revenue** and **mining expenditure**;
- (b) subtract the mining expenditure from the mining revenue, giving the **mining profit**;
- (c) calculate the mining allowances the miner is entitled to claim. In order of application these allowances are:
 - (i) **royalty credits**;
 - (ii) **pre-mining losses**;
 - (iii) **mining losses**; and
 - (iv) **starting base losses**;
- (d) subtract the total of the mining allowances from the mining profit;

20 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 3-4.

21 See Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 12-26, for detailed explanations of each of these cases.

- (e) multiple that figure by the **MRRT rate** (22.5 per cent) to get the MRRT liability; and
- (f) if the miner is entitled to them, it can subtract the **low profit offset** and the **rehabilitation tax offset** from the MRRT liability.

Mining revenue

1.46 The revenue from a **mining project** is calculated using the following two steps:

- (a) The revenue amount for the **mining revenue event** is determined, consistent with s. 30-25(2).
- (b) Using the method that satisfies s. 30-25(3), work out how much of that revenue amount is reasonably attributed to the taxable resource:
 - (i) in the form in which it existed when it was at its **valuation point**; and
 - (ii) at the place where it was located when it was at its valuation point.²²

1.47 The valuation point, therefore, is the 'point in the mining production chain that separates upstream and downstream operations.'²³

1.48 The MRRT Act does not expressly require a particular method for calculating revenue amounts at the valuation point, and instead requires that the method used:

...must produce the most appropriate and reliable measure of the amount, having regard to, amongst other things, the functions performed, assets employed and risks assumed by the miner across its value chain and the information that is available.²⁴

Mining expenditure

1.49 Mining expenditure includes expenditure 'necessarily incurred ... in that year, in the carrying on (by the miner or another **entity**) of **upstream mining operations** for the mining project interest' and is restricted to expenditure 'of either a capital or revenue nature'.²⁵ It does not, therefore, include the expenditure of assets, which are dealt with as upfront deductions under depreciation.

22 MRRT Act, s. 30-25(1).

23 Minerals Resource Rent Tax Bill 2011 and related bills, Revised Explanatory Memorandum, p. 8.

24 MRRT Act, s. 30-25(3).

25 MRRT Act, s. 35-10.

Upstream and downstream mining operations

1.50 The MRRT applies to the realised profits, or positive cash flows, generated by a mining project upstream of the valuation point. For that reason mining revenue and expenditure are calculated with regard to whether they are part of the **upstream mining operations** of the mining project or part of the **downstream mining operations**.

1.51 The upstream mining operations of a mining project:

... relate directly to finding and extracting a taxable resource from the mining project area for the mining project interest. Any activity or operation directed at doing anything to, or with, the taxable resource after it reaches the valuation point is not an upstream mining operation.²⁶

1.52 Upstream mining operations could include, among other things:

- activities preliminary to extraction, such as exploration, mine planning, training staff, research on extraction processes, preparation of the mine site, mine site rehabilitation and restoration; and
- activities undertaken as a consequence of extraction, such as transport to the valuation point, initial crushing, building the road linking the miner to the run-of-mine stockpile and buying and maintain the trucks used for this transport.²⁷

1.53 Downstream mining operations are mining operations involving taxable resources after they reach the valuation point. Generally, it is the sale of resources downstream of the valuation point that generates profit for a mining project. As it taxes realised profits only, the MRRT:

... requires taxpayers to determine the amount of those proceeds that are reasonably attributable to the resource and upstream operations for tax purposes.²⁸

Allowances

1.54 The MRRT provides for an allowance component that can be used to reduce the profit of a mining project interest. Essentially, a mining allowance is the method by which the cost of bringing the resource to the valuation point is taken into account, ensuring that the tax is only imposed on the realised profits of the mining project.

26 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 76.

27 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 77–79.

28 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 8.

1.55 Allowances differ depending on the particular case into which the mining project falls. The four allowance types are set out above (royalty credits, pre-mining losses, mining losses, and starting base losses) and must be applied in that order.²⁹

1.56 When profits are high, miners will pay royalties to State and Territory Governments as well as MRRT. The MRRT recognises this by providing the miner with a deduction, called a royalty allowance. The royalty allowance is 'grossed up', using the MRRT rate, so that it reduces the MRRT liability by the amount of the royalty.³⁰

1.57 Importantly, where the full royalty credits for the year cannot be applied as a royalty allowance, the unused portion is uplifted and carried forward to be applied in a later year. The uplift rate is the long term bond rate plus 7 per cent (LTBR + 7 per cent).³¹

The uplift rate

1.58 Losses incurred by a mining project can be uplifted, with interest, and carried forward for use as a deduction against profit in later years. The uplift rate³² is the long-term bond rate (LTBR) plus seven per cent.

The starting base allowance and alternative valuation methods

1.59 One of the allowances under the MRRT is the **starting base allowance**. Starting base allowances:

... recognise investments in assets (starting base assets) relating to the upstream activities of a mining project interest that existed before the announcement of the resource tax reforms on 2 May 2010. They also recognise certain expenditure on such assets made by a miner between 2 May 2010 and 1 July 2012.³³

29 For a more detailed explanation of the operation of mining allowances see Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, chapters 6 and 7, pp. 95–143.

30 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 15.

31 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 15.

32 The uplift rate is an annual interest allowance provided to compensate for risk where losses are required to be carried forward and offset against future project profits.

33 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 119.

1.60 Unlike other losses, starting base losses cannot be transferred to other mining project interests.³⁴

1.61 **Starting base assets** can be valued using either:

- (a) the 'market value method,' based on 'the market value of the mining project interest's upstream assets at 1 May 2010'; or
- (b) the 'book value method,' based on 'the most recent audited accounting value of those assets at 1 May 2010'.³⁵

1.62 The Revised Explanatory Memorandum to the MRRT bills highlighted some important differences between the two methods:

- the market value method includes the value of the mining right, while the book value method excludes it;
- the market value method recognises the starting base for each asset over its remaining effective life, while the book value method recognises the starting base, in set proportions, over five years;
- there is no uplift for the remainder of the starting base under the market value method but the remainder under the book value method is uplifted by LTBR plus seven per cent; and
- under the market value method, starting base losses unable to be applied in the year are uplifted at the consumer price index (CPI) rate, while they are uplifted at LTBR plus seven per cent under the book value method.³⁶

1.63 The issue of how starting base allowances are calculated is one of the more contentious aspects of the MRRT. Simply put, it is argued by small miners that the market valuation approach provides large and established miners with a substantial 'tax shield'. This issue, along with other design features of the MRRT affecting the level of revenue raised, is discussed in the next chapter.

34 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 119.

35 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 17.

36 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 17.