Dissenting Report by Senator Bishop

Comments on the preparation of the majority report

1.1 The majority report by Opposition senators of the Economics References Committee into the Development and Operation of the Minerals Resource Rent Tax is an intensely political document designed to support the single minded obsession of the Opposition to reject the MRRT. The report does not reflect the totality of the evidence that the committee received.

1.2 The simple fact is that resource rent taxes are the best way to tax the high profits being generated by the resources sector.

1.3 Government senators went out of their way to cooperate with the rushed time tabling demands of the Opposition. The urgency imposed by the Opposition Chair and senators was unnecessary and detracts from the seriousness of the report.

1.4 The majority report was designed in haste, drafted in isolation, inconsistent with the evidence, flawed in approach and unhelpful to any serious players in the mining industry.

1.5 Opposition senators could not even manage the courtesy to provide it to Government senators in time for them to formulate a more considered response to the intensely political arguments it contains. It was not provided to Government senators until 24 hours before its final adoption.

Overview of the dissenting report

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Introduction

1.6 The recommendations in the Coalition majority report are predictable and short sighted. The Mineral Resource Rent Tax will, once the current decline in commodity prices has passed, deliver significant positive and beneficial returns to Australia over the long term. It will do this because the three phase mining boom continues. We have seen the boom in prices, we are currently moving through the boom in investment and the boom in exports is beginning to commence. As it does, the MRRT will ensure that Australians receive a fair return on the resources they own.

1.7 The ongoing nature of the boom has been underlined by repeated exchanges between Treasury officials and the Economics Legislation Committee through recent estimates hearings. Most recently, the following exchange in February 2013 underlines this:

> Dr Gruen: So the point that I made at the end of my remarks was that we ought to see a significant contribution from commodity exports to output…
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> Senator MARK BISHOP: It was prior to that. You were making a distinction between the huge ramp-up of investment over the last eight or 10 years and the switch now to the production side, because the investment would tail off.
>
> Dr Parkinson: It was the point about smoothness of the transition from the resource to non-resource sector.
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> Dr Gruen: My point was simply that mining investment is currently at a level of GDP that we have not seen before and it has been rising rapidly. Our assessment is that mining investment's share of the economy is going to peak sometime over the next year. The question is whether we will see a smooth changing of the guard from mining investment to other contributors to growth. We are certainly already seeing a big pick up in iron ore exports and thermal coal exports; both of those are growing strongly. Coking coal is a bit more volatile. But certainly that is one element that we are seeing—production coming on stream and producing output which mostly gets exported.[1]

Effective policy

1.8 It is acknowledged that mining is a speculative industry that requires high returns to workers and investors. But at times, the kinds of returns mining interests accrue can be out of all proportion to these costs because much of their profit is due to the inherent underlying and finite value of the resources owned by Australians. It is an inescapable fact that when these minerals are dug up and sent overseas they are gone forever. For this reason, it is entirely reasonable that the Commonwealth should seek to recoup some of the value of these resources.

1.9 And it is entirely reasonable that the mechanism for recouping that value is through the MRRT, a resources rent tax which is designed to tax profits only.

1.10 Inevitably with a tax on profits there will be volatility in revenue particularly as prices and investment plans change.

Extensive Consultation

1.11 The final MRRT legislation was the result of a significant and protracted consultation process with stakeholders.

1.12 The initial heads of agreement, signed by the Prime Minister, the Treasurer and the Minister for Resources and Energy with the three largest mining companies in

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1 *Committee Hansard*, 14 February 2013, p. 44.

the country, was the product of 'intense consultation and negotiation with the resources industry.'[2] Between them, BHP Billiton, Rio Tinto and Xstrata account for some 95 per cent of total iron ore exports from Australia.

1.13 There followed extensive consultation on the design elements of the MRRT. The public consultation that was initially conducted by the Policy Transition Group continued through the industry based Resources Tax Implementation Group. There was also consultation via the exposure draft of the legislation.

1.14 In short, the MRRT was developed in partnership with the resource sector through one of the most comprehensive stakeholder consultation processes conducted by an Australian government.

The design of the MRRT

1.15 The MRRT protects the long term attractiveness of investment in Australian iron ore and coal by ensuring that only the most highly profitable mines are taxed. There are several design elements that achieve this.

1.16 The MRRT applies at a rate of 30 per cent to all new and existing iron ore and coal projects.

1.17 An extraction allowance of 25 per cent recognises the miner's use of specialist skill in the extraction of resources, thereby bringing the tax level down to 22.5 per cent.

Starting base allowance

1.18 The MRRT also recognises the massive investment to get the resource to market and so applies only on profits attributable to the resource just after extraction. Projects, through the book-value or market-value starting base allowance, will be able to immediately write-off new investment and immediately deduct expenses. And no tax will be payable until the project has made enough profit to pay off its up-front investment.

1.19 The starting base allowance has been the focus of much discussion. It is important to recognise that the decision to allow a choice between using a market value starting base allowance or a book value starting base allowance was to redress issues with the original Resources Super Profits Tax (RSPT). Stakeholders, including the big three miners and the MCA recognised that a market value starting base allowance represented a much fairer transition arrangements for existing projects than

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2 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=.

that provided under the RSPT. It is also important to note that 'allowing market value of existing assets is a well-established principle for easing the transition to new tax arrangements.'[3]

1.20 While there has been some criticism of the market-value starting base allowance, it is important to note that it does not represent a permanent tax shield for established projects. In a response to a question on notice about market valuation, Professor Fargher wrote that ' I do not believe that the market valuation for the starting base will erode the MRRT revenue forever, but it would appear to erode the expected tax collections substantially for at least the next five years…'[4]

1.21 Another important design feature of the MRRT recognises the speculative nature of mining, 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 rate is the long-term bond rate plus seven per cent.

1.22 These elements mean that the biggest and most profitable miners will pay the bulk of the MRRT.

Smaller miners

1.23 There are other design elements which mean smaller mining operations will not be overly impacted by the operation of the MRRT.

1.24 Companies with annual profits of less than $75 million benefit from 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.[5]

1.25 Small miners whose profits will not exceed the $75 million threshold do not have to account for the tax or maintain MRRT records.

1.26 A key design feature means that those miners expecting to remain below the threshold for an extended period do not have to fully comply with the MRRT which would be overly burdensome. These miners have the choice of electing to use a simplified MRRT method. It is understood however, that smaller miners have expressed some concerns about the effectiveness of the simplified MRRT arrangements. This is discussed below.

Other design features

1.27 Other design features of the MRRT that received approval from stakeholders included:

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3 Minerals Council of Australia, *Submission 10*, p, 4.

4 Response to question on notice, Professor Neil Fargher, 2 May 2013

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

i) appropriate differentiation between mineral commodities on grounds of international competitiveness;

ii) appropriate recognition of commercial returns for downstream operations based on arm's length principles to ensure the MRRT is levied on the primary resource value only;

iii) the provision of immediate deductibility of capital expenditure to encourage investment into coal and iron ore projects;

iv) a more appropriate return to capital invested through a higher MRRT uplift rate; and

v) taxpayers with low levels of profitability will not have an MRRT liability.[6]

Investment pipeline

1.28 Despite protestations by parts of the mining industry, there is no evidence that future investment in the mining sector is threatened by the MRRT.

1.29 The Treasurer, the Hon Wayne Swan MP, has at various times referred to there being three booms – the boom in prices, the boom in investment and the boom in exports. It is clear that the boom in investment continues as evidenced by the ongoing strength of the investment pipeline. Comments made by Treasury officials in late 2012 underline this.

> In 2012-13, capital expenditure planned in the mining sector comes to $119 billion, more than 2.5 times the $47 billion invested in 2010-11, only two years before.
>
> And there's more of this to come, with a half trillion dollar investment pipeline in the total resources sector – massive in the context of a $1.5 trillion economy.
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> Not only is the pipeline larger - up $290 billion or 136 per cent since October 2007 - but over half of this pipeline is already under construction or scheduled to commence, which means the pipeline is more resilient now than it was before the GFC.
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> Also many of these projects are underpinned by long term supply contracts – improving the resilience of the projects and the export volumes that flow from them.[7]

6 Minerals Council of Australia, *Submission 10*, p, 5.

7 Mr Rob Heferen, Executive Director , Revenue Group, *Tax policy during a resources boom*, Speech to AMEC Convention 2012, 4 September 2012. http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2012/Tax-policy-during-a-resources-boom

1.30 The strength of the investment pipeline was underscored by an exchange between Senator Bishop and Mr Timothy Marney, Under Treasurer, Department of Treasury, Western Australia during the Perth hearing on 8 April 2013.

> Senator MARK BISHOP: My final set of questions relates to the status of the alleged mining boom—however characterised—in Western Australia. Do you seriously quarrel with the proposition that, since the MRRT was announced—however well designed or otherwise—the Western Australian economy has gained around 20,000 jobs, that there has been nearly $100 billion of capital expenditure in mining in Western Australia, that capital expenditure in mining has increased by nearly 115 per cent, that total business investment has increased by over 70 per cent in the state and that we are experiencing net good terms in this state?
>
> Mr Marney **:** I would have to check the individual figures—
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> Senator MARK BISHOP: Give or take.
>
> Mr Marney **:** but the broad story is consistent. The growth in the state has continued to progress and, in many ways, support the rest of the nation in terms of jobs growth and exports. If you are asserting therefore that the MRRT has not had a negative or adverse impact on the resource sector in the state, that is probably not surprising that it has not actually raised much revenue.[8]

Sovereign risk

1.31 Not only is there no threat to investment, it is clear that, despite extreme claims to the contrary, there is no impact on sovereign risk. Professor Garnaut emphasised this point:

> Senator MARK BISHOP: My take is that the MRRT, however flawed, has had minimal impact on that investment going forward and has had minimal impact on sovereign risk in terms of investment dollars coming into this country. Do you share that view or do you have a different take?
>
> Prof Garnaut: I do not think that lawful changes in taxation arrangements amount to sovereign risk. There is plenty of real sovereign risk around the world. I have been personally very close to some of it in the recent past. This is not properly called sovereign risk. I see the use of the term in this context as just the cut and thrust of politics and lobbying.[9]

Issues raised during the inquiry

1.32 The final point raised by Mr Marney above, that the MRRT has not raised much revenue, is important.

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8 *Proof Committee Hansard*, 8 April 2013, p. 40.

9 Professor Ross Garnaut, 29 April 2013, *Proof Committee Hansard*, p. 9.

The nature of rent taxes

1.33 The Treasurer has argued that the MRRT 'will generate more money from the big resources companies over the long term', and in so doing cites 'the experience of the petroleum resource rent tax which began 25 years ago and had raised $28 billion to date'.[10]

1.34 In a statement to the media in October 2012, the Treasurer explained that:

> The design of a resource rent tax is such that it delivers the revenue when profits are high and in the case of commodities where prices are high and of course when they go down, it doesn't necessarily deliver the same amount of money.
>
> In the past few months we've had a real crash in commodity prices which has not only affected resource rent taxes but it has affected company taxes as well.[11]

1.35 So, the short term reduction in revenue is a product of fluctuating commodity prices and a persistently high Australian dollar and shows that the profits-based tax is operating as it was designed. This position is clearly supported by the Minerals Council of Australia (MCA), the peak mining organisation in Australia, and other miners.

1.36 In its submission to this inquiry, the MCA noted the recent reduced profitability of the mining industry and said that:

> [T]here is no evidence to suggest the MRRT is operating in a way that should be viewed as surprising or out of line with market conditions. Important in this latter context are:
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> - The sharp fall in commodity prices in the September quarter 2012 (the first quarter of the operation of the MRRT) with coal prices staying well down on levels reached in recent years
> - What appears to be a “structural break” in the relationship between mineral commodity prices and the $A/$US exchange rate
> - The resultant impact on industry profitability with costs remaining high and “sticky”; hence not falling in line with the deterioration in industry conditions.
>
> Beyond such variables, the number of additional “moving parts” in the MRRT equation, the fact that it is a new tax and the history of forecasting error with similar taxes undermine any claim that the MRRT is operating

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10 *Swan defends MRRT as long-term gainer*, The Sydney Morning Herald, 13 February 2013, http://news.smh.com.au/breaking-news-national/swan-defends-mrrt-as-longterm-gainer-20130213-2ed7i.html

11 *Abbot cashes in on mining tax*, The Australian, 26 October 2012, http://www.theaustralian.com.au/national-affairs/in-depth/abbott-cashes-in-on-mining-tax/story-fnb56a2t-1226503464599

other than in a manner consistent with a resource rent tax designed to collect additional revenue at the peak of the commodity cycle. [12]

Revenue collection

1.37 The volatility of rent taxes noted above is, then, entirely normal but also makes projecting revenues difficult. Fluctuations in projections do not necessarily mean that the tax will fail to raise considerable revenue in the future.

1.38 The final receipts for the MRRT's first full year of operation will not be known until mid-2014. This is in keeping with normal tax collection processes and, in the case of the MRRT, stems from its complexity, a characteristic of all resource rent taxes.

1.39 Dr Martin Parkinson, Secretary to the Treasury, noted some of this complexity in responses to the Economics Legislation Committee during estimates hearings in February 2013. Dr Parkinson described the current situation as follows:

> Just to be clear, there are five factors that determine the extent of revenue collections. The first is commodity prices and volumes; we can see the commodity prices—subject to the fact that we cannot see long-term contracts, but we can get a reasonable estimate—and the spot prices in real-time and we can get very quick estimates of movements in volume. The second thing that we can see in real-time is the exchange rate, and the third thing we can see in real-time is state royalty rates. What we cannot see is the starting cost base that the firms are able to pick, nor can we see the netback arrangements—that is how the price at the shipping gate compares to the valuation put on it at the mine.[13]

1.40 Once full returns are received in 2014, Treasury will be able to more clearly predict future revenue projections.

Royalties

1.41 The MRRT provides for the full crediting of State royalties paid by mining companies, which can then be used as an allowance to reduce mining profit subject to the MRRT.

1.42 The Senate Economics Legislation Committee found that:

> Moves by some states to increase royalties have the potential to undermine the superannuation and taxation reforms the MRRT is intended to support. The committee sees the announced increases as opportunistic, made in the

12 Minerals Council of Australia, *Submission 10*, p, 5.

13 Dr Martin Parkinson, Committee Hansard, 14 February 2013, p. 51.

> knowledge that, long-term, the miners will be compensated for the increased royalties under the design of the MRRT.[14]

1.43 The GST Distribution Review final report also examined the issue of minerals taxation. In a statement following the release of the report, the Treasurer said that:

> The Panel considered the interaction between the Minerals Resource Rent Tax and state mineral royalties and confirms that resource rent taxes are more efficient than royalties. The Panel finds that royalty increases are neither desirable nor sustainable, and makes a series of recommendations to remove the incentive states currently have to raise royalties.[15]

1.44 The position that resource rent taxes are more efficient than royalties is endorsed by Professor Ross Garnaut who made the following comments during the Committee's hearing in Melbourne.

> Senator MARK BISHOP: Following this discussion about the utility of some form of mining tax going forward, do you agree or disagree with the Henry review's view that a pure resources rent tax is superior to a royalties form of revenue gain?
>
> Prof Garnaut: Yes.
>
> Senator MARK BISHOP: You do agree with that. Why is that?
>
> Prof Garnaut: For the reasons that I brought up earlier on that a royalty regime will deter marginal investments.
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> Senator MARK BISHOP: Correct.[16]

1.45 Through the GST Review process, the government is committed to ensuring that appropriate steps are taken to ensure that Australians receive fair returns for the exploitation of the finite resources that belong to them.

Compliance costs

1.46 It is acknowledged that the MRRT is a complex tax but then so are a range of other taxes. Dealing with complex tax legislation is normal business for complex businesses. This point was emphasised by Mr Brian Purdy, Senior Manager Finance for BHP Billiton. In his evidence to the committee he stated that:

> Mr Purdy: […] Regarding the complexity of the MRRT: it is complex. But a number of aspects of the company tax are very complex for our companies as well. The petroleum resource rent tax is complex as well. A

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14 Senate Economics Legislation Committee, *Mineral Resource Rent Tax Bill 2011 [Provisions] and related bills*, p. 33.

15 The Hon Wayne Swan MP, Treasurer, *Release of the GST Distribution Review Final Report*, 30 Nov 2012, http://ministers.treasury.gov.au/wmsDisplayDocs.aspx?doc=pressreleases/2012/119.htm&pageID=003&min=wms&Year=2012&DocType=0

16 Professor Ross Garnaut, 29 April 2013, *Proof Committee Hansard*, p. 8.

> lot of the complexity does not simply come because we have to do our own calculations. We have independent audits and verifications of our numbers that we have to go through. You talked about deferred tax assets disclosed in financial statements. That means that we have to go through and get audited by our independent auditors. Therefore, we have a process of verification around those numbers. We have a process that we are going through at the moment around building systems, to report numbers to our companies and to the ATO, and we are in the process of working with the ATO on a pre-lodgement process, which is common with most new taxes, leading up to the first MRRT filing. So it is a complex tax, but we deal with lots of complex taxes.

1.47 So, there is nothing remarkable about the complexity of the MRRT and it is reasonable that it comes with compliance requirements. In designing the MRRT, the Government took steps to ensure that compliance requirements were appropriate to the size of the venture.

1.48 A feature designed to keep compliance costs manageable is that the MRRT only applies on profits beyond $75 million. This is a reasonable attempt to shield smaller miners from the full compliance costs. And, in the current climate, the dip in commodity prices means that smaller miners will most likely remain below the $75 million ceiling and will not face an unfairly heavy burden any time soon.

1.49 However, there is some evidence that smaller miners currently under the $75 million threshold still experience noticeable compliance costs in anticipation of one day exceeding the threshold.

1.50 Mr Craig Ferrier of Golden West Resources attempted to quantify the costs and indicated that:

> I would estimate that the costs incurred over, say, a two-year period, both in terms of external advisers and our own internal costs, would probably be in the order of $50,000 to $75,000.[17]

1.51 It is clear that there is room to relieve further what little compliance burden there is on small miners who may pass the threshold in the future, especially given that it may be some years before thresholds are crossed. This point was underlined in an exchange between Senator Bishop and Mr Ferrier.

> Senator MARK BISHOP: I do not claim to be an accountancy expert, but I would have thought that if your production is going to depend on port access either out of Geraldton or further south, and that is a government decision, and they are having problems in terms of raising sufficient finance to fund the expansion of either or both of those ports, it is going to be a long time before your volume is sufficient to worry the tax accountants about that $75 million threshold. Is that a fair comment?

17 Mr Craig Ferrier, Golden West Resources, 8 April 2013, *Proof Committee Hansard*, p. 27.

> Mr Ferrier: In the current environment, I think it is an extremely fair comment.

1.52 The issue of compliance costs for smaller miners was underlined by Professor Guj in the Perth hearing who noted that 'the compliance cost is almost a fixed cost. It is not really a function of the magnitude of your business.'[18]

1.53 It would appear that the elements of the MRRT designed to lessen the burden for smaller miners are not working as intended. This element of the MRRT should be remedied to exclude those small miners who are unlikely to ever be caught by the MRRT from the requirement to file extensive information to government on a regular basis. The MRRT is intended to only apply to the larger miners crossing the threshold of liability. It is poor public policy to apply a layer of bureaucratic compliance when the relevant companies will never face a tax liability.

Recommendation 1

That the Government modify the simplified MRRT requirements for miners currently under the $75 million threshold, but anticipating exceeding it in the future, so as to exclude them from the unnecessary and onerous requirement to file extensive information to the Australian Taxation Office on a regular basis.

1.54 The final element to be considered in relation to compliance is that when a miner is making large profits above $75 million, the compliance costs associated with filing MRRT returns is entirely appropriate given the size of these mining ventures. Professor Garnaut made just this point during questioning from Coalition senators:

> Senator MATHIAS CORMANN: So they [low quality projects] are arguably in a worse position than they were before because they now have to go through the compliance burden of the MRRT to prove they do not have to pay it while still paying the taxes that they were due to pay before.
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> Prof. Garnaut: We are talking about fairly large businesses here even for the lesser mines and most of the data that is required. So in the whole scheme of things, compliance costs will not be particularly high and most of the data that is required is required for income tax purposes anyway.[19]

1.55 It remains, therefore, that the level of compliance costs is entirely reasonable for large companies and while it has been mitigated by the Government for smaller mining companies sitting permanently under the $75 million threshold, there is still room to reduce what burden remains for those companies anticipating exceeding the threshold some years hence.

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18 Professor Pietro Guj, 8 April 2013, *Proof Committee Hansard*, p. 21.

19 Professor Ross Garnaut, 29 April 2013, *Proof Committee Hansard*, p. 4.

Broader economic benefits of the mining boom

1.56 It is worth noting that even at those times that the MRRT collects less revenue, the benefits of the mining boom are still being felt across the country. Reserve Bank of Australia research shows that:

> … the resource economy accounted for around 18 per cent of gross value added (GVA) in 2011/12, which is double its share of the economy in 2003/04. Of this, the resource extraction sector – which we define to include the mining industry and resource-specific manufacturing – directly accounted for 11½ per cent of GVA. The remaining 6½ per cent of GVA can be attributed to the value added of industries that provide inputs to resource extraction and investment, such as business services, construction, transport and manufacturing.[20]

1.57 Similarly, Bureau for Resource and Energy Economics research found that:

> While Western Australia (66 per cent) and the Northern Territory (56 per cent) enjoyed the highest increases in real weekly household income during the Millennium Boom, households in all jurisdictions had increases in weekly earnings of about 30 per cent or more over the period 2002–03 to 2011–12. Overall, average weekly real household income in Australia rose 39 per cent over the past decade.[21]

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20 Rayner, V. and Bishop, J., *Industry Dimensions of the Resource Boom: An input-output analysis*, Reserve Bank of Australia, Feb 2013. http://www.rba.gov.au/publications/rdp/2013/pdf/rdp2013-02.pdf (accessed 3 May 2013)

21 Remarks made by Professor Quentin Grafton, Executive Director/Chief Economist of the Bureau of Resources and Energy Economics, 18 September 2012, p. 9. http://www.bree.gov.au/documents/presentations/ANCRE-SEP2012_ProfGrafton_speech-text.pdf (accessed 3 May 2013)

Conclusion

1.58 It is clear, therefore, that the MRRT is operating as intended; a profits based tax will collect more when profits are high and less when profits are low. External factors have reduced the profitability of the mining industry for the moment, hence reduced revenue from the MRRT. The MRRT will, however, continue to generate revenue over the long term.

1.59 There is absolutely no evidence to suggest that the MRRT presents a sovereign risk. Indeed, the evidence is all to the contrary. This issue was explored specifically in a series of questions to BHP Billiton, Xstrata and Rio Tinto. In response to the same broad question as to whether the MRRT adversely affected investment plans, BHP Billiton representatives agreed that 'investments were [still] made'[22], Xstrata representatives agreed that 'investment by [Xstrata] has continued to be significant in this country'[23], and Rio Tinto representatives noted the following:

> Mr O'Neill: […] We are on the record as indicating that over the course of the last decade up until 2011 we have invested more in Australia than we have actually earned from our projects in this country. We have continued to pursue that investment window that is there associated with the commodity surge from China. In fact, you are familiar with the Pilbara operations. We have been investing there.[24]

1.60 The above testimony points to the continuing strong investment pipeline since the MRRT was introduced.

Senator Mark Bishop
Deputy Chair

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22 Mr Christian Bennett, BHP Billiton, 29 April 2013, *Proof Committee Hansard*, p. 26.

23 Ms Cassandra McCarthy, Xstrata, 29 April 2013, *Proof Committee Hansard*, p. 29.

24 Mr Mark O'Neill, Rio Tinto, 29 April 2013, *Proof Committee Hansard*, p. 27.