The Senate

Economics
References Committee

Development and operation of the Minerals Resource Rent Tax

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Senate Economics References Committee

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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.

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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 <u>replaced</u> 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]

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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]

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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]

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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.

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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.

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 tax[17] 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.

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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;

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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.

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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.

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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 rate[32] 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]

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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 **Staring 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.

Chapter 2

Explaining the revenue shortfall

2.1 This chapter considers the extent to which design features of the MRRT, as opposed to other factors such as commodity prices, are responsible for the failure of the MRRT to raise the revenue the government predicted in budget update after budget update.

2.2 During this inquiry and previous Senate Estimates hearings, the Prime Minister's and the Treasurer's assertion that the MRRT revenue shortfall in 2012/13 compared to the most recent $2 billion revenue estimate is supposedly a consequence of low commodity prices, a high dollar and international economic conditions was challenged not just by a broad range of observers, but by Treasury itself. Many observers pointed to specific design features in the MRRT as the reason for the shortfall, whereas Treasury Secretary, Dr Martin Parkinson, made clear again and again that changes in commodity prices, production volumes, exchanges rates and state royalty arrangements had already been factored into the much reduced $2 billion MRRT revenue estimate. For a range of reasons, Treasury had not been able to properly assess the fiscal implications of design features such as the market value based depreciation and the net back arrangements.

2.3 Much of the discussion in this inquiry regarding the integrity and reliability of the Treasurer's MRRT revenue estimates centred on the fact that, unlike the proposed RSPT, the MRRT provided mining companies with the option of calculating their depreciable starting base asset by market value as at 1 May 2010, as an alternative to the book value method (that is, the 'most recent audited accounting value of those assets at 1 May 2010').

2.4 The objective of the deliberate MRRT design feature providing for market value based depreciation arrangements is well understood. It helps ensure existing projects are not subject to retrospective taxation. However, it is clear that either intentionally (because it was convenient at the time helping to mask the fiscal impact of the mining tax deal), or out of pure incompetence, the Treasurer did not properly cost and assess the fiscal implications of this key MRRT design feature.

2.5 The complexity of the MRRT's netback arrangements – that is, the need for mining companies to determine the value of a commodity in the condition they were in just after extraction (the 'valuation point'), on a project-by-project basis – was also raised by a number of witnesses as a likely explanation for the difference between Treasury's projections and the actual revenue raised to date. Treasury conceded both during this inquiry and previously during Senate Estimates in February 2013 that they had struggled to assess the fiscal implications of the netback arrangements.

2.6 Some witnesses pointed out the obvious, that the amount of revenue raised was impacted by the fact that the MRRT only applied to iron ore and coal, the effective 22.5 per cent MRRT rate compared to the 40 per cent RSPT rate, the full crediting of all state royalty payments against any MRRT liability and the level of the uplift rate in relation to both losses and royalty credits,.

2.7 All of these factors are considered below. This chapter also considers whether the RSPT, had it been implemented as announced in May 2010, would have led to a substantially different revenue outcome.

History of MRRT revenue projections

2.8 In the 2010-11 Budget, which was released on 11 May 2010, nine days after the announcement of the RSPT, it was projected that the RSPT would raise $3.0 billion in 2012-13 and $9.0 billion in 2013-14.[1]

2.9 When the MRRT was announced on 2 July 2010, the government asserted that despite significant concessions in relation to rate and base of the MRRT compared to the RSPT and more generous deductions, that the revised arrangements would raise just $1.5 billion less over the forward estimates than the RSPT over its first two years (2012-13 and 2013-14).[2] Specifically, whereas the RSPT was estimated to raise $3 billion in 2012-13, the Treasurer asserted the MRRT would raise $4 billion and for 2013-14 the MRRT was said to raise $6.5 billion instead of the $9 billion for the RSPT.

2.10 However, following persistent scrutiny by the Senate Fuel and Energy Committee about the reasons for this rather small fiscal impact, the Treasurer was forced to concede in his July 2010 pre-election Economic Statement that the fiscal impact of the mining tax deal would have been a much more significant $7.5 billion if the government had not also made significant upward revisions to its commodity price assumptions underpinning its MRRT revenue estimates.'[3] These upward commodity price adjustments thus increased the forecast revenue over the forward estimates (again, effectively meaning 2012-13 and 2013-14 in the context of the MRRT) by $6 billion.

2.11 Despite repeated requests at the time by the Senate Fuel and Energy Committee and subsequently by the Senate in successive Orders for the Production of Documents, the Gillard government steadfastly refused to release the commodity price assumptions it had used to estimate its predicted MRRT revenue.

2.12 The Gillard government's secrecy around its MRRT revenue assumptions, such as the commodity price assumptions used, was in stark contrast with the transparent release of such information by State governments of all persuasions in states like Western Australia and Queensland.

2.13 Given that the higher forecast commodity prices used to forecast MRRT revenue in July 2010 were never applied to the Rudd government's forecasts of RSPT revenue, the $1.5 billion difference in projected revenue for 2012-13 and 2013-14 provides an inadequate basis for comparing the revenue estimates for those taxes, both initiated and developed by the Treasurer Wayne Swan.

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1 Budget 2010-11, *Budget Paper No. 1*, Statement 5: Revenue, p. 21.

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.'

3 Australian Government, *Economic Statement*, 14 July 2010, p. 31.

2.14 With this caveat in mind, Treasury documents released under Freedom of Information (FOI) on 11 March 2011 suggested that the RSPT, over a nine year period from 2012-13 to 2020-21, would have raised $99.0 billion (using the parameter variables used in the 2010-11 budget costing) whereas the government predicted at that time that the MRRT would raise a much lower $38.5 billion over the same period (despite the much upgraded commodity price assumptions).[4] Over the four years from 2012-13 to 2015-16, the same FOI document predicted the RSPT would raise $37 billion, against MRRT revenue estimates for the same period of $22.5 billion (see Table 1, below).

2.15 MYEFO 2010-11 reported that the 'strong appreciation of the Australian dollar' since the Pre-Election Economic and Fiscal Outlook (PEFO) 2010 (which was released on 23 July 2010 and did not update the MRRT forecast in the Economic Statement)[5], was 'having a damping effect on receipts from taxes on profits through reductions in the incomes of businesses in export-oriented and import-competing industries'. The net impact on the MRRT had resulted in a decline in projected receipts from $4 billion to $3.3 billion in 2012-13 and $6.5 billion to $4.1 billion in 2013-14, for a total decline of $3.1 billion in revenue across the two financial years. MYEFO stated that this was almost entirely due to appreciation of the Australian dollar, 'with US dollar commodity prices broadly the same at the end of the projection period as at PEFO.'[6]

2.16 In the Budget 2011-12, released on 10 May 2011, it was projected that the MRRT would raise $3.7 billion in 2012-13, $4.0 billion in 2013-14 and $3.4 billion in 2014-15.[7] These figures were unchanged in the Explanatory Memorandum for the MRRT package, which was introduced into the Parliament on 2 November 2011.[8]

2.17 MYEFO 2011-12 saw a further downward revision in MRRT revenue estimates over the forward estimates of $500 million, with the decline spread across the years 2013-14 and 2014-15. Changes to the low profit offset exemption accounted for $60 million of the decline in revenue across the forward estimates.[9]

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4 Treasury document, 'MRRT Model – delinked.xls,' FOI release No. 1962, 14 February 2011, http://archive.treasury.gov.au/documents/1962/PDF/MRRT_Model.pdf.

5 Secretary to the Treasury, Dr Ken Henry AC, and Secretary to the Department of Finance and Deregulation, Mr David Tune PSM, *Pre-Election Economic and Fiscal Outlook 2010*, 23 July 2010, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2010/Pre-Election-Economic-and-Fiscal-Outlook-2010.

6 Australian Government, *Mid-Year Economic and Fiscal Outlook 2010-11*, 9 November 2010, pp. 32, 283.

7 Australian Government, Budget 2011-12, *Budget Paper No. 1*, Statement 5: Revenue, p. 35.

8 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 4.

9 Australian Government, *Mid-Year Economic and Fiscal Outlook 2011-12*, 29 November 2011, p. 167.

2.18 On 8 May 2012, less than two months after the passage of the Bills, revenue projections from the MRRT were again revised down in the 2012-13 Budget to $3.0 billion for 2012-13 (down $700 million), $3.5 billion in 2013-14 (down $300 million) and $3.2 billion in 2014-15 (up $100 million). $3.7 billion in MRRT revenue was projected for 2015-16.[10]

2.19 In MYEFO 2012-13, released on 22 October 2012, the government massively revised MRRT revenue down by $4.3 billion over the forward estimates, which included a downward revision of 2012-13 revenue from $3.0 billion to $2.0 billion (see Table 1).

2.20 Even those much reduced MRRT revenue estimates were not achieved, with the actual comparable net MRRT revenue of $88 million collected for 2012-13 so far coming in more than 90 per cent below the Treasurer's much reduced $2 billion MRRT revenue forecast.

2.21 Appearing before the committee, Dr Parkinson provided a summary of the reasons for these fluctuations, starting with MYEFO 2010-11:

> In MYEFO 2010-11 the primary driver of the downward revision was the increase in the value of the Australian dollar against the US dollar which obviously impacts on the profitability of the firms, everything else being equal. In the budget for 2011-12, there was a further increase in the Australian dollar offset by an increase in the US dollar price for iron ore and met coal—metallurgical coal. In MYEFO 2011-12 the exchange rate was offset by some falling prices and an increase in WA iron ore royalties. Budget 2012-13 was driven by further increases in the exchange rate. MYEFO 2012-13, which is where you said we get to the $2 billion, is really reflecting significant falls we were seeing at the time in the price for iron ore and metallurgical coal.[11]

2.22 Importantly, in a previous Senate Estimates hearing in February 2013, Dr Parkinson had made very clear that contrary to the Treasurer's assertions that changes in commodity prices, exchange rates and state royalties were to blame for the lower MRRT revenue collections, those changes had in fact already been factored in and that specific design features in the MRRT Heads of Agreement were in fact to blame. Specifically he said:

> We have adjusted those estimates for the things that we can see that have changed in the interim. What we have not done is adjust the estimates for things that we cannot see. It is obviously very difficult for us to get a handle on some of these things, and now we have to go through a process of trying to work out what has actually been behind the moves. 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

10 Budget 2012-13, *Budget Paper No. 1*, Statement 5: Revenue, p. 20.

11 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, 3 April 2013, p. 28.

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.

CHAIR: What was the fifth point, sorry?

Dr Parkinson **:** There is an initial starting cost base, and then there is a netback arrangement which basically says that we can envisage a price at the docks, ready to go on the ship, but we do not know how much of that price is actually attributed to the various points in the production chain. The point that is relevant for the MRRT is close to the mine—that is, when it comes out of the ground. It is very difficult for us to actually get a handle on those. What we will do—and we did this at MYEFO—is use the best available information. We use the best available information on commodity prices, we use our exchange rate forecasts and we update that for actuals—we use the things that we can see. The things that we cannot see, we have actually got to try and get to the bottom of, and the Treasurer has been very explicit in saying that the Treasury and the tax office, in the normal course of events, will unpick this and try to understand what is going on.[12] []

12 Economics Committee Hansard, Thursday, 14 February 2013, pp.51-52

Table 1: Changes in RSPT/MRRT revenue projections, $ billion[13]

		2012-13	*2013-14*	*2014-15*	*2015-16*	*Total*
2 May 2010	*RSPT announced*					
11 May 2010	Budget 2010-11	3.0	9.0	12.5*	12.5*	37
2 July 2010	*MRRT announced*					
14 July 2010	Economic Statement	4.0	6.5	6.5*	5.5*	22.5
9 November 2010	MYEFO 2010-11	3.3	4.1	6.5*	5.5*	19.4
10 May 2011	Budget 2011-12	3.7	4.0	3.4	5.5*	16.6
2 November 2011	MRRT Bills introduced into Parliament	3.7	4.0	3.4	5.5*	16.6
29 November 2011	MYEFO 2011-12	3.7	3.8	3.1	5.5*	16.1
8 May 2012	Budget 2012-13	3.0	3.5	3.2	3.7	13.4
22 October 2012	MYEFO 2012-13	2.0	2.4	2.1	2.6	9.1

* RSPT revenue projections for 2014-15 and 2015-16, and MRRT revenue projections for the same years, as projected at the time of the 2010-11 Budget and the 2010 Economic Statement respectively, were contained in Treasury modelling that was released under Freedom of Information in early 2011. Treasury document, 'MRRT Model – delinked.xls,' FOI release No. 1962, 14 February 2011, http://archive.treasury.gov.au/documents/1962/PDF/MRRT_Model.pdf.

Revenue raised to date

2.23 As noted in chapter one, the MRRT has raised $126 million in the first two instalment quarters of 2012-13. Two points should be noted in this respect: first, the $126 million represents gross revenue, whereas the government's MRRT revenue estimates in the Budget were net revenue estimates. That is, the MRRT revenue estimates in the government's various budgets and budget updates took reduced company tax revenue as a result of MRRT payments being a tax deduction for company tax purposes into account – which means the company tax adjusted and budget estimate comparable MRRT revenue figure is in fact $88 million, not $126 million. Secondly, as this is the first financial year in which the MRRT applies, there are only three MRRT collection quarters in 2012-13.

2.24 The $88 million net MRRT revenue collected does also not take into account the costs to the government of administering the new tax. According to answers by the ATO provided to various Senate estimates committees, the cost of implementation and

13 Based on sources cited above.

administration of the MRRT just for the ATO is more than $53 million to date.[14] Treasury Secretary, Dr Parkinson, indicated to this inquiry that he was not prepared to deploy the resources required to assess how much taxpayers money has been spent by Treasury to develop and implement the RSPT and MRRT fiascos.

2.25 During the inquiry, AMEC indicated that smaller miners had been forced to spend about $20 million so far to comply with the MRRT just to prove that they did not have to pay any MRRT, whereas the larger miners BHP Billiton, Rio Tinto and Xstrata all indicated that they had spent several million dollars to comply with and administer the MRRT so far.

2.26 During the inquiry, Rio Tinto and BHP Billiton both told the committee that they had made an MRRT instalment payment in the third and final quarterly assessment period for 2012-13, but were not in a position to disclose the amount of their respective payments. Xstrata, meanwhile, confirmed that it had not made any MRRT payments in any of the instalment quarters of 2012-13.[15]

2.27 Notwithstanding any additional amounts of tax paid in the third and final instalment period for 2012-13, no one disputes that MRRT revenue in 2012-13 will fall well short even of the much reduced $2 billion MRRT revenue estimate contained in the Treasurer's 2012-13 MYEFO released on 22 October 2012.

2.28 It is worth noting that the instalments are, as the ATO explained to the committee, a pre-payment based on a taxpayers estimate of their annual liability. In this sense, the MRRT instalments are basically a pay-as-you-go income tax payments. They are therefore not assessed on a quarterly basis by the ATO, and are subject to subsequent adjustment.[16]

2.29 The ATO indicated that they will not know for certain until June 2014 what the actual MRRT liability will have been, which means that even some of the low instalments made so far may have to be refunded to the mining companies who have made them.

Views on the revenue shortfall

The government's explanation for the revenue shortfall

2.30 The government's explanation for the shortfall in MRRT revenue was that 'revenue from resource rent taxes have taken a massive hit from the impact of continued global instability, commodity price volatility and a high dollar.' The government further noted that revenues across the board were down substantially,

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14 Senator Cormann, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 49.

15 *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 21.

16 Ms Stephanie Martin, Deputy Commissioner, Resource Rent Tax, Australian Tax Office, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 48.

emphasising that the 'MRRT is a profits-based tax that raises more revenue when profits are higher and less when they are lower.'[17]

2.31 But of course the Secretary of Treasury, Dr Parkinson, comprehensively discredited that assertion by the Treasurer. Various profit announcements by relevant mining companies in recent months are also inconsistent with the Treasurer's already discredited assertions.

2.32 The government has long maintained that resource rent taxes are, as it was put in the 2011-12 *Budget Paper No. 1*, 'a highly variable source of revenue as they are heavily influenced by commodity prices and exchange rate levels.'[18]

2.33 Dr Parkinson indicated to this committee that Treasury would not be in a position to properly 'get to grips' with what was driving MRRT revenue levels until the ATO had received tax returns from mining companies following the end of the financial year, and had a chance to quality assure those returns, aggregate the data and share it with Treasury.[19]

2.34 Asked when the government would know definitively know how much MRRT revenue had been raised in 2012-13, the ATO indicated that that it would not know this until it had received all returns from 2012-13, which are due by 1 June 2014.

The 'big three' on the low levels of MRRT paid

2.35 The three big miners, Rio Tinto, BHP Billiton and Xstrata, all explained the low amounts of MRRT paid to date (relative to Treasury's projections) by reference to market conditions.

2.36 Rio Tinto noted that it had not paid MRRT in the period to 31 December 2012 primarily because of the significant decline in iron ore and coal pricing in the second half of 2012, together with the continued strength of the Australian dollar despite these price falls.[20]

2.37 Similarly, Xstrata maintained that while it may be the case that the coal industry in Australia had not to date generated much if any MRRT revenue, this 'unfortunately reflects the reality of the current parlous state of the Australian export coal industry.' Like Rio Tinto, Xstrata also noted the ongoing strength of the Australian dollar as a factor, along with increasing cost pressures in Australia such as labour, consumables, the carbon tax and increased royalties.[21]

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17 The Hon Wayne Swan MP, 'Minerals Resource Rent Tax revenue', media release, 8 February 2013, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/019.htm&pageID=003&min=wms&Year=&DocType=0.

18 Australian Government, Budget 2011-12, *Budget Paper No. 1*, Statement 5: Revenue, p. 29.

19 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, 3 April 2013, pp. 27, 38.

20 Rio Tinto, *submission 8*, p. 2.

21 Xstrata, *submission 14*, p. 2.

2.38 Appearing before the committee alongside representatives of the three big miners, Mr Mitchell Hooke, Chief Executive Officer of the Minerals Council of Australia (MCA), also underlined the decline in relative profitability in the mining industry in recent years. He told the committee that:

> …according to ABS data, the mining industry's gross operating profit as a proportion of sales has deteriorated to the point today where it is comparable to and indeed less than what it was at the start of the boom in 2003-04.[22]

2.39 The three big miners also stressed that the MRRT's volatility was a design feature, not a design flaw, and it was entirely appropriate that it collected less revenue at a time when profits were down. As BHP Billiton put it, the MRRT is, by design, a 'top-up tax', in that it was applied 'on top of' existing royalties and corporate tax. As such, the MRRT is:

> ...inherently volatile, susceptible as it is to commodity price and exchange rate movements and cost pressures. It is not, and was never expected to be, a form of stable taxation revenue – that is a role better left to Australia's corporate income tax regime and royalties. [23]

2.40 Mr Hooke stated that it appeared that while the government had 'repeatedly and correctly stated that MRRT revenues would be volatile,' it did not appear that the extent of this variability had been properly figured into Treasury's revenue projections:

> The only feasible explanation for [the] disparity in the estimate figures and the reality of the current situation is that Treasury expected that with the imposition of, firstly, the RSPT and now the MRRT, that it would be mining boom business as usual: that investment would continue unabated, that the exchange rate would return to the characteristics of a commodity's nominated currency and revert to somewhere in the order of 75c to 80c to the US dollar, as it had through the first phase of the boom to the GFC; that commodity prices would not downside correct or closer approximation to the long-run equilibrium of marginal costs of production; that operating costs would not have nearly doubled since 2006; that multi-factor productivity would not have deteriorated by a third over that period; and that capital expenditure intensity would not be at unprecedented levels. Clearly this would not have been, nor is, the case. Both industries have entered a period and a phase of heightened uncertainty and volatility in the last 12 to 18 months with a marked deterioration in conditions in the coal sector in particular.[24]

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22 *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 19.

23 BHP Billiton, *submission 13*, p. 2.

24 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 19.

Alternative views on the impact of commodity prices on MRRT revenues

2.41 Directly challenging the Gillard government's attribution of the revenue shortfall to the decline in commodity prices, Western Australia Treasury told the committee:

> The Commonwealth's mining tax revenue estimate for 2012-13 has fallen by 33 per cent between its 2012-13 budget projections and MYEFO. There has been significant volatility in the iron ore price throughout 2012-13 commencing in the September quarter. While the fall in iron ore prices would have played some part in that decline in the Commonwealth's MRRT revenues, Western Australia's iron ore royalties were influenced by the exact same price factors. However, Western Australia's iron ore royalties estimate for 2012-13 fell by only 11 per cent between our 2012-13 budget and our midyear review. So something else is going on. For there to be a threefold decline relative to ours means something else is going on in those estimates other than price.[25]

2.42 Although approaching the issue from a different perspective, Professor Garnaut also noted that while commodity prices had fallen from their record highs, they nonetheless remained very high by historical standards.[26]

2.43 Western Australia Treasury and Professor Garnaut, like the overwhelming majority of witnesses appearing before this committee, suggested that the lower than expected MRRT revenues were attributable to specific design features of the tax, rather than simply a corollary of lower commodity prices. These design features are considered below.

The starting base allowance

2.44 As noted in chapter one, one of the allowances under the MRRT is the starting base allowance. Starting base allowances recognise investments in assets (starting base assets) relating to upstream mining activities of a mining project that existed before the announcement of the government's intention to introduce a rent-based resource tax on 2 May 2010. The starting base arrangements also recognise certain expenditure on such assets made by a miner between 2 May 2010 and 1 July 2010.

2.45 Whereas the RSPT would only have allowed miners to value their starting base assets using the 'book value method' – that is, using the most recent audited accounting value of those assets as at 1 May 2010 – the MRRT also provides miners with the option of using a 'market value method' – that is, where the miner uses the market value of the asset (including the mining right) as at 1 May 2010.[27]

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25 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, p. 34.

26 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 7.

27 See chapter one for more detail on key differences between the 'book value' and 'market value' methods.

2.46 A major focus of this inquiry was the revenue impact (and, as discussed in chapter six, equity impact) of allowing miners to use the market value method to determine their depreciable starting base.

The market valuation method as a tax shield

2.47 At the time the MRRT legislation was before the Parliament, other commentators also suggested that allowing the depreciation of assets based on market valuation could prove costly in terms of revenue raised. For instance, in an article in *The Age* (16 February 2012), Professors of Accounting Peter Carey (Deakin University) and Neil Fargher (ANU) noted that:

> …under division 75, miners can choose between the 'book value' and 'market value' of an asset, which will be allocated against revenue over the productive lift of a mine in order to calculate MRRT liability. Depreciating assets based on market valuation is not generally accepted accounting practice, yet it is allowed in the legislation. In simple terms, a mining asset that cost $100 million to bring to production might today be worth $350 million if sold on the open market. A miner could use this higher valuation to calculate depreciation, which would reduce the profit subject to the tax.[28]

2.48 Professor Fargher revisited these points when he appeared before the committee, and again reiterated that the market valuation method was unusual accounting practice. Asked to comment on the MCA's argument (noted below) that using a market valuation method for existing assets was a well-established principle for easing the transition to a new tax regime, Professor Fargher explained that it:

> …it is difficult to argue that if the information is not in the public domain prior to the tax being written on the market value. If you are writing a tax on the market value of something that is known and observable, their statement seems reasonable. If you have market value of assets that you do not have a value for, writing the tax on unobservable market values does not seem reasonable—or at least seems dangerous.[29]

2.49 Dr Denniss of the Australia Institute explained to the committee that it appeared:

> …unusual and counterproductive to have allowed the market valuation of the asset to be used, and allow me to try to explain why. If I spend $100 million building a mine, that is the capital that I have invested—that is what I am risking. I presumably spend that $100 million because I think at commodity prices today, or the commodity prices I expect, I will be able to make a decent return on that $100 million. By definition, I would not have built it or convinced someone to give me the money if that was not the case. Now, if commodity prices double after I build the mine my profits will obviously go up substantially—probably more than double—and in turn, if

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28 Peter Carey and Neil Fargher, 'Flaws in the mineral tax mean Australia may profit little from its resource wealth,' *The Age*, 16 February 2012, http://www.theage.com.au/opinion/society-and-culture/minings-small-change-20120215-1t6dr.html.

29 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 13.

> I were to sell that mine I would obviously be able to get a lot more for it than I spent on it because I am not selling what I built, I am selling the flow of profits. So when we allow the mining companies to value their investment at the new market price rather than the depreciated actual expenditure, we have already wiped out, for the taxpayer, most of the super profit because the super profit is now built into this new market price. So if the purpose of the superprofits tax is to collect windfall revenue for the owners of the resource—you and I—then to let the miner use today's valuation of their mine, rather than what they actually spent on the mine, as the base is an incredibly generous gift from us, the owner to them, the miner. So yes, I can't understand why they did it. If they understood what they were doing, I don't know why they did it, and if they did not understand what they were doing, they should not have done it.[30]

2.50 Professor Pincus, speaking to his joint submission with Professor Ergas, explained to the committee why the market valuation method, together with the uplift rate, would mean that MRRT revenue would depend on the extent to which profits exceeded market expectations as at 1 May 2010. Professors Pincus and Ergas started from the economic proposition that:

> …that expected profits will be fully capitalised in the market price of an asset. The value of an asset in the market should be equal to the present value of the cash flows anticipated from the asset, discounted at a rate that takes account of risk. The discount rate is the weighted average cost of capital, or WACC, which is what the market requires to invest in the company and its projects. So it follows that the market value of excess returns is zero, in that all such returns have been capitalised into the market value.
>
> What the MRRT does is tax profits above a lift-up rate, or what we have called the 'allowable rate'. To the extent that that rate is lower than the WACC, the tax falls on profits that have been capitalised into sharemarket prices already. The amount of the MRRT revenue depends on the extent to which profits succeed market expectations at the MRRT valuation date.[31]

2.51 Like a number of other witnesses (in particular, AMEC, FMG and Professor Guj) Professors Pincus and Ergas also held that the market value starting base arrangements lacked equity, in that they favoured established projects with relatively low risk. This issue is explored further in chapter six.

2.52 Professor Pietro Guj explained that the very high market values of established mining projects as at 1 May 2010 would provide these projects with a significant depreciable starting base for capital deduction, meaning established projects could potentially pay no MRRT following its initial introduction:

> It is worth nothing that the MRRT was devised at a time of rapidly rising commodity prices and that initial revenue forecasts of market valuation

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30 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 6.

31 Professor Jonathan Pincus, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 17.

> were high, reflecting an expectation of an ongoing ... mineral boom. Recent drops in iron ore and, particularly, coal prices and a sustained high exchange rate will have no effect on MRRT collection from projects where the starting base capital deduction was high enough to reduce the MRRT liability to zero. Other than increasing the magnitude of the losses with the carry-forward for future deduction, MRRT collection would have only been reduced by drops in commodity prices and high exchange rates relative to earlier expectations for projects with the lower level of deductions and so liable to pay MRRT in the first year of its enforcement. At least in the case of iron ore, where more than 90 per cent of production is attributable to three companies with high market value or high book values it was logical to expect that initial MRRT collections would be low.[32]

2.53 Professor Garnaut told the committee:

> If you genuinely were allowing for a deduction for the market value of an asset, the current market value of those assets includes the value of the untaxed rent. If you are genuinely deducting the market value, almost by definition you are giving away the revenue from established projects. [...] That is a reason you cannot expect early revenue from established projects, and from new projects. The structure of the resource rent tax is such that a new project is not meant to pay resource rent tax until it has recouped its investment with a reasonable rate of return. If the market-value deduction has shielded all past investments then, almost by definition, you do not expect early revenue.[33]

2.54 FMG told the committee that while FMG itself had access to a sizeable tax shelter in the starting base allowance that made it unlikely it would have to pay any MRRT in the foreseeable future, the tax shelter would be even larger still for the miners that had negotiated the MRRT Heads of Agreement with the government:

> Because we were a reasonably recent company, it was more likely that our accounting values were closer to the market values. Because other companies have been around for a lot longer and would have written down the accounting values of their infrastructure and mine operations, it is likely that there would have been a greater gap between the accounting values and the market value.[34]

2.55 Professor Fargher told the committee that it was his expectation that all large companies would use the market valuation method to calculate their starting bases. He added that while some smaller companies that will not hit the MRRT profits threshold might take the book value approach, these companies would not be paying any tax anyway.[35]

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32 Professor Pietro Guj, *Proof Committee Hansard*, Perth, 8 April 2013, p. 15.

33 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 6.

34 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 5.

35 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 14.

Is recognition of prior investments at market value appropriate?

2.56 It is important to note that witnesses critical of the MRRT or the government's failure to properly anticipate the potential impact of the starting base depreciation arrangements (or indeed both), were not necessarily critical of the concept of recognising prior investment, or even providing miners with the choice of using market value for the depreciable assets.

2.57 Professors Ergas and Pincus explained that while the market valuation method of starting base assets created issues, including in terms of reducing revenue raised going forward, it did not necessarily follow that the government would be justified in only allowing mining companies to value their assets at book value. Indeed, if mining companies were required to use the depreciated book value of their assets this would likely result in:

> … extremely high effective tax rates because—in some cases, at least—these are very long lived assets that were built many years ago at times when the price level was much lower than it is today. As a result of that, you would be identifying as superprofits returns that from any reasonable economic perspective were not superprofits in any sense that we might normally imagine.
>
> So, from that moment, what would have happened if you had done that is that you would effectively have expropriated a very large share of the value of investors' claims over those resources. That, it seems to me, would have created enormous sovereign risk problems going forward.[36]

2.58 FMG, while emphasising its strident opposition to the MRRT, nonetheless agreed that it was appropriate to recognise prior investment in a new tax regime:

> The tax does need to realise some degree of treatment for capital that has been expended in the past. That was always one of the contentious points in the design of the RSPT and then the MRRT—how do you do that? How do you give someone credit for money that they have spent in the past? Is it book value? Obviously I was surprised that market value was the outcome. But you do need to give people some recognition of past expenditure.[37]

2.59 Professor Garnaut, meanwhile, both suggested that recognising prior expenditure in transitional arrangements was a complex business and implied that the government had not struck the right balance in its attempt to address this complexity:

> Transitional arrangements for past expenditures and what became profitable projects are always matters of complexity requiring deft judgement about the relative importance of a number of considerations. The transitional arrangements for the MRRT are extreme in their generosity to highly profitable established mines.[38]

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36 Professor Henry Ergas, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 24.

37 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 5.

38 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 1.

2.60 For its part, the MCA argued that allowing market valuation of existing assets was a 'well-established principle for easing the transition to new tax arrangements.' In this respect, the MCA stressed its view that the MRRT had lessened (though not removed) the punitive and retrospective manner in which the RSPT recognised prior investments.[39]

2.61 In its recently released report, *Taxes paid in 2012* (March 2013; attached to Rio Tinto’s written submission to this inquiry), Rio Tinto indicated that had made no MRRT payments in 2012. It explained how both the royalty credit allowance (discussed further below) and the starting base allowance related to its non-payment of MRRT in 2012, but also why these were important design features of the tax:

> Where a mining company like Rio Tinto has existing investments that become subject to the MRRT a separation of old investments not subject to the MRRT from new investments in the same mine, which will be subject to the MRRT, would be impractical. Instead the tax was designed to allow a mining company to claim a deduction (the starting base allowance) in each tax year for the May 2010 market value of the investments over the shorter of the life of the mine or 25 years. The royalty credit and the starting base allowance are deliberate design features of the MRRT that respectively ensure there is no double taxation of the same income, and that the MRRT is not levied retrospectively on existing investments.[40]

2.62 In its submission, Xstrata argued that a fundamental flaw with the RSPT was that it would have applied to existing projects and mine investments. ‘The MRRT provided a workable alternative on the issue of prospectivity by recognising the value of existing investments through a deductible starting base.’[41]

Treasury view on the impact of starting base arrangements

2.63 Treasury told the committee that because mining companies were not required to submit their returns until the end of the financial year, it was not yet possible to determine what impact the starting base arrangements were having on revenue.[42]

2.64 Having established that Treasury’s revenue projections were based on estimates of the starting base of MRRT liable mining projects of approximately $360 billion depreciated over approximately 19 years (Treasury’s estimate of the average effective life of a mine), Dr Parkinson emphasised that until the ATO and Treasury had been given a chance to review tax returns it was not possible to compare these assumptions with what had actually taken place:

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39 MCA, *submission 10*, p. 4.

40 Rio Tinto, *Taxes paid in 2012: A report on the economic contribution made by Rio Tinto to public finances*, March 2013, p. 9, http://www.riotinto.com/documents/RioTinto_taxespaidin2012.pdf.

41 Xstrata, *submission 14*, p. 2.

42 Mr Rob Heferen, Executive Director, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 29; and Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, Canberra, p. 31.

> [Individual] taxpayers do not have to declare their starting base until they put in their tax return, and that is the only time when we will actually know what the effective life is that they have used. As Mr Heferen said, that is perfectly legitimate under any self-assessment system, but then the tax office comes into play and is able to engage with the taxpayer and say: 'Is this really the actual life? Is this really the actual starting base?'[43]

2.65 The ATO expanded on this point for committee, stating that because the MRRT instalments received to date were not subject to a quarterly assessment, and were basically pay-as-you-go instalments, the ATO was not in a good position to assess the impact of the starting base arrangements on revenue. While the ATO had gained 'some insights of a general nature' from speaking to miners, the fact remained that mining companies:

> …do not have an obligation to give [us specific information about how they have determined their liability] until they lodge their returns. It is not until that point where they actually have to exercise their statutory choice, whether they do a book value or market value.
>
> We have had some insights and some feedback of a general nature from them about what has been occurring. That is where it sits at the moment until we get to their lodgements.[44]

2.66 Asked by the committee to explain why miners were given the choice between using the market value method or the book value method to value their starting base assets, Treasury responded that it was 'not uncommon for taxpayers to be provided choices around a range of things in other areas of tax to facilitate reduction compliance costs to take account of specific circumstances the taxpayers may be in.'[45] However, when pressed to explain what the public benefit of allowing taxpayers this choice was, the committee was told 'that goes to a policy question about the public benefit of the tax. I do not think that, as public servants, we can provide assistance there.'[46]

The complexity of the netback arrangements

2.67 The committee heard from a number of witnesses that the complexity of the netback arrangements, and in particular the need for mining companies to determine commodity revenue at an artificial 'valuation point' that does not coincide with any actual commercial event, added to the uncertainty regarding Treasury's projections.

2.68 As noted in chapter one, the MRRT Act does not require a particular method to be used in determining revenue attributable to the valuation point, except to require that the method used:

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43 Dr Martin Parkison, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 31.

44 Ms Stephanie Martin, Deputy Commissioner, Resource Rent Tax, Australian Tax Office, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 47.

45 Mr Rob Heferen, Executive Director, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 45.

46 *Proof Committee Hansard*, Canberra, 3 April 2013, p. 46.

> …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.[47]

2.69 Asked about the potential in the MRRT design for mining companies to reduce their MRRT liability by inappropriately allocating costs across their projects or across their value chain, Professor Fargher explained that the ATO:

> …has the ability to disallow something that they would rule as—let us call it—clearly inappropriate. The mining companies have a choice of at least half a dozen methods that could be considered appropriate. To make it clear, we have got an observable market price somewhere down the value chain. We are estimating costs to get back to the tax point. The more that we can include in that further down the vertically integrated chain, the less tax base we are going to have. In accounting, wherever that problem occurs, it generally eventually results in problems between the tax office and the taxpayer. Basically, joint costs have to be somewhat arbitrarily allocated at the end of the day. Therefore, because there is an arbitrary allocation there, the taxing authority might consider reducing the choices available to the taxpayer to one or two that seem reasonable rather than giving them the option to take five or six, working out the best one from their perspective and then using that.[48]

2.70 Talking about the complexity of the MRRT generally, Mr Pearce (FMG) touched on the specific complexity of the netback arrangements, suggesting that:

> …to try to artificially calculate a revenue point that does not actually exist and to artificially allow deductions that do not naturally exist and have to be calculated is a very, very complex thing.[49]

Treasury view

2.71 Treasury conceded that it was possible that its lack of visibility of how miners had worked through the netback arrangements added to the uncertainty of its revenue projections. For instance, an official from Treasury's Revenue Group told the committee that some of the difficulties surrounding the impact of the starting base on revenue ‘also arise for the netback arrangements. To try to get the value at the point of extraction could differ from company to company and no doubt between iron ore and coal.’[50]

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

48 Professor Neil Fargher, *Proof Committee Hansard*, 3 April 2013, p. 14.

49 *Proof Committee Hansard*, Perth, 8 April 2013, p. 8.

50 Mr Rob Heferen, Executive Director, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 32.

Reliance on unaudited information

2.72 In discussing the starting base and netback arrangements, Professor Fargher explained to the committee his view that the MRRT provided, as he has previously put it, 'incentives and opportunities for creative avoidance' by taxpayers.[51]

2.73 Professor Fargher originally outlined these concerns in an article published with Professor Carey in *The Age* on February 2012. In that article, Professors Fargher and Carey noted that the MRRT was not based on audited company profits, but rather on a portion of profits from particular mining activities. It further requested mining companies to determine the amount of proceeds and costs that relate to these activities. The design of the MRRT and the reliance on the miners themselves to determine the appropriate proceeds and costs therefore provided mining companies with 'incentives and opportunities for creative avoidance [that] appear even greater than those applying to company tax.'

> At numerous points, opportunities exist to reduce revenue estimates and increase costs so as to minimise the taxable profit reported. Volatility in commodity prices could also allow strategic timing of the recognition of revenue and expenses.[52]

2.74 Professor Fargher made the same points in his opening remarks to the committee, adding that while the estimates of revenue and costs were subject to ATO review, 'the taxpayer still has significant choice within the legal precedent and accepted market valuation principles.' Professor Fargher further noted that this aspect of the MRRT may not have been adequately considered in the government's revenue projections.[53]

2.75 Asked whether some auditing of the claimed MRRT revenues and costs should be required, Professor Fargher responded:

> Yes. As the filings are made, particularly on the starting base, I believe they will have to be reviewed by the Australian tax office, and I would expect that the Australian tax office will effectively audit some of those filings. I guess the word 'audit' has a technical meaning in this sentence. I am using it more in the sense of a tax audit rather than a financial statement audit. But, for example, it would be interesting for, say, the policy unit in tax to know when a taxpayer has increased their depreciation, reducing the net book value for company tax purposes but increasing the depreciation in order to get a bigger saving under the MRRT. That would seem to be an inconsistent approach that might be picked up of an audit of the filings.[54]

51 Quote from Professors Neil Fargher and Peter Carey, 'Mining's small change,' *The Age*, 16 February 2012.

52 Professors Neil Fargher and Peter Carey, 'Mining's small change,' *The Age*, 16 February 2012.

53 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 10.

54 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 13.

2.76 Pressed on why it was noteworthy for a taxpayer to want to organise their affairs in the most tax efficient manner, Professor Fargher explained that while this was not itself remarkable, what was surprising was:

> …how many choices and estimates were involved in the MRRT. It is taken for granted that taxpayers will choose their methods, within reasonable allowances, to minimise their taxes. In designing a good tax policy, some of these choices are sometimes eliminated to get to an effective tax.[55]

Limiting the MRRT to iron ore and coal

2.77 A key difference between the RSPT and the MRRT is that the former would have applied to all mineral resources, while the latter only applies to coal and iron ore.[56]

2.78 Some critics of the MRRT suggested that there was no sound economic reason for the tax to only apply to iron ore and coal. For example, Dr Denniss suggested that it was 'excessively narrow' to only apply the MRRT to these two commodities, and there was no good economic reason it should not be applied to all resources.

> The economic argument for why you would have tax on iron ore and coal is exactly the same argument that applies to those other resources. It is more efficient and equitable to have a broader tax base.[57]

2.79 Similarly, Professor Quiggin told the committee that there was no 'obvious justification' for limiting the MRRT's application to iron ore and coal. Therefore:

> …whatever the political feasibility of it, it would certainly be the obvious route in terms of horizontal equity within the mining industry. The rationale that is applied to coal and iron ore applies equally well to a number of other high-value minerals.[58]

2.80 During his appearance before the committee, Professor Garnaut made much the same point:

> In the context of doing this properly and permanently—doing for hard minerals what we did for offshore petroleum so it does not have to keep on being changed—you would not be continuing a distinction between coal and iron ore and gas on the one hand and other minerals on the other. A very profitable goldmine or copper mine or uranium mine generates

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55 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 11.

56 The MRRT also applies to 'anything produced from a process that results in iron ore being consumed or destroyed without extraction' and 'coal seam gas extracted as a necessary incident of mining coal.' MRRT Act, s. 20-5(1). Oil and gas, meanwhile, are subject to the PRRT.

57 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, pp. 1, 4, 8.

58 Professor Ross Quiggin, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 14.

> resource rents in exactly the same way as a very profitable coal or iron ore or gas project.[59]

2.81 In contrast, the MCA explained to the committee that there was, in fact, a strong rationale for limiting the MRRT to bulk commodities. Specifically, a key principle of the MRRT, according to the MCA, was that a resource-based tax should be limited to the value of the resource, and not reach into the value added from infrastructure and other activities such as processing and smelting. If this principle was properly applied (and MCA argued it was not in the case of the RSPT), then commodities such as uranium and gold simply would collect very little tax revenue:

> The valuation point is run-of-mine. There is not much value in a gram of gold and a tonne of ore at run-of-mine. If you want to move it downstream then you are actually getting into normal profits and then you are getting into the company tax run again. We have been through this previously a number of times. It actually goes to the inherent value of the rent. You have got two buckets of value coming up out of the mine: one is the inherent value of the resource; the other is the entrepreneurial expertise added by the miner. The problem with the RSPT is that it was using superprofits as a pretty ordinary mechanical proxy for a rent tax. That was what we essentially fixed in terms of the design of the MRRT.[60]

Treasury view

2.82 Under questioning, Treasury declined to offer an economic rationale for the decision to limit the MRRT to iron ore and coal. Instead, Treasury simply stated that it was a 'policy decision' of the government, and therefore it would be inappropriate for it to make an argument regarding the reasons for restricting the MRRT to iron ore and coal.[61]

The definition of 'rent' and the uplift rate

2.83 As outlined in chapter one, losses incurred by a mining project can be uplifted and carried forward for use as deduction against profit in future years. The uplift rate – that is, an annual interest allowance on losses provided to compensate for risk – for the MRRT is set at the long-term bond rate (LTBR) plus 7 per cent.

2.84 Some witnesses questioned whether the MRRT's definition of 'rent' (or 'superprofit') was too high to collect meaningful revenue. Dr Denniss explained to the committee that in his view:

> …the way this scheme has been defined and the definition of superprofit is such that while commodity prices are down slightly on their historic highs they are still well above the long-term average, and the fact that the mining

59 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 7.

60 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 33.

61 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 44.

> tax is collecting so little revenue at this point in the commodity cycle suggests to me that the definition of a rent has been set excessively high.[62]

2.85 Addressing the uplift rate specifically, Dr Denniss told the committee that he believed it was:

> …very generous, and again, if the purpose of the scheme is to collect the super profit component then I would like to see the economic or other evidence that was used to generate why they choose seven per cent. … I just have not been convinced that that number was anything other than politically acceptable rather than economically justified.[63]

2.86 Asked if an after-tax bond rate of two or three per cent would be more appropriate as an uplift rate, Dr Dennis responded:

> Yes—and I do not want to suggest there is certainty around this; plenty of my colleagues could have a good long argument about exactly which bond rate, how it should be adjusted and which definition of inflation should be used. I think that, without suggesting it would be simple and clear that everyone could agree on it, a number more like 2 to 3 per cent would at least have some economic justification based on those bond yields rather than, again, the seven per cent for which I have seen pretty flimsy justification.[64]

2.87 Professor Fargher was less definitive in his assessment of the appropriateness of the uplift rate, suggesting that there was:

> …some basis for coming up with that seven per cent uplift rate and the risk-free rate over a longer period of time. In the world we are in today it seems very high. In the world we were in 20 years ago, it may have seemed quite reasonable. So, going forward, it comes down to your guess as to where we are going to be. There is certainly a distinct chance that as of today we may not get significant super profits that will exceed this hurdle which will result in significant tax being paid.[65]

2.88 In Professor Fargher's view, the uplift rate should correspond to the kind of profits that the tax is meant to capture. Since definitions of 'super profits' will vary over time according to the expectations that are related to underlying economic conditions, if the MRRT was to be redesigned:

> …the uplift rate should be considered in regard to the underlying economics of what is trying to be captured there. Locking in a particular rate of seven per cent seems quite arbitrary. I would have thought some

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62 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 1.

63 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 6.

64 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 6.

65 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 14.

> clever economists in Treasury could come up with something which varies with the health of the economy and the extended health in this industry.[66]

2.89 In putting his views on the matter before the committee, Professor Garnaut compared the high uplift rate in the MRRT with the PRRT uplift rate of the LTBR plus 5 per cent. Professor Garnaut told the committee that in his view there was no good reason why the MRRT uplift rate should be higher than the PRRT uplift rate. At the same time, Professor Garnaut suggested that the an uplift rate of the LTBR plus 2 or 3 per cent might not properly allow for the risk typical of MRRT liable projects:

> You have to recognise that this is a project based tax and therefore there is more risk. You do not get complete economic offset for losses. There is a provision for transferring exploration costs from failed projects to projects generating assessable income, but that is not done immediately. Why you would look at something like five per cent rather than two or three per cent is in recognition that there will be failed projects where investors will not recoup their losses. My assessment is that a five per cent margin above the long-term bond rate would not introduce an incentive to overinvestment. These are risky investments, not like the transmission and distribution of electricity, where we allow, I think, in today's terms, a return well in excess of George Fane's suggested rate of return, for a completely riskless investment. These investments are not riskless investments.[67]

Treasury view

2.90 When asked about the economic rationale and fiscal impact of the uplift rate, Treasury declined to provide the committee with information, suggesting the settings were 'policy issues', and as such it would be inappropriate for Treasury to comment on.[68]

The 22.5 per cent MRRT rate

2.91 In discussing why the MRRT had raised so little revenue, if not necessarily why it had fallen short of Treasury projections, some witnesses suggested that there was no apparent reason for setting the MRRT rate (22.5 per cent, including the extraction allowance) lower than the PRRT rate (40 per cent).

2.92 For instance, Professor Garnaut told the committee that 'it is not obvious why the tax rate is lower and the uplift rate higher than for the PRRT.'[69] While emphasising that he thought the issue should be properly revisited in the context of broader discussions about federal financial relations, Professor Garnaut also told the committee that he did not believe 40 per cent was too high a rate.[70]

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66 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 15.

67 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 8.

68 Mr Rob Heferen, Executive Director, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 45.

69 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 1.

70 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 8.

2.93 In response to arguments such as that put by Professor Garnaut, the MCA told the committee that there was, in fact, a strong economic argument for the difference between the PRRT rate and the MRRT rate:

> Firstly, the economic argument centres around internationally competitive tax rates. Secondly, there is an economic argument about the flatter capital and return profile of minerals resources as distinct from petroleum. Thirdly, petroleum is offshore, so it only has one set of resource rent in addition to company tax. We have a third dimension, which is royalties. So we have got the company tax, the royalties and, of course, now the MRRT, which you are making a lot of headwind out of, when in fact it is a top-up tax to the other two principal taxes which we have spoken about.
>
> So, yes, there is an economic argument and it centres around whether you are going to impose tax rates that put this country's minerals resources into an uncompetitive position, way over what our competitors are facing in those emerging resource rich countries which I referred to earlier. That then is the fundamental economic argument. Treasury itself argues that the 40 per cent under the RSPT was an arbitrary figure plucked from the air. There is a very strong case to be made for a differentiation in resource rent taxes.[71]

Treasury view

2.94 Treasury declined to answer committee questions as to the economic rationale of having an MRRT rate of 22.5 per cent (that is, 30 per cent less the extraction allowance) when the PRRT rate is 40 per cent, except to say that it was 'policy decision' of the government.[72]

The full crediting of state royalties

2.95 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.

2.96 Under the proposed RSPT, resource entities would have received a refundable credit for state royalties paid, 'at least up to the amount of royalties imposed at the time of announcement, including scheduled increases and appropriate indexation factors.'[73]

2.97 In the MRRT Heads of Agreement, the Prime Minister, Treasurer and Minister for Resources and Energy made an emphatic commitment to credit 'all' royalties against any MRRT liability.

2.98 While the Gillard government tried to walk away from that commitment after the 2010 election by suggesting that 'all' did not mean 'all', that is, that 'all' did not

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71 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 32.

72 Mr Rob Heferen, Executive Director, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 44.

73 Australian Government, *2010-11 Budget – Budget Paper No. 2*, p. 45.

include 'future increases' in royalties, the government's resistance on this point was very short lived. Indeed, the PTG was emphatic in its view 'that there be full crediting of all current and future State and Territory royalties under the MRRT so as to provide certainty about the overall tax impost on the coal and iron ore mining industries.'[74]

2.99 The question of the crediting of state royalties against MRRT liabilities has been the matter of much recent debate, and indeed the subject of a Private Senator's Bill introduced by Senator Milne on 12 September 2012 and subsequent inquiry into that Bill by the Senate Economics Legislation Committee.[75]

2.100 In its dissenting report for that inquiry, the Greens noted that they had obtained Parliamentary Budget Office costings that indicated that limiting the royalties that could be credited to those in place at 1 July 2011 would mean the MRRT would raise an additional $200 million in 2012-13, $500 million in 2013-14, $700 million in 2014-15 and $800 million in 2015-16, a total of $2.2 billion over the forward estimates.[76]

2.101 In the current inquiry, the committee heard from witnesses who objected to the full crediting of state royalty and witnesses, such as the MCA, who argued that the full crediting of royalties 'is a key design feature of the MRRT imparting a measure of stability to the overall tax burden on coal and iron ore projects and so as to avoid double taxation on the mining profit.'[77]

2.102 It is clear that the Gillard government's commitment to credit all royalties against any MRRT liability provided a direct incentive to State and Territory governments to increase their royalties on iron ore or coal, which five out of six State governments have done since the MRRT Heads of Agreement was signed on 1 July 2010.

2.103 Indeed, the fact that state royalties are creditable against any MRRT liability means that State and Territory governments no longer have the same incentive to offer lower royalty rates in the context of competitive federalism, as the benefit of such lower rates would flow to the federal government in Canberra and not to the industries individual states may wish to attract.

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74 Policy Transition Group, New Resource Taxation Arrangements (December 2010), p. 57, *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 Wayne Swan MP and the Hon Martin Ferguson AM MP, *Government Accepts Resource Tax Recommendations*, media release, 24 March 2011, http://minister.ret.gov.au/MediaCentre/MediaReleases/Pages/GovernmentAcceptsResourceTaxRecommendations.aspx

75 See Senate Economics Legislation Committee, *Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012*, p. 15.

76 See Senate Economics Legislation Committee, *Minerals Resource Rent Tax Amendment (Protecting Revenue) Bill 2012*, p. 15 .

77 MCA, *submission 10*, p. 18.

2.104 The general consensus from witnesses during this inquiry as during the most recent Senate Estimates hearing, was that, whatever its impact on revenue overall, the difference between the revenue projections as at MYEFO and the announcement of the revenue raised in the first two collection quarters could not be attributed to the full crediting of royalties, as the government has long been aware of state intentions regarding royalty rates.

2.105 As Western Australia Treasury explained to the committee:

> ...there has been a perception—indeed, a misperception—that the crediting of state royalties and increases in state royalties in some jurisdictions have in some way contributed to the lower than forecast MRRT collections. This is, as I said, a misperception, as the scheduled royalty increases across most states in terms of their own royalty regimes were generally well known at the time of the Commonwealth's 2012-13 budget and therefore could and should have been factored into any revenue estimates under MRRT. So the amount that they should have expected to be credited against MRRT revenues was known prior to the formulation of those estimates. For example, in the case of Western Australia, there was an increase in Western Australia's iron ore fines rate from 5.625 per cent to 6.5 per cent effective from 1 July 2012 and then further on to 7.5 per cent from 1 July 2013. Both of those increases were announced in May 2011. So those issues were fully known prior to the locking down of the Commonwealth's estimates. I understand the Commonwealth Treasurer and Commonwealth Treasury have publicly advised that Western Australia's changes to its own royalty regime were factored into the Commonwealth's 2011-12 MYEFO estimates.[78]

Treasury view

2.106 Whatever the impact of the full crediting of state royalties on the amount of revenue collected, Treasury confirmed to the committee this had already been factored in to the $2 billion revenue projected for 2012-13 in MYEFO.[79]

Would the RSPT have raised more revenue?

2.107 Discussing the disappointing level of revenue raised to date by the MRRT despite a period of what remained relatively high profits, Professor Quiggin told the committee that his preference would be for the government to go back to the Henry Review and the original RSPT design as a starting point.[80]

2.108 In its submission, BHP Billiton pointed out that the government would be refunding mining companies for losses, given current economic circumstances, had the RSPT been enacted.'[81]

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78 *Proof Committee Hansard*, Perth, 8 April 2013, p. 34.

79 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, 3 April 2013, p. 28.

80 Quiggin, *Proof Committee Hansard*, Melbourne, 29 April 2013, pp. 14-15.

81 BHP Billiton, *submission 13*, p. 2.

2.109 The MCA similarly pointed to Deloitte Access Economics estimates that the RSPT would have generated a negative net revenue of approximately $900 million in the first two quarters of 2012-13 when applied to iron ore and coal, as:

> …the design of the original RSPT the government was to refund royalties paid when there was no super tax liability offset. Quite simply, under the RSPT the government would have been writing cheques to mining companies at the time of fiscal weakness—clearly not a sustainable proposition.[82]

Committee View

2.110 The overwhelming evidence received by this inquiry confirms that the Prime Minister and the Treasurer have only got themselves to blame for the mining tax fiasco in general and the massive budget black hole from the MRRT in particular.

2.111 Back in June 2010, the MRRT was negotiated by a desperate government under pressure in the lead-up to a difficult election.

2.112 The government made significant concessions as part of its negotiations with BHP Billiton, Rio Tinto and Xstrata and failed to properly assess and cost the fiscal implications of those concessions.

2.113 Given the Gillard government's long track record of incompetence, the immediate suspicion is that this is another case of mere government incompetence.

2.114 The truth however is likely to be much more sinister.

2.115 It is the considered view of this committee that the Gillard government was well aware that it had overestimated MRRT revenue and underestimated the fiscal impact of the concessions it made in its mining tax deal.

2.116 In the lead-up to the 2010 election the Prime Minister and the Treasurer had two main objectives. They wanted to get the 'mining industry' off their back and they didn't want any costly concessions in any deal to undermine its pre-election narrative of an 'early return to surplus'.

2.117 As such, it was very convenient for the Treasurer that he was able to rely on significant and to this day secret increases in commodity price assumptions, while turning a blind eye to the true fiscal cost of various key design features of the MRRT Heads of Agreement.

2.118 Why, for example, was the Treasurer so desperate to keep commodity price assumptions used to estimate MRRT revenue back in June 2010 secret?

2.119 It is also clear from the evidence to this committee, including evidence from Treasury itself, that the three miners who participated in the negotiations provided the government with their estimate of the likely combined market value to be used for the purposes of market value based depreciation arrangements.

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82 *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 20.

2.120 Yet Treasury also indicates that the government was effectively flying blind on the fiscal implications of that key feature of the MRRT Heads of Agreement.

2.121 Incompetence or deliberate and convenient ignorance?

2.122 The committee does not even question the merit of the concessions made. What the committee does question is why the Gillard government did not properly cost the fiscal implications of those concessions before signing on the dotted line.

2.123 It is clear from the overwhelming weight of evidence, including from Treasury itself, that changes in commodity prices, production volumes, exchange rates and state royalties had already been factored into the progressively downgraded MRRT revenue estimates – all the way to the $2 billion MRRT revenue estimate for 2012/13 which was 50 per cent down on the original Swan MRRT forecast.

2.124 As such, the Prime Minister's and the Treasurer's repeated assertions that those factors were mainly to blame for revenue collections more than 90 per cent below the Treasurer's official MRRT revenue estimates have been comprehensively discredited as the sort of dishonest spin that sadly we have come to expect from this Treasurer.

2.125 Any Chief Financial Officer of a publicly listed company would have long lost his or her job if they had come in more than 90 per cent below forecast on a key revenue item like this.

2.126 It is clear that the specific design features of the MRRT agreed to by a government in its negotiations with the three biggest miners in Australia are mainly to blame for the massive revenue shortfall compared to the Treasurer's budget estimates.

2.127 The committee does not support any moves to limit the full crediting of state royalties or any changes to depreciation or netback arrangements.

2.128 Any such changes would make a bad tax worse. It would also again create further unnecessary uncertainty for one of Australia's most important industries.

2.129 The Gillard government's MRRT is a complex, distorting, inefficient, costly to administer, costly to comply with and unnecessary tax. Incredibly, it has not raised any meaningful revenue when the government has already spent all the money they thought it would raise and more.

2.130 Because of its complexity, inefficiency and increased cost of compliance, the MRRT is bad for investment in the mining industry and as such is bad for our economy. It is now abundantly clear that it is also bad for the federal budget, exposing it to unnecessary structural risks.

2.131 The inefficient and complex MRRT is unnecessary, because the mining industry already pays its fair share of tax. Indeed, the mining industry already pays more than $20 billion a year in federal and state taxes. It is not in our national interest for this important industry to be weighed down by a complex, inefficient and distorting tax which doesn’t even raise any meaningful revenue.

2.132 To the contrary, it is in our national interest to encourage increased investment in mining through competitive taxation and regulatory arrangements so mining remains strong and can continue to make a significant contribution to both our national prosperity and government revenue.

2.133 For all these reasons (and other reasons outlined in subsequent chapters), it is the committee's very strong view that the Minerals Resource Rent Tax should be abolished immediately.

2.134 In fact, confronted with the obvious failure of the MRRT, any federal government committed to our national interest would long have taken action to remove this bad tax.

Recommendation 1

The committee recommends that, in the national interest, the Minerals Resource Rent Tax be abolished at the earliest opportunity.

Chapter 3

The impact of the MRRT on the budget

3.1 This chapter considers the impact the shortfall in MRRT revenue will have on the budget and the extent to which this shortfall was predictable (and indeed predicted by many outside of government). It also questions the government's decision to link the growing cost of new and ongoing budget measures to what even the Gillard government now recognises as a highly volatile and uncertain source of revenue.

3.2 Consideration is also given to whether MRRT revenues are likely to increase over time or whether in fact the design features of the MRRT mean it is unlikely to raise significant amounts of revenue in the foreseeable future – if ever.

Was the revenue shortfall predictable?

3.3 At various points during the inquiry, witnesses told the committee that the low level of revenue raised by the MRRT relative to Treasury's predictions was, in fact, entirely predictable, given the design features discussed in the previous chapter.

3.4 In fact, the Senate Select Committee on the Scrutiny of New Taxes, which conducted the most comprehensive inquiry into the government's MRRT had repeatedly warned that the government's mining tax package was a fiscal train wreck in the making. [1]

3.5 FMG told the committee that, on the one hand, it was not surprising that Treasury had not been able to determine the impact the starting base depreciation and netback arrangements on revenue. As Mr Pearce of FMG explained:

> I am not surprised they could not see it. It has been very hard for us to see, and we are in charge of our own detail. Both calculations and the principles embedded in both the netback and the starting base are incredibly complex. It has taken us, as I say, the better part of two years to work through our own circumstances with the assistance of outside experts and consultants to help us firm up the opinions, the facts and the database that will support our positions opposite the tax office. So I am not surprised at all that Treasury have not been able to work their way through the detail, because we did not know the outcome of that process in detail until we went live last July.[2]

3.6 However, when asked if he was surprised by the low revenue raised by the MRRT, Mr Pearce responded:

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1 Senate Select Committee on Scrutiny of New Taxes, *The Mining Tax: A bad tax out of a bad process*, 29 June 2011, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=scrutinynewtaxes_ctte/completed_inquiries/2010-13/national_mining_taxes/report/index.htm &, Labor's Mining Tax a fiscal train wreck in the making, Senator Mathias Cormann Press Release, 29 June 2011, http://mathiascormann.com.au/media/2011/2011.06.29%20-%20Mining%20Tax%20Inquiry%20Report.pdf

2 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 3.

> Not at all. We had been saying for years—often, with AMEC, as a fairly lonely voice in the wilderness—that our belief was that the tax as designed would not raise any income for the government.[3]

3.7 A number of witnesses told the committee that it appeared unusual that the government had failed to properly allow for the fact that it had limited visibility of the impact on revenue of the starting base and netback arrangements.

3.8 For instance, in suggesting how the MRRT might be improved, Professor Neville R. Norman wrote in his submission:

> Deductions or subtractions such as the starting allowance should be designed with full knowledge of the likely sums being claimed. There should be boundary conditions, including a lower bound of zero of the tax, thus preventing tax credits or rebates arising This is an elementary point of tax design that seems to have been forgotten.[4]

3.9 Clearly a competent Treasurer would have ensured he had that information in front of him before pressing ahead with signing the MRRT Heads of Agreement.

3.10 Asked whether he was surprised that the government appeared to have signed up to what he suggested were overly-generous concessions to the mining companies in the MRRT Heads of Agreement, Dr Denniss responded concisely – he was.

3.11 He added further that he was surprised that:

> …if they were taking it at face value or were making estimates without any information from the firms—for example, as you said, those asset valuations—they did not have some sort of contingency built into the negotiation. By that I mean that, given the incredible incentive for the firms to increase the cost base, they should have either had some promises from the miners up front or left the door open to come back and revisit exactly this issue. I think it was poorly designed in that regard.[5]

3.12 Professor Fargher made a similar point when he was also asked if he was surprised that the government had agreed to the market value based depreciation arrangements without being fully aware of what the starting base value would be and its fiscal impact:

> Was I surprised? The honest answer is yes. You mentioned several factors in the design of the tax where the tax base was observable and estimates could be made based on prices and exchange rates. I believe that Treasury did make those estimates. You mentioned previously that the starting base and depreciation arrangements were viewed as somewhat unobservable by Treasury. My concern and surprise stems from the fact that negotiations led

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3 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 5.

4 Professor Neville Norman, *submission 11*, p. 1.

5 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 3.

> to clauses being written without at least an estimate of their impact being made. I am not in a position to know whether estimates were in fact made.[6]

3.13 Professor Fargher was not, however, surprised by the low revenue raised by the MRRT. He reminded the committee that, together with Professor Peter Carey, he had written an article that was published in *The Age* on 16 February 2012 ('Mining's small change') which had argued that it was difficult to reconcile the Gillard government's projections with the 'very generous allowances' afforded to the largest miners through the starting base and depreciation arrangements in the MRRT legislation which was then still before the Parliament.[7]

3.14 In contrast to the government’s projections, independent modelling suggested that design features of the MRRT, and in particular the starting base arrangements discussed in the previous chapter, would mean that little to no MRRT revenue was collected in the foreseeable future. An exchange between Professor Guj and Senator Bishop during the committee's public hearing in Perth on 8 April 2013 is particularly instructive in this regard:

> **Prof. Guj:** [...] One of the reasons why I am sitting in this room today is that the little bit of modelling which [I did] as a hobby, if you wish, was the only piece of quantitative work done that was in the public arena. I have not seen anything else done. I can only hope that Treasury did some modelling. I do not know; I have not seen anything.
>
> **Senator MARK BISHOP:** They do not make their modelling public.
>
> **Prof. Guj:** No. To their credit, though, I had an opportunity to talk to Treasury. They invited me to discuss my model, not theirs, and they were very much in line.
>
> **Senator MARK BISHOP:** So they were aware of the detail of your model and they had discussions with you about it?
>
> **Prof. Guj:** Yes. I had a discussion with Treasury and it was quite interesting that at the end of the discussion they said that in general terms, apart from some minor issue relating to how I made the assumption, they were in agreement with my conclusion.
>
> **Senator MARK BISHOP:** State or federal Treasury?
>
> **Prof. Guj:** Federal Treasury. I said, 'Well, what are you going to do about it?' They said that was a different story altogether. So it is not as if it comes as a great surprise that we are not getting much money.[8]

Treasury view

3.15 Treasury at various times over the past three months has directly contradicted the Treasurer's assertions that changes in commodity prices, production volumes,

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6 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 11.

7 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 10.

8 Professor Pietro Guj, *Proof Committee Hansard*, Perth, 8 April 2013, p. 20.

exchange rates and state royalties for iron ore or coal were to blame for the significant MRRT revenue shortfall compared to the government's budget estimates.

3.16 The Secretary of Treasury also effectively rejected the Gillard government's assertions that it was in fact Treasury who was to blame for getting the MRRT revenue forecasts wrong.

3.17 Indeed, it is worth pointing again to the evidence by Treasury Secretary Dr Parkinson both before Senate Estimates in February 2013 and before this inquiry.

3.18 First, when asked what went wrong with Treasury's MRRT revenue estimates (and whether he accepted responsibility given the Gillard government was pointing the finger at Treasury) Dr Parkinson told Senate Estimates:

> We have adjusted those estimates for the things that we can see that have changed in the interim. What we have not done is adjust the estimates for things that we cannot see. It is obviously very difficult for us to get a handle on some of these things, and now we have to go through a process of trying to work out what has actually been behind the moves. 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.

And that:

> There is an initial starting cost base, and then there is a netback arrangement which basically says that we can envisage a price at the docks, ready to go on the ship, but we do not know how much of that price is actually attributed to the various points in the production chain. The point that is relevant for the MRRT is close to the mine—that is, when it comes out of the ground. It is very difficult for us to actually get a handle on those. What we will do—and we did this at MYEFO—is use the best available information. We use the best available information on commodity prices, we use our exchange rate forecasts and we update that for actuals—we use the things that we can see. The things that we cannot see, we have actually got to try and get to the bottom of, and the Treasurer has been very explicit in saying that the Treasury and the tax office, in the normal course of events, will unpick this and try to understand what is going on.[9]

3.19 Dr Parkinson further reinforced those statements before this inquiry:

9 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, pp.51-52

3.20 I said at our estimates hearing that there are a range of factors that influence the revenue estimates, some of which we could see and some of which we could not see in broadly real time. We could see prices to a reasonable approximation in real time, we could see volumes to a reasonable approximation in real time, we could see state royalty rates and we could see the exchange rate. But the other factors that determine the extent to which revenue is collected are things that we do not have any particular insight into at the moment. The obvious one of those is the starting base and the other costs associated with production.[10] Treasury did not concede any flaws in its modelling, noting nevertheless that it had recently reviewed its forecasting methodology (as was a matter of public record). Dr Parkinson told the committee that, following on from this work, Treasury was thinking about the forecasting accuracy of its 'top-down' approach to its MRRT modelling – that is, an approach where Treasury had taken a broad industry-wide aggregate of estimated MRRT revenue (including how mining companies had used allowances), rather than attempting to determine revenue on a project-by-project basis. However, Dr Parkinson again conceded that at this stage it was not possible for Treasury to determine whether a project-by-project approach would be any better or worse than the top-down approach or what impact allowances available to miners was in fact having on revenue.[11]

3.21 When Dr Parkinson was asked by the committee why the firms negotiating the MRRT with the Gillard Government in late June/early July 2010 had not been required to set out the likely fiscal implications of the market value based depreciation arrangements, he responded that ‘firms may have known exactly what the starting base was at that time, but there was no legal obligation on them to report that to us.’ Asked, in turn, why the government had then signed up to depreciation arrangements without knowing the revenue implications, Dr Parkinson simply responded that this was ‘a policy question’, indicating that Treasury could not answer the question.[12]

3.22 Yet Treasury also told the committee that the miners negotiating the MRRT Heads of Agreement had in fact given advice to the government that the market value of relevant iron ore and coal assets for the purposes of the market value based depreciation arrangements was about $360 billion at the time. [13]

Design features or unexpected 'loopholes'?

3.23 While some of the commentary from those arguing in favour of an increased mining tax has argued that the miners have exploited unintended 'loopholes' in the MRRT to avoid significant payments under the tax, the generally accepted view expressed during this inquiry – including from Treasury, the mining industry and

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10 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, pp.28.

11 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, Canberra, p. 33.

12 Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, Canberra, pp. 29-30.

13 Mr Robert Heferen, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 30.

critics of rent-based resource taxation – was that so-called 'loopholes' were, in fact not loopholes, but quite deliberate design features of the MRRT.

3.24 As the MCA told the committee, while some commentators would have it:

> …that the key design fundamentals, the market value assessment of existing project capital assets, the starting base, deferred tax assets, capital expenditure deductions and the creating of royalties are loopholes or concessions. Again, this does not bear rational scrutiny with respect to established precedents in tax law and accounting practice. The market value determination of capital assets is established in Australia's capital gains tax law. Deferred tax assets is a standard accounting practice. The immediate deductibility of capital expenditure on MRRT-applicable projects is proper treatment for a resource rent tax, just as it is for the petroleum resource rent tax.
>
> Given that there was no reform of state and territory royalties as indicated and intended by the Henry review, royalties remain a cost of doing business and therefore, like any business cost, are deductible from tax-subject revenues.[14]

3.25 Similarly, when asked if aspects of the MRRT that had apparently affected revenue, such as the market value depreciation arrangements and royalty crediting, represented 'loopholes', Professor Ergas responded:

> They are certainly not loopholes in the conventional sense. As you say, a loophole is an unintended consequence that people, in a sense, exploit typically by circuitous means. These were fairly obvious features of the MRRT that many commentators picked up on at the time when the MRRT was announced. Indeed, we discussed that at some length in our published paper, which came out shortly after the MRRT was settled. So I do not think they could be described as unexpected, relative to the design of the MRRT.[15]

3.26 Under questioning, Treasury officials agreed that it would be wrong to characterise design features of the MRRT such as market value based depreciation arrangements, netback arrangements and the crediting of state royalties, as 'loopholes.'[16]

3.27 It is clear to the committee that market value based depreciation, netback and royalty crediting arrangements were in fact deliberate design features of the MRRT explicitly agreed to by the Gillard government.

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14 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, pp. 36-37.

15 Professor Henry Ergas, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 19.

16 Mr Rob Heferen, Executive Director, Treasury, and Dr Martin Parkinson, Secretary, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 34.

3.28 In the committee's view, the Gillard government has no one but itself to blame for the non-costed, yet costly, fiscal consequences of those deliberate MRRT design features.

3.29 After a bruising battle with the mining industry and in the shadow of a difficult election, the new Gillard Labor government had neither the insight, the strength or the appetite to follow proper process to ensure the implications of the MRRT Heads of Agreement were properly assessed before being formally locked in.

3.30 This is yet again further evidence of both the fiscal recklessness and incompetence that has characterised the Gillard government in general and Mr Swan's tenure as federal Treasurer in particular.

The linking of costly budget measures to hypothetical MRRT revenue

3.31 As a Parliamentary Library analysis of MRRT revenue and expenditure estimates released following the 2012-13 Budget points out, there is:

> ...no practical hypothecation of MRRT revenue to linked measures. While legislation that has been passed by the Parliament to implement some measures has been dependent on the successful passage of the MRRT legislation, future revenues and expenses are simply put through the Consolidated Fund.[17]

3.32 Nonetheless, in order to sell the MRRT to a sceptical public, the Gillard government when announcing the RSPT and then the MRRT explicitly linked a number of costly budget measures, such as the increase in compulsory superannuation, company tax cuts and a long list of other promises to revenue from the MRRT. Many of those promises have since been deferred or scrapped altogether by the Gillard government. The reason is that the money just wasn't there to pay for them as a result of the failure of the MRRT.

3.33 If the current government were to remain in office beyond this year it is expected that further measures attached to the MRRT, such as the Low Income Super Tax Offset will also be scrapped.

3.34 The abovementioned Parliamentary Library's analysis, which was based on the MRRT revenue and expenditure on linked measures as forecast in the 2012-13 Budget, calculated that the net impact of the MRRT package (that is, MRRT revenue minus expenditure on linked measures) would be +$2.068 billion in 2012-13 and -$619 million in 2013-14. Of course, the +$2.068 billion was based on revenue of $3 billion in 2012-13. The Parliamentary Library concluded that:

> ...unless MRRT revenue increases significantly in future years it will be difficult to cover expected future higher costs of some measures, such as

17 Kai Swoboda, 'Minerals Resource Rent Tax: changes to revenue and expenditure estimates,' in Parliamentary Library, *Research Paper No. 9, 2011-12*, 'Budget Review 2012-13,' 11 May 2012, p. 160, available at http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview201213.

> the $3.6 billion costs in 2019-20 associated with the superannuation guarantee reaching 12 per cent.[18]

3.35 The Parliamentary Library analysis also concluded that while the flow of MRRT revenue would be quite volatile, the cost of linked expenditure items would be ‘relatively stable and expected to grow over time, [and] will have to be paid even if the mining revenue falls.’

3.36 The government has previously indicated that it believes it is reasonable to fund commitments through MRRT revenue, despite the variability of this revenue. The Treasurer explained this position in February 2012:

> There are swings and roundabouts when you have a variable revenue stream [but] I don't accept that in an environment where revenue is adjusted depending upon variable factors beyond the forward estimates it is unsustainable to make the commitments we have made. They are entirely sustainable within the budget framework.[19]

3.37 However, others suggested that there is a clear and growing structural risk to the budget when tying growing costs in the budget to a volatile revenue source like the MRRT.

3.38 For example, FMG argued that it was 'a dangerous thing to do to spend money based on a highly variable income stream.'[20] Professors Pincus and Ergas described it 'as a form of fiscal illusion.'[21]

3.39 Going further, Professor Pincus argued that the volatility of MRRT revenues made the government's linked expenditure measures problematic:

> Volatile tax bases can cause inefficiency if governments overstate their value and treat the expected revenue as if it were a sure thing and make fixed spending commitments against that revenue in situations where governments cannot simply smooth out revenue variations.[22]

3.40 The committee is of the view that targeting an important industry for Australia with a complex, inefficient and distorting new tax, which at best was going to generate highly volatile and downward trending revenue while linking any such revenue to the growing fixed cost of related promises is another demonstration of the extreme fiscal recklessness and incompetence that has characterised Mr Swan's tenure as Treasurer for Australia since 2007.

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18 Kai Swoboda, 'Minerals Resource Rent Tax: changes to revenue and expenditure estimates,' in Parliamentary Library, *Research Paper No. 9, 2011-12*, 'Budget Review 2012-13,' 11 May 2012, p. 160.

19 Adrian Rollins and David Crowe, 'Swan unruffled by "variable" mining tax', *Australian Financial Review*, 13 February 2012.

20 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 13.

21 Professor Jonathan Pincus and Professor Henry Ergas, *Submission 2*, p. 4.

22 Professor Jonathan Pincus, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 17.

Future prospects for MRRT revenue

3.41 While several mining companies and Treasury indicated to the committee that it remained to be seen whether revenues would improve, most experts appearing before the committee suggested that the design features of the tax made it highly unlikely that that MRRT revenues would end up anywhere near the government's budget revenue estimates.

3.42 For instance, after explaining the impact the starting base depreciation arrangements were having (and would continue to have) on MRRT revenues, Professor Fargher was asked if the MRRT was likely to raise any meaningful revenue in the foreseeable future. He responded, 'not in the next five years, if that is your definition of "foreseeable future".' [23]

3.43 Professor Garnaut told the committee that the MRRT may not ever raise significant revenue, essentially because of two features: the shielding of past expenditure through the market valuation of starting base assets; and the interaction between the MRRT and state royalties.[24]

3.44 FMG, now Australia's fourth largest miner, told the committee that while it expected to pay more than $1 billion in company tax and state royalties, it did not expect to pay any MRRT for at least five years. [25]

Committee view

3.45 The committee notes that the expenditure measures that the government tied to the Minerals Resource Rent Tax are fixed and increasing, whereas revenue from the Minerals Resource Rent Tax was always going to be highly volatile, unlikely to raise any significant revenue in the foreseeable future and, according to Treasury's own projections, even in a best case scenario downward trending over time.

3.46 The committee believes that the linking of expenditure measures to hypothetical Minerals Resource Rent Tax revenue was fiscally reckless and irresponsible and has exposed the budget to even greater structural risk.

3.47 Not only would scrapping this failed Minerals Resource Rent Tax be good for investment and the economy, it would also immediately put the Budget in a stronger structural position. Firstly, because the increased economic growth which would follow from the removal of this unnecessary lead from the mining industry's saddle bags which would lead to increased company tax and state royalty revenue. Secondly, because by scrapping all but one of the measures attached to the MRRT along with the MRRT itself, the structural position of the budget improves. The budget would no longer be exposed by the linking of a highly volatile downward trending revenue source to the growing fixed cost expenditure of the many promises the current government has attached to it.

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23 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 12.

24 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 7.

25 Mr Stephen Pearce, FMG, *Proof Committee Hansard*, p. 2, Perth, 8 April 2013

3.48 It takes a particular kind of lack of talent to come up with a significant complex new tax, which, when all is said and done, actually leaves the budget worse off.

3.49 It might seem counterintuitive to some, but abolishing the MRRT will be good for the Budget.

Chapter 4

The negotiation and development of the MRRT

4.1 While criticisms of the MRRT were broad and varied, a common thread running through this criticism was that the MRRT's design flaws were, in large measure, attributable to the deeply flawed process of developing the tax.

4.2 In particular, critics from both the resources sector and academia suggested that the government had engaged in rushed, behind-closed-doors negotiations with a small group of multi-national, multi-project mining companies, to the exclusion of the overwhelming majority of Australian miners, and entirely for reasons of political expediency.

4.3 This chapter considers the process by which the MRRT was designed, including the extent of the involvement in that process of the Department of the Treasury and mining corporations that would be paying the tax.

The MRRT Heads of Agreement process

4.4 As noted in chapter one, the design features of the MRRT were determined in negotiations in late June, early July 2010 between the government and representatives from BHP Billiton, Rio Tinto and Xstrata. The agreement struck between the government and the large miners on the key features of the MRRT was recorded in the MRRT Heads of Agreement.

4.5 AMEC characterised the MRRT process as 'ill thought-through, shambolic, [and] non-consultative,' and emphasised that neither it nor its members were consulted during the Heads of Agreement process.[1]

4.6 As AMEC told the committee:

> The MRRT was clearly ill conceived as it was a direct result of a private and secret consultation process with three large multinational companies. AMEC was not consulted in any way during this private negotiation process. It should be acknowledged that these companies had no mandate to act on behalf of hundreds of mining and exploration companies with Australian projects or interests in iron ore and coal. They did not have any mandate to act in any way on behalf of AMEC or its wide membership base.[2]

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1 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 13.

2 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 1.

4.7 FMG endorsed AMEC's characterisation of the Heads of Agreement process, telling the committee that FMG was 'very frustrated with the outcome' of the 'secret negotiation' between the government and the three large miners.[3]

4.8 Despite having a very different perspective on the merits of rent-based resource taxation, Dr Denniss was also critical of the manner in which the MRRT was developed. While conceding that the process behind the development of the MRRT was beyond his area of expertise, Dr Denniss suggested that he did not believe:

> …you get the best policy when you design it very quickly, in isolation. It seems to me that if we had had a more transparent process we probably would have had more views. We would have had more people putting information on the table, rather than the mining companies themselves, and we probably could have overcome some of those problems I have identified.[4]

The level of Treasury's involvement in the Heads of Agreement process

4.9 Concerns have previously been expressed regarding the extent of Treasury's involvement in the negotiations between the government and the three large mining companies on the tax.[5] These concerns were explored in the current inquiry.

4.10 It is already a matter of public record that Treasury officials were not present present during the government's negotiations of the Heads of Agreement with BHP Billiton, Rio Tinto and Xstrata. Instead, the government was represented by the Treasurer, the Minister for Resources and Energy, their respective chiefs of staff, and a senior advisor to the Prime Minister, Mr Tom Bentley.[6]

4.11 However, the significance of Treasury not being 'in the room' during the negotiations was disputed by Treasury officials during this inquiry. Asked if Treasury officers were present during the Heads of Agreement negotiations, Mr Rob Heferen (Executive Director, Treasury) emphasised that it was not the case that 'this business was going on and we were miles away not being engaged.' He further suggested that it was not particularly noteworthy that Treasury officers were not present during the negotiations:

> And advice had been provided in the lead-up to the discussions so issues were worked through. Like any department doing its role, Treasury provided advice to its minister. The cabinet analogy, where ministers make

3 Mr Stephen Pearce, Chief Financial Officer, FMG, *Proof Committee Hansard*, Perth, 8 April 2013, p. 3.

4 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 1.

5 See, for instance, Select Committee on the Scrutiny of New Taxes, *The Mining Tax: A bad tax out of a flawed process*, June 2011, pp. 36-39.

6 Senate Select Committee on the Scrutiny of New Taxes, *The Mining Tax: A bad tax out of a flawed process*, June 2011, p. 36.

> decisions in cabinet, is a useful one; it is very rare for others to be involved in that decision-making process.[7]

4.12 Under questioning from the committee, BHP Billiton indicated that they did, in fact, have meetings with Treasury officials during the Heads of Agreement negotiation process.[8]

4.13 Treasury also rejected suggestions that it had been unusually reliant on information provided by the mining companies in arriving at its projections during the development of the MRRT. Treasury, as Mr Heferen told the committee:

> ...has its own avenues to try and understand the price of volumes and so forth. Information for the minister is very important, but it would go through a pretty considered process of triaging that to make sure that it resonates with everything else around that could be used to check, and those processes were certainly gone through.[9]

The lack of consultation with the States

4.14 The government has also been criticised for not consulting with the States on the design of the tax, particularly in light of the Henry Review's recommendation that the Australian and State governments 'should negotiate an appropriate allocation of the revenues and risks from the resource rent tax.'[10]

4.15 In his submission to this inquiry, the Treasurer of Queensland, the Hon Tom Nicholls MP, also linked the shortfall in revenue collected to date from the MRRT with the apparent failure of the Commonwealth to consult with the States on the tax:

> Despite the experience gained by the States through many years of partnership with the mining companies in the development of their industry, we were not invited to be in any way involved in the forecasting of revenue collected in the first half of the year – forecasting which has been proved inaccurate.[11]

4.16 Asked if the Commonwealth had in fact asked Western Australia to agree not to raise its royalties as part of the introduction of the MRRT, Mr Marney told the committee that he had no recollection of any such request ‘in the limited negotiations and consultations that were undertaken and my recollection is that the Premier made it

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7 Mr Rob Heferen, Executive Director, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 44.

8 Mr Brian Purdy, Senior Manager Finance, BHP Billiton Iron Ore, BHP Billiton, *Proof Committee Hansard*, Melbourne, 29 April 2013, pp. 30-31.

9 Mr Rob Heferen, Executive Director, Treasury, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 32.

10 Australia's Future Tax System, *Report to the Treasurer*, part 2: detailed analysis, vol. 1, December 2009, p. 231

11 Queensland Government, *Submission 3*, p. 1.

very clear to the Commonwealth Treasurer as to what his intentions were in terms of royalty policy going forward.'[12]

4.17 Supporters of the concept of a rent-based resources tax – if not necessarily of the design of the MRRT specifically – also told the committee that given state ownership of resources, it would have been logical to design the MRRT in consultation with the States.

4.18 For example, Dr Denniss told the committee that a 'well-designed scheme' (which he did not think the MRRT was) 'would have started with both the federal government and the state government in the room.' Dr Denniss further agreed with Senator Cormann's suggestion that while Dr Henry had recommended that the Commonwealth consult with the States on a resource rent tax, the Treasurer had never attempted to do so.[13]

4.19 As discussed further in the next chapter, Professor Garnaut was also strongly of the view that given the legitimate interest of both the States and the Commonwealth in onshore resource taxation, it followed that negotiations on a rent-based resources tax in Australia would ideally take place within broader Commonwealth-state discussions about federal financial relations.[14]

Committee view

4.20 It is widely accepted by both supporters and opponents of the MRRT that the process followed by the government in developing first the RSPT and then the MRRT was deeply flawed.

4.21 First there was the complete lack of consultation.

4.22 When commissioning the Henry Tax Review, the government raised significant expectations. It was to be root and branch reform of our tax system to make it simpler, fairer, more efficient and less distorting.

4.23 Instead of releasing the Henry Tax Review when the government received it, the report was kept secret until the government was ready to announce the RSPT along with the revenue it would generate for the budget.

4.24 Furthermore, neither the RSPT nor the MRRT bear much resemblance with what was recommended by the Henry Tax Review.

4.25 When the RSPT ended in tears, instead of cutting its losses, the government made a bad process worse.

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12 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, p. 36.

13 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 2.

14 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 1.

4.26 They excluded 99 per cent of the industry, to negotiate the design of a new tax personally, exclusively and in secret with the three biggest miners operating in Australia.

4.27 State and Territory governments, which have a significant interest in how the MRRT was to interact with royalties on iron ore or coal, incredibly and incompetently, were excluded from the process.

4.28 To cover up the lack of credibility of its original MRRT revenue estimates the Treasurer went out of his way to keep his flawed MRRT revenue assumptions secret, where other governments release that sort of information transparently as a matter of course.

4.29 The government failed to properly assess the cost of significant concessions made in the MRRT Heads of Agreement, signing up without a proper understanding of the fiscal implications of the mining tax deal.

4.30 When various flaws in the MRRT Heads of Agreement became too obvious to ignore, the government started to blame everyone (except themselves) from the States and Territories who were increasing their royalties to Treasury who had failed to run proper forecasts.

4.31 Every step of the way, when further failures of the government's mining tax were exposed, the government sought to hide the fiscal implications through more secrecy and cover-ups.

4.32 The reality is that the failure of the MRRT was entirely predictable and indeed predicted.

4.33 Moving forward, genuine sustainable tax reform can only be successfully pursued with genuine, active and inclusive engagement with all relevant stakeholders through an open and transparent process. Indeed genuine tax reform should be pursued from a position of fiscal strength, not just as a lazy grab for cash by a Labor government under constant short term fiscal pressure.

Chapter 5

The logic of a Commonwealth-administered resource rent tax

5.1 Throughout this inquiry, the committee has heard from various stakeholders and experts who not only expressed misgivings about the development and operation of the MRRT specifically, but also suggested it was neither efficient nor appropriate for the Commonwealth to impose a rent-based resources tax.

5.2 These stakeholders and experts generally emphasised one or more of the following points:

- either in theory or application (or both), rent-based resource taxes are not nearly as efficient as proponents would claim;
- the state-based royalty system is not as inefficient as detractors suggest;
- even if rent-based resource taxes are more efficient than royalties, this efficiency is lost in the MRRT because the design of this new tax is overly complex and is applied on top of (rather than in place of) existing state royalty regimes; and
- the imposition of a resource rent tax by the Commonwealth is an intrusion into what has traditionally been a state area of responsibility, consistent with the states' ownership of mineral resources.

Is the Australian mining industry 'paying its fair share'?

5.1 Asked how Australia's taxation of mining companies compared internationally, Professor Quiggin suggested that miners were 'getting a very sweet deal' in Australia:

> We are much more generous to the mining companies. A number of other developed countries, of course, have asserted complete public ownership over those minerals, as well as many others. I think a relevant consideration here is the continued threats by the mining industry that activity will move overseas. The nominated countries typically have been places, first, that do not provide anything like the range of public goods to the mining industry that Australia does—not only, obviously, things like infrastructure but also other benefits of a secure legal framework and so forth—and then many of those countries have sought to raise taxation along similar lines.[1]

5.2 In contrast, the mining companies that the committee heard from during the inquiry, and the peak mining industry bodies, strongly refuted any suggestion that miners in Australia were not already 'paying their fair share' of taxation or contributing to the economic prosperity of the nation.

1 Professor John Quiggin, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 15.

5.3 For instance, the MCA told the committee that it did not consider the MRRT necessary in order for all Australians to be sharing in the benefits of the mining boom. On the contrary, the benefits of the mining boom, according to the MCA, were already washing through the Australian economy, providing both direct and indirect employment, and 'sustainably contributing to the social and economic welfare of all Australians before the advent of this new MRRT tax.'[2]

5.4 In answer to a question on notice, MCA expanded on the benefits on mining to the economy and employment:

> BREE research shows that over the period of the mining boom, between 2002-03 to 2011-12, Australia performed better across a range of key economic variables compared with the preceding eight years. Recent RBA research finds that resource economy accounted for around 18 per cent of gross value added in 2011/12 and around 10 per cent of total employment given the flow through of mining to business services, construction, transport and manufacturing.
>
> The MCA KPMG Analysis of the Changing Resident Demographic Profile of Australia's Mining Communities (February 2013) shows that there is higher full-time employment in mining regions – 66 per cent compared with 58 per cent across regional Australia in general.
>
> All but two mining regions recorded an unemployment rate below the national unemployment rate (5.2 per cent) and the regional Australian unemployment rate (5.4 per cent)
>
> Mining represents 17 per cent of the total workforce in mining regions compared to 2% nationally.
>
> Around 5 per cent of the minerals workforce is comprised of apprentices and trainees (Training and Education Activity in the Minerals Sector, NCVER, 2013).
>
> Further, the mining industry is also the biggest employer of indigenous Australians, many in regional and remote areas.[3]

5.5 The MCA also noted that Deloitte Access Economics had calculated the cumulative total of revenues from federal company tax and state royalties paid by miners at more than $130 billion since the start of the millennium. MCA also told the committee that annual tax and royalty payments from the minerals sector had, in fact, risen fourfold since the start of the mining boom. MCA added that, contrary to claims made during the 2010 mining tax debate, 'the industry's effective tax rate has actually risen in recent years and it is at the Mount Everest of comparable international rates.'[4]

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2 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 18.

3 Minerals Council of Australia, Answer to Question on Notice received 03/03/2013

4 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 18; MCA. *submission 10*, pp. 10-14.

Is the MRRT a 'federal incursion' into a state responsibility?

5.3 In his letter to this committee, the Queensland Treasurer and Minister for Trade, the Hon Tim Nicholls MP, suggested that the MRRT represented 'a federal incursion into what has traditionally been a state revenue base and a state responsibility.'[5]

5.4 The Queensland Treasurer pointed to the broader problem of how states would raise the revenue they required given that the 'encroachment by the Federal Government into revenue bases traditionally held by the states is not sustainable, particularly where, as in this case, inadequate compensation is to be made available to the resource states.'[6]

5.5 Western Australia Treasury made a similar argument, telling the committee that the MRRT had destabilised federal financial relations. With regard to Commonwealth threats to remove funding from states if they exercised their prerogative to raise royalties, Western Australia Treasury told the committee:

> Any attempt to prevent increases in mining royalties in favour of maximising Commonwealth MRRT revenues would undermine state sovereignty and capacity to achieve fairer returns to their communities—those communities that own the mineral wealth. It would also raise serious concerns about the effective operation of the Australian federation if that were the case.[7]

5.6 Summarising Western Australia's concerns, Western Australia Treasury told the committee that:

> …resources are constitutionally vested in the states. Royalties are payments to states for the extraction and removal of those resources and they, rightly, should be payments to the states to compensate the community for the loss of those resources.[8]

5.7 Professor Garnaut told the committee that resource rent taxation in Australia needed to be considered as part of a broader reconsideration of federal financial relations, and in this connection stressed that both the Commonwealth and the states had legitimate revenue raising powers in this area:

> The Commonwealth has a completely legitimate taxation power in relation to corporate income. The states have a completely legitimate power. It is not a question of one level of government usurping powers from the other.

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5 Queensland Government, *submission 3*, p. 1.

6 Queensland Government, *submission 3*, p. 2.

7 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, p. 35.

8 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, p. 36.

> There are two legitimate constitutional heads of legislative authority, and we have to talk about the coordination of those.[9]

5.8 Any discussion of a rent-based resource tax in Australia, concluded Professor Garnaut, would need to take place within the broader context of a more fundamental reconsideration of federal financial relations. By implication, he suggested that the current MRRT had not been negotiated with regard to the broader context of federal financial relations, and therefore the introduction of the tax had simply invited additional complexity and instability into Australia's approach to resource taxation and, more broadly, financial relations between the Commonwealth and the states.[10]

Is the MRRT a simpler, fairer way to tax resources?

5.9 When the RSPT was first announced on 2 May 2010, the government claimed that the new tax was part of a long-term tax plan to 'make the tax system fairer and simpler for Australian working families and households.'[11] In light of the original intent underlying the government's introduction of a rent-based resource tax, the committee considered in the course of the inquiry whether the MRRT had, in fact, made Australia's tax system simpler and fairer.

5.10 Not surprisingly given his aforementioned views on the complexity and instability created by the MRRT's interaction with state royalties, Professor Garnaut told the committee that he did not believe that the introduction of the MRRT had made Australia's taxation system fairer or simpler.[12]

5.11 While emphasising that the MRRT was a vast improvement on the RSPT, the MCA told the committee that the tax as implemented was very complex:

> In a general sense, rent taxes are complex. Secondly, the accounting concepts are quite different when you are working through a rent tax or a superprofits tax as distinct from a normal profits tax. In particular the key point of difference is that they are a project by project consideration. [...] So there is quite a difference in the way rent taxes have to be accounted for on the books and the way they are considered in terms of the tax liabilities, and that adds to the overall perspective of tax compliance.[13]

5.12 Professor Guj also indicated that, even were it not for the complications that arose in Australian resource taxation because of Australia's federal arrangements (discussed below), the inherent complexity of applying a rent-based tax to resources might count against its application:

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9 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 8.

10 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p.2, 8.

11 The Hon Kevin Rudd 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.

12 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 2.

13 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p 24.

> The problem is that it works with oil and gas because the magnitude of the interests involved justify the cost of complexity.
>
> In mining, we are looking at 385 small, piddling mines in Western Australia. They have been lumbered with a system that is far too complex. So there is a price to complexity. I do not say that you should not tax complexity, but by all means you need to have it if the benefits of complexity overcome the price...[14]

5.13 Professor Guj subsequently added that while it may be appropriate for governments to tax rents:

> ...if you want to draw up true [rent-based] instruments, which are very complex, which imply high compliance costs and so on, there have got to be overwhelming benefits. At the moment, I do not see that that balance has been achieved with the MRRT as formulated.[15]

5.14 The complexity of the MRRT was further underlined by other witnesses during the inquiry. AMEC, for instance, told the committee:

> We have been sitting on an ATO liaison that was established towards the end of 2010 that has the sole purpose of looking at the detail and design aspects of the tax and trying to work out administrative procedures that will lessen the impact, the costs and ease the whole process of the administration of the tax. That group is still meeting. It has got a whole suite of working groups that sit within it, and we are still working with that group today. It is coming up to three years that we have been operating with that liaison group and the working groups associated with it. I do not know how many taxes get introduced that need a liaison group from the ATO that needs to operate for an ongoing period for about three years with a whole subsequent bunch of working groups to try and work through the administration of a tax. I have never experienced that before but I think it is indicative of the complexity of this tax that we all struggle with getting our heads around the administration of it—and the cost of it.[16]

Is the MRRT more efficient and reliable than state royalties?

5.15 A number of witnesses to this inquiry maintained that rent-based taxes are more efficient way to tax resources than resource royalties. However, other witnesses, including the state governments of Queensland and Western Australia, contended that their royalty systems were more efficient than the MRRT and provided a more stable source of revenue.

5.16 Some witnesses spoke in favour of rent-based taxes, at least in principle. For example, Dr Denniss, while critical of certain design features of the MRRT, told the committee that he nonetheless supported the idea of a resource rent tax. He added that

14 Professor Pietro Guj, *Proof Committee Hansard*, Perth, 8 April 2013, p. 16.

15 Professor Pietro Guj, *Proof Committee Hansard*, Perth, 8 April 2013, p. 17.

16 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 9.

the 'vast majority of academic economists would agree that [a resource rent tax is] an effective and efficient tax base to have'.[17]

> [From] an economist's point of view, the advantage of a profits based rather than a royalties based approach is that you collect a lot more tax from the most profitable mines, and of course there are coalmines in Australia that were producing profitably at $40 or $50 a tonne; they are making very high profits now. The Henry tax proposal—the RSPT—was aimed at collecting a lot of tax from those most profitable mines. … The marginal mine, using the economist's definition—the last one to go into production—will by definition pay no superprofits tax because it is hypermarginal. In the scheme of the entire industry that is a small price to pay. If you efficiently collect, with no distortions, a large amount of tax from 99 per cent of miners, and one miner—that marginal miner—is not paying a superprofits tax, then most economists would agree that that is a small administrative price and a small equity price to pay…[18]

5.17 Dr Denniss further suggested that a properly designed rent based mining tax 'also has the very substantial advantage of giving some cyclical revenue growth.' That is, a well-designed mining tax, combined with a macro-economic instrument such as a sovereign wealth fund, could potentially ease the pressures that a booming resources sector has placed on the exchange rate and non-mining sectors of the economy.[19]

5.18 Asked if state royalties were as flexible as a rent based tax given royalty rates can change according to price of a commodity (as they do in Queensland for coal), Dr Denniss responded:

> Of course the states can, when they choose to, provide for changes in royalties. States can intervene in a legislative way. But the advantage of a super profits tax is that it does that automatically. A super profits-type tax is an automatic instrument which, once instituted, does the work itself. Yes, states can come in retrospectively and change a legislative instrument but I would not describe the royalties as being as flexible as a super profit tax.[20]

5.19 Other economists told the committee that whatever the theoretical advantages of resource rent taxation relative to resource royalties, the MRRT failed to realise those advantages, not least because of the way it interacted with state royalties.

5.20 For example, asked if the MRRT was an economically efficient tax, Professor Guj suggested that if it was viewed in isolation – that is, if it was the only tax on resources, rather than a tax on top of royalties – then it might be considered slightly

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17 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p.1-2.

18 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 3.

19 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 1.

20 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 7.

more efficient than royalties. However, Professor Guj also indicated that considered in light of its interaction with state royalties, the MRRT in its 'current formulation would not in my view represent an improvement.' Questioned further on this point by the committee, Professor Guj added:

> If you were to ask me whether I think the resource rent tax system would be an appropriate way of taxing resource rent, in an ideal environment—perfect market, perfect information, complete knowledge of where mining resources are and so on and the capacity to adjust the normal rate of profit to the risk of individual projects—my answer would be yes, and you would find that most economists would answer that way. The system we have put in place is not that type of system.[21]

5.21 The state governments that this committee heard from during the inquiry challenged the very idea that royalties were inefficient, and underlined the simplicity of royalties relative to the MRRT. According to the Queensland Treasurer, the estimated cost of administering state royalties in Queensland had been approximately $2.1 million in 2012-13, and it was estimated that $2.2 billion in royalty revenue would be collected in 2012-13. He contrasted this with the MRRT, arguing that it had been estimated:

> ...that he additional cost of implementing and administering the MRRT and extended petroleum resource rent tax to 30 June 2013 exceeds $50 million. These figures do not include further costs borne by the Australian Government in developing and revising the Resource Super Profits Tax and the MRRT, or the costs borne by industry participants, states and other relevant stakeholders in understanding and negotiating the workings of each iteration of the resource rent tax.[22]

5.22 Western Australia Treasury, meanwhile, challenged the suggestion by supporters of rent-based resource taxation that royalty systems are an impediment to exploration and investment in the resources sector:

> [Royalties] are a key feature of virtually every successful resources economy and the Department of Mines and Petroleum regularly advise us that the royalty system has not in any way impinged upon exploration activity or resource project development. As we have seen in recent years, the development in Western Australia has been spectacular, with all of that occurring against the backdrop of a comprehensive *ad valorem* royalty regime. Indeed, since the current royalty regime in Western Australia was introduced in 1981, the value of the state's mineral production has increased from just $2 billion to $82 billion in 2011-12. In light of this fact, it is very clear that the assertion that royalties do not support growth in the resource industry is false. More significant issues for resource project developers are the overall taxation system, access to quality mineral resources,

21 Professor Pietro Guj, *Proof Committee Hansard*, Perth, 8 April 2013, p. 16.

22 Queensland Government, *submission 3*, p. 1.

> infrastructure, low sovereign risk, access to a skilled workforce and a stable government.[23]

5.23 Western Australia Treasury also noted that the claimed efficiency merits of the MRRT over *ad valorem* royalties has been challenged by independent experts:

> Indeed, the GST distribution review's final report noted that estimates in the Henry review report about the inefficiency of ad valorem royalties are highly sensitive to the assumptions used and that, if higher commodity prices were assumed instead, the portrayed distortion caused by royalties would be found to be much lower.[24]

5.24 Both the Queensland Government and the Western Australia Treasury also emphasised that the MRRT did not provide the same level of revenue stability as state royalties.[25]

5.25 Professor Fargher noted that because of their long experience with royalties, states had a better information base than the Commonwealth would have had in designing the MRRT.[26]

5.26 Professors Pincus and Ergas challenged the idea that royalties are more distorting than the MRRT, and argued that:

> …much of the burden of royalties is born by foreigners in the form of higher world mineral prices which benefit the Australian economy. This terms of trade benefit offsets most of the damage to economic efficiency that royalties would otherwise cause.

5.27 Professors Pincus and Ergas also argued that the 'MRRT discriminates against risky projects to an extent that royalties do not.[27]

5.28 In his submission, Professor John Rolfe noted that not all royalties are created equal – whereas royalties based on production volume may not capture resource rents, *ad valorem* royalties, which are based on a percentage of the resource value, automatically adjust when values vary. There is even less difference, he continued:

> ...between a resource rent tax and specialised types of royalty arrangements. Under a progressive *ad valorem* system the rate charged increases with the value of the minerals, effectively capturing a higher proportion of the revenue (and profits). In Queensland there is already a multi-tier system of royalties for coal, and a variable rate system (between 1.5% and 4.5% on other minerals). Under a profit-based royalty system (as applies in the

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23 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, pp. 35-36.

24 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, pp. 35-36.

25 Queensland Government, *submission 3*, p. 1; Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, p. 35.

26 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 16.

27 Professor Jonathan Pincus, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 17.

> Northern Territory) the royalty rate to be applied is based on an estimate of the net value of a mine's production.
>
> In summary then, the theoretical efficiencies that are often used to justify a resource rent tax are largely overstated. Royalty systems can be designed that provide some flexibility in relation to resource prices on the one hand, effectively changing marginal royalty rates in line with changed prices and profits, at the same time as providing greater certainty about payments from industry to government and avoiding marginal low profit operations. While resource rents are theoretically more efficient than royalties in economic terms, a range of practical issues limit those benefits.[28]

5.29 Professor Rolfe also challenged the idea that super profits could, in fact, be taxed without removing incentives to operate:

> Under certain assumptions about having a closed economy and very good knowledge about available resources and future costs and prices, these arguments are valid. However, in an open economy with imperfect knowledge and large fluctuations in costs and prices, it becomes very difficult to identify 'super' profits from 'normal' profits. In reality, some mining ventures are very risky, and can only be justified if very large profits may be possible. ... In the Australian situation where the extent of the resource base and opportunities for new development are not well known, a resource rent tax such as the MRRT will act as a drag on resource developments.[29]

5.30 Mr Philip Kirchlechner, Director of Iron Ore Research, argued that flaws in the underlying theory of rent, rather than specific design features of the MRRT, explained the lack of revenue it has raised. Specifically, Mr Kirchlechner suggested that:

> The theory of rent may be a useful intellectual device to illustrate the idea of super profits – excess profits derived from sheer manipulation or exploitation rather than contribution – but in practice it is extremely challenging, or even impossible, to quantify them. The difficulty of identifying rents clearly and separating them from returns to other factors of production has been recognized even by early proponents of rent taxation.[30]

5.31 Mr Kirchlechner also added that the economic rents that are usually associated with mineral deposits are not really rents at all, as 'if you tax them you would remove incentives to explore and to develop new technologies to exploit hitherto uneconomic resources.'[31]

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28 Professor John Rolfe, *submission 12*, pp. 2-3.

29 Professor John Rolfe *submission 12*, pp. 2-3.

30 Mr Philip Kirchlechner, *submission 16*, p. 1.

31 Mr Philip Kirchlechner, *submission 16*, p. 5

Interaction between the MRRT and state royalties

5.32 A broad range of witnesses told the committee that the interaction between state royalties and the MRRT was problematic, and created new complexities and inefficiencies, both in terms of resource taxation and federal financial relations more broadly.

5.33 The MCA emphasised to the committee that the MRRT was effectively a 'top-up tax' – that is, a tax on top of state royalties and company income tax, not tax reform. As Mr Hooke told the committee:

> While the MRRT goes some way in addressing [the flaws of the original RSPT] in better aligning the design with the concept of a resource rent tax, it still remains devoid of any complementary reform of state and territory royalties as initially proposed by the Henry review.[32]

5.34 The state governments that the committee heard from were highly critical of Commonwealth attempts to prevent the resource states from raising their royalties.

5.35 Western Australia Treasury, for instance, pointed to the contradictory nature of, on the one hand, the Commonwealth insisting that Western Australia does not raise its royalty rates, and on the other, a horizontal fiscal equalisation process wherein the Commonwealth Grants Commission actually requires Western Australia to recover a national average royalty rate in order to avoid penalisation in the GST distribution process.[33]

5.36 Western Australia Treasury characterised Commonwealth insistence that it not raise royalties, and threats to take money from Western Australia in other ways if it raised royalties regardless, as 'financial bullying':

> There are many financial flows to the states outside of GST distribution. They can be in the form of co-contributions to major infrastructure projects, for example. The implicit threat is if we were to exercise our state rights in terms of ensuring an efficient and effective royalty regime, and if that compromised the Commonwealth's financial position through MRRT, we would benefit less out of those processes.[34]

5.37 Professor Garnaut told the committee that while he believed a resource rent tax would be more efficient than state royalties – on the basis that royalties undermine the profitability or even deter marginal projects – he also argued that the retention of royalties meant 'that the advantages of the PRRT for encouragement of complete economic utilisation of marginal ore projects are not available within the MRRT.'[35]

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32 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 19.

33 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, pp. 37-38.

34 Mr Tim Marney, Under Treasurer, Department of Treasury, Western Australia, *Proof Committee Hansard*, Perth, 8 April 2013, p. 38.

35 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 1, 5.

5.38 Noting the inefficiencies created by the royalty system, Professor Garnaut told the committee that all the problems of the state royalty regimes remained in place with the introduction of the MRRT, and 'to the extent that the states have been raising royalties, will have been exacerbated.'[36]

5.39 The Isaac Regional Council suggested that, to be successful, the MRRT would need to 'connect with and compliment [sic] the state's royalties systems.'[37]

5.40 Dr Denniss allowed that while there might be a role for some royalties in a well-designed resource taxation scheme, the current interaction between the MRRT and state royalties gave states an incentive to 'take advantage of fiscal federalism', which 'is not good for anybody in the long run and potentially not even for the people pushing for it.'[38]

5.41 When it was suggested to Dr Denniss that state royalties were a legitimate revenue stream for the states, given their ownership of resources, he responded:

> I agree it is legitimate. I think there is room for improving the system for everybody. Constitutionally, obviously, there is a legitimate role. Regarding royalties, there is a difference between a profit and the royalty for access to a resource. In public debate it is not always obvious. For example, I can own some land, sell it and make capital gain. It is the Commonwealth that levies the capital gains tax. They are not mutually exclusive, I suppose.[39]

5.42 Professor Pincus suggested that the way in which the MRRT and state royalties interacted could ultimately also affect the level of company tax collected:

> An aspect of the controversy surrounding the MRRT relates to the incentives it creates for the states to increase royalty rates. Indeed, although we have not verified this proposition, it is conceivable that the increases in those royalties could do much to reduce the Commonwealth revenue take not merely for the MRRT but also in company tax. In other words, the MRRT could not only itself not raise much revenue for the Commonwealth but it might reduce its tax take overall if the increases in royalties are sufficient to reduce company tax payable. Whether this is so or not depends on the precise order of the taxes that are imposed and the quantum of the effects.[40]

Should the MRRT be 'improved' or discarded in its entirety?

5.43 While some witnesses and submissions suggested that the MRRT could be improved, others suggested that the best course of action would be to repeal the

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36 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 3.

37 Isaac Regional Council, *Submission 6*, p. 1.

38 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 8.

39 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 8.

40 Professor Jonathan Pincus, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 17.

MRRT outright. Not surprisingly, the respective positions expressed in submissions and during the hearings in this respect were closely aligned to whether submitters and witnesses believed rent-based taxes were efficient and therefore worth pursuing.

5.44 For example, Dr Denniss told the committee that he believed Australia was 'better off having the tax than not having one.' The focus, he argued, should be on improving the tax rather than discarding it, and by this he essentially meant lifting the rate of the tax and broadening its application.[41]

5.45 In contrast, FMG contended that the MRRT had proven:

> ...inefficient, discriminatory and administratively burdensome because of the technical complexity in applying concept from income tax, GST, OECD transfer pricing guidelines, mining law, accounting concepts and market valuation principles. It is not substitute for long term strategic and holistic tax reform and no design could improve it.[42]

5.46 The MCA, meanwhile, suggested that the mining companies negotiated the MRRT Heads of Agreement because, while they did not believe then or now that the MRRT was necessary to share the benefits of the mining boom, it had to do the best it could with 'the hand of cards that we were dealt.' When directly asked if Australia would be better off without the MRRT, Mr Hooke answered:

> Yes. There is absolutely no question that we would be better off without the MRRT, but that does not detract from our commitment to honour the agreement. We did not blink. The government did not blink. We will work with the government of the day. If you are asking me whether we wanted a new tax, the answer is no. If you are asking me whether we think it was necessary to take us to the point of Mount Everest on new taxes and even run the risk of going over the edge, the answer is no. Would we look a gift horse in the mouth if this tax were to be withdrawn? No.[43]

5.47 Professor Garnaut, meanwhile, suggested that while Australia might retain some version of the MRRT, consideration of any revised tax would have to form part of a much larger and more fundamental reconsideration of the current state of federal financial relations.[44]

5.48 Mr Utting told the committee that while his organisation, the Yilgarn Iron Producers Association, was happy to help contribute to the improvement of the MRRT, ‘we see the best-case scenario is to get rid of the tax.’[45]

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41 Dr Richard Denniss, Executive Director, The Australia Institute, Australian National University, *Proof Committee Hansard*, Canberra, 3 April 2013, pp. 1, 4.

42 Fortescue Metals Group, *submission 4*, p. 2.

43 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 21.

44 Professor Ross Garnaut AO, *Proof Committee Hansard*, Melbourne, 29 April 2013, PCHM, p. 4.

45 Mr David Utting, Chief Executive Officer, Yilgarn Iron Producers Association, *Proof Committee Hansard*, Perth, 8 April 2013, p33.

Committee View

5.49 The committee considers that the evidence presented during this inquiry bears out the strong contribution the resources sector has already made to Australian prosperity before the MRRT's introduction and continues to make despite the MRRT's obvious failure to generate meaningful additional revenue for government in an efficient way.

5.50 The committee is satisfied that the resources sector is already 'paying its fair share' through company tax, state royalties and a whole series of other state and federal taxes. The MRRT adds an unnecessary, inefficient and ineffective burden on what remains one of the most important industries for Australia.

5.51 The committee considers that Australia's national interest will be much better served by ensuring that our tax and regulatory policy settings provide for a globally competitive environment for mining investment so that the mining industry can continue to help drive our prosperity, employment and significant government revenue in the years ahead.

5.52 The committee agrees that the MRRT represents an inappropriate 'federal incursion' into an area of state responsibility under our Constitution, and one that has added unnecessary complexity, inefficiency and costs to the Australian taxation of resources. The committee further notes that the introduction of the MRRT without any meaningful consultation with the states and territories represents another broken promise – this time the promise made in the lead-up to the 2007 election that the incoming government would pursue a new era of cooperative federalism.

5.53 The committee remains strongly of the view that the MRRT is beyond repair and should be scrapped.

Chapter 6

The impact of the MRRT

6.1 Although the inquiry was concerned primarily with the development of the MRRT and its failure to raise the revenue the government had projected, in the course of the inquiry a number of witnesses argued that the MRRT was hurting the Australian mining industry and damaging Australia's reputation as a good place to invest.

The MRRT's discrimination against smaller, less established miners

6.2 A number of experts appearing before the committee explained how the MRRT, and in particular the ability for established miners to apply the market value method to their depreciable starting base assets, put smaller and less established miners at a comparative disadvantage to the large, established miners, particularly those miners that had negotiated the MRRT Heads of Agreement with the government.

6.3 For instance, Professor Ergas explained that for larger mining companies with diverse portfolios of well-established mining projects, the discount applied by the market to take account for risk in determining asset value would be lower, and therefore the required rate of return on projects would be lower. As such, for established projects, the market price would generally be higher in relation to expected profits than for smaller, less established miners. The end result of this is that large, established miners have access to a tax shelter that is not available to smaller, less established miners that are operating riskier projects with higher required rates of return. Professor Ergas further added, under questioning, that large, established mining projects such as those in the Pilbara had generally started out as risky undertakings. He concluded, 'If we deter similar risky undertakings going forward, then we will not have the next generation of large mining projects to underwrite future prosperity.'[1]

6.4 Similarly, Professor Guj explained to the committee that his analysis had shown that, because of the capacity of established mining projects to use market valuation of the mine as at 1 May 2010 as a depreciable starting base for capital deduction, there was a 4.3 per cent total taxation bias in favour of projects that pre-existed the 2 May 2010 announcement of a resource rent tax. [2]

6.5 FMG told the committee that, as a now larger more established miner, it had access to a significant tax shelter which ensured it was unlikely to pay any MRRT in the foreseeable future. However, it also indicated that it did not think it would exist today had the MRRT been around when FMG was getting started back in 2003:

> We are in the very fortunate position of being an existing miner and an existing project at the time that the tax was introduced, unlike many of the

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1 Professor Henry Ergas, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 19.

2 Professor Pietro Guj, *Proof Committee Hansard*, Perth, 8 April 2013, p. 15.

> smaller exploration companies that Mr Bennison and AMEC represent. We have run, if you like, the MRRT across models that we had from when Fortescue was first established, and we do not believe Fortescue would exist today if the tax had been in existence at the time the company first was trying to get the project up and funded.[3]

6.6 On the same subject, AMEC told the committee:

> In AMEC's view the tax is unfair and discriminatory to small emerging mining companies, which generally have higher risk profiles, have limited access to working capital, have lower economies of scale and consequently a higher unit cost production in comparison to large mature miners. This will make it more difficult for them to compete with large mature miners in domestic and global markets. The design of the proposed MRRT or the actual implemented MRRT provides mature miners with significant tax shields through the starting base allowance and additional financial advantages to large mature multinational conglomerates that are not available to emerging miners in the same proportion. Such a situation ultimately distorts the unit cost of production and investment decisions.
>
> […]
>
> …modelling shows that under the MRRT regime a small emerging miner could be paying an additional effective tax rate of 60 per cent compared to large mature miner, who could be paying an extra two per cent. This differential is caused by the large tax shield provided to mature miners who are able to claim a significant deduction for the market value of their starting base assets, and it allows them to reduce the MRRT liability for the remaining life of the mine or 25 years, whichever is less. Small emerging miners are not able to claim such extensive tax shields and therefore the unit cost of production and ultimate effective tax rate are detrimentally affected. This is a significant issue with respect to competitive neutrality and equality, and it is fundamental to AMEC'S continued opposition to the design of the MRRT.[4]

6.7 AMEC further stated that while the government had tried to provide some concessions to smaller miners, 'these are of no value and do not address the discrimination factor.'[5]

6.8 Asked about the costs imposed on mining companies by the complexity of the MRRT, Professor Fargher responded:

> There [are] a range of costs. At some end there is the administrative cost, which might be relatively trivial, of just administering the tax. Go beyond that and I would expect these large companies would be taking significant

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3 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 3.

4 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 1-2.

5 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 2.

> tax advice, and once they start trying to strategically reduce their tax payable then I would worry that there would be distortions from the tax that were not foreseen. I believe the complexity is in unforeseen ramifications of the tax and that is the most dangerous outcome that can come from not seeing the complexity.[6]

6.9 While emphasising that the possible distortions introduced by the MRRT were not yet apparent, Professor Ergas suggested that:

> …it is certainly possible that uncertainty associated with this tax and the general impression that the Australian government may in future try to tax resources even more heavily, has contributed to the deferral or the slowing of many major resource projects that we have experienced in recent months.[7]

Administrative costs imposed by the MRRT

6.10 Mining companies, mining peak bodies and independent experts appearing before this committee pointed to the significant administrative burden associated with the MRRT.

6.11 The committee heard evidence that indicated that, even for companies that are unlikely to pay MRRT at any time in the foreseeable future, the compliance burden was still considerable. This was particularly true for smaller companies that lack the economies of scale of the larger, more established miners. The evidence given by Golden West Resources is particularly illustrative in this respect:

> In addition to the demands placed on companies to determine their starting base, we have also had to grapple with the compliance demands of MRRT instalments and instalment liability notices, notwithstanding that we have no mining activity and no revenue from mining. Given the stage of development of our project, the bulk of our iron ore resources are covered by granted mining leases rather than by exploration licences. As a consequence, we did not meet the definition of 'explorer' as provided by the commissioner for nil rate determinations that would have automatically entitled us to exemption from the requirements to report and lodge instalment notices. Ultimately, after making submissions to the ATO, we were successful in obtaining an exemption from lodging instalment notices for the current year. This exercise in futility would appear to be required to ensure that we are not fined or sanctioned in some way for failing to pay MRRT instalments on our non-existent mining profits. No doubt our staff—that is me and my financial controller—will be made to jump through the same hoops again next year. [8]

6.12 Similarly, FMG told the committee that although FMG did not anticipate paying the MRRT at any point in the foreseeable future, it had taken FMG:

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6 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 16.

7 Professor Henry Ergas, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 26.

8 Mr Craig Ferrier, Executive General Manager, Golden West Resources, *Proof Committee Hansard*, Perth, 8 April 2013, p. 24.

> …close to two years to be prepared for the introduction of the MRRT and it has cost us some $3 million to $5 million. There has been a large amount of consulting cost and use of internal resources to be prepared for the tax. It should be noted that that amount of money is many times what it costs us to meet our obligations with respect to the primary taxes: income tax and royalties. This year, Fortescue will pay in excess of $1 billion in income tax and state government royalties. We do not expect to pay any MRRT for this financial year or for the years ahead.[9]

6.13 Pressed by the committee to explain the nature of the burden on FMG, Mr Pearce related this burden back to the sheer complexity of the tax, and difficulties involved in determining revenue at an artificial valuation point and the starting base allowance.[10] This complexity was further explained in FMG's written submission:

> [The MRRT] has introduced a new layer of administrative complexity into an already highly regulated industry Taxing at a 'project' level rather than a corporate level has further complicated matters and is significantly increasing the cost of overall taxation compliance. Implementing the MRRT regime, in terms of systems modification requirements, technical consultancies and legal interpretation, within Fortescue alone has cost many millions of dollars. The MRRT imposes an additional layer of taxation on top of the existing State and Territory based royalty systems and the Federal income tax regime in a manner that does not simply taxation, nor make the taxation process more efficient. In fact, since it is an entirely new tax impost all it has done is to increase the complexity of the compliance burden and necessarily acts as an investment deterrent to the extent that it reduces forecast project returns.[11]

6.14 Addressing the administrative costs imposed by the MRRT, AMEC told the committee:

> AMEC has also consistently expressed concern that there will be inefficient and higher levels of administration and compliance costs to industry and government associated with the new regime. Late last year AMEC conservatively estimated that the minimum accumulated total set-up cost for all small iron ore and coal miners and junior exploration companies, excluding the large miners, is estimated to be over $25 million in the first year and the ongoing annual administration and compliance costs will be in excess of around $2 million to $3 million.[12]

6.15 AMEC also explained that in the process of surveying its membership about the administrative cost of the MRRT, it had received feedback that these costs:

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9 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 2.

10 Mr Stephen Pearce, Chief Executive Officer, Fortescue Metals Group, *Proof Committee Hansard*, Perth, 8 April 2013, p. 5.

11 FMG, *submission 4*, p. 2.

12 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 2.

> … revolved around the valuation of the project [and] developing charts of account, bearing in mind they had to revise the charts of account so they could classify the data in accordance with the way the tax is designed. There is also forms design. There are policy and procedure manuals. There are IT systems. They had to rejig their accounting processes. There is staff training. That in itself is a major issue. There are individual staff costs. There is audit, professional advice, consultants—legal, accounting—to make sure that they are complying, so that when the ATO comes and knocks on their door they have got all the information that is required. Then, on an ongoing basis, IT continues to be an issue, and staffing, in terms of data collection—the input, the reconciliations, the appropriate reporting. Even if they have nil returns, they still have to fill in the return on a quarterly basis.[13]

6.16 Professor Guj noted that while the MRRT offered the option of a simplified accounting approach for companies under the $75 million threshold, the fact that small mining companies would aspire to one day rise above that threshold meant few were likely to avail themselves of this option. Under the simplified accounting approach, mining companies theoretically:

> ...would not have to keep their accounts in a manner that would allow them to comply with the MRRT, if required. However, there is a very big price in terms of forgoing a range of benefit that would be denied to them if at one stage for any reason whatsoever the volumes of the revenues and the cost would be such that they actually crossed that particular threshold. So there are certain problems.
>
> I do not remember the details, but when we were discussing this with the ATO during some of the consulting process while drafting the legislation, I could hear some of the people saying that no-one will take advantage of this simplified system. I would not touch it with a hundred-foot pole. In fact we actually asked that question: why did you put that condition in? You would have to be resigned to always be a very small miner if you want to go down that track.[14]

6.17 The MCA touched on the same issue, telling the committee that:

> ...there are a lot of small to mid caps out there who are having to make a decision about whether … they take advantage of the de minimus provision of $50 million cut-off phasing up to $100 million, or whether they in fact invest a fair amount of compliance cost upfront today with the prospect that they might grow in the future.[15]

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13 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 6.

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

15 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 24.

6.18 Rio Tinto, BHP Billiton and Xstrata, meanwhile, estimated that the costs involved for them in determining their MRRT liability was probably in the order of 'several million dollars.'[16]

Australia's reputation as an investment destination

6.19 AMEC told the committee that it was concerned that the threat to Australia's ability to attract mining investment, related in part to the MRRT, was a 'serious predicament' that was little understood in the Australian political system. In particular, there was a threat to the 'greenfield minerals exploration, which is where the mines of tomorrow are going to come from.'[17]

6.20 Mr Craig Ferrier, Executive General Manager of Golden West Resources, suggested that not only did the MRRT impose a substantial administrative burden on small miners, but also made it harder to raise the necessary investment capital to grow and develop:

> As an advanced exploration project that had defined a significant iron ore resource at the time of the announcement of the proposed resource super profits tax in May 2010, like other iron ore companies we have had to deal with the uncertainty and perceptions of increased risk and cost within capital markets created by a tax that was fundamentally flawed in its concept, design and implementation. This has had the effect of reducing the capital available for projects within the iron ore sector and arguably has reduced the number of new projects that have been developed and advanced to commence mining operations.[18]

6.21 Further to this was the issue, raised at various points during the inquiry, about the impact the MRRT had had on perceptions of sovereign risk in Australia, and by extension the effect on Australia's reputation as an investment destination.

6.22 Professor Fargher suggested that sovereign risk was relative to the frequency and retrospectivity of taxation changes:

> Certainly if there are too many retrospective changes it is generally regarded that that can increase your sovereign risk. If there are periodic changes which have been carefully thought through, that change in sovereign risk should be relatively small.
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> […]
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> … Say the petroleum resource tax is changed two or three times over a period—I hate to be quoted—of maybe 10 or 15 years, the industry seems to be able to work with that. If you are changing tax law frequently,

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16 *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 24.

17 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 12.

18 Mr Craig Ferrier, Executive General Manager, Golden West Resources, *Proof Committee Hansard*, Perth, 8 April 2013, p. 24.

particularly with regard to retrospective items, that certainly becomes a difficulty for a miner who wants to make a long-term investment.[19]

6.23 Mr Ferrier of Golden West resources told the committee that both the RSPT and MRRT had had a negative impact on international perceptions of Australia as a destination for capital.

> As the CFO of other iron ore explorers and producers in previous roles, and now as CEO of Golden West, I can attest to the fact that I have been frequently reminded by investors that Australia is not considered as attractive for foreign capital as it once was. This is typically contrasted against other jurisdictions, most notably Africa. As a proud Australian I inherently take exception to this point of view and highlight the risks associated with investment and the challenges of operating offshore. However, our actions perhaps are the best example of this perception of increased risk and costs. Following the fall in the price of iron ore in the second half of 2012, Golden West assessed the number of investment opportunities associated with projects in the Mid West and Yilgarn regions of Western Australia. Ultimately, our board chose to invest in a company whose focus was exploring for DSO iron ore in Liberia, West Africa. Whilst there can be debate as to the extent to which decisions such as these are directly attributable to the additional costs and risks imposed by the MRRT, it would be naive to believe that such considerations did not form part of the decision-making process.[20]

6.24 Similarly, in its submission, the Queensland Government argued that the MRRT 'has undoubtedly damaged Australia's international reputation in the mining industry without raising significant revenue for the people of Australia.'[21]

6.25 AMEC told the committee that it was not only the MRRT as it currently existed that was creating uncertainty, both also the persistent perceived threat that the tax would be broadened to apply to other commodities:

> This uncertainty and lack of predictability point to the fact that Australia's reputation and credibility as a safe place in which to invest have been put in doubt. Action should be taken to reverse those trends by promoting investment, growth and productivity in the industry, not by penalising it.[22]

6.26 Asked about the impact of the MRRT on investment of smaller and junior miners in the exploration space, Mr Bennison also told the committee:

> For us, a lot of this is about death by a thousand cuts, of which the MRRT is a very significant cut. Independent research, like that of the Fraser Institute, clearly demonstrates that Australia as an investment destination in

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19 Professor Neil Fargher, *Proof Committee Hansard*, Canberra, 3 April 2013, p. 15.

20 Mr Craig Ferrier, Executive General Manager, Golden West Resources, *Proof Committee Hansard*, Perth, 8 April 2013, pp. 24-25.

21 Queensland Government, *submission 3*, p. 2.

22 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 2.

> the mining and exploration sector is clearly out of favour. We have dropped down the list dramatically. I think it is indicative of the lack of investment in IPOs in recent years. Probably in 2013 and 2014 we will see one of the lowest level of IPO listings on record. I think that is further indication of how the policy environment, particularly in the tax area, has been seen as a massive risk in Australia.
>
> […]
>
> [We] cannot endure these sort of taxes and this sort of ad hoc policy arrangement, particularly on the smaller producing and emerging companies and also obviously in the exploration sector, where risk is a significant issue.[23]

6.27 During its appearance before the committee, the MCA made a distinction between taxes that add costs, and taxes that destroy value. It placed the MRRT is the latter category, and suggested this had a bearing on Australia's international competitiveness:

> A lot of people think that taxes add to costs. Royalties do, carbon tax does but the MRRT actually destroys value in the after-tax adjusted returns that companies can expect. That is what goes to the disincentive to invest. Anything that puts us at a disadvantage in international competitiveness is what is the lead in our saddlebags. If that cannot be justified in terms of efficiency dividends, environmental dividends, social dividends and economic dividends then we are really cutting off our nose to spite our face.[24]

The MRRT's impact on communities

6.28 The Isaac Regional Council confirmed in its submission that communities in its council area affected by mining were not formally consulted prior about the MRRT.[25]

6.29 In this respect, the Isaac Regional Council noted that while it supports the ongoing development and growth of the mining industry, it has serious concerns regarding the sustainability of regional communities who are subject to current industry workforce models, such as the 'fly-in, fly-out' model, and the need for a coordinated Commonwealth, state and local government approach to mitigating such impacts.[26]

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23 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard*, Perth, 8 April 2013, p. 7.

24 Mr Mitchell Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, Melbourne, 29 April 2013, p. 26.

25 Isaac Regional Council, *Submission 6*, p. 1.

26 Isaac Regional Council, *Submission 6*, p. 2.

6.30 Sustaining our Sustainability, a community not-for-profit group, also expressed doubts over whether MRRT revenues would cover the social and environmental costs that it claimed mining activity imposed on rural communities.[27]

27 Saving our Sustainability, *Submission 15*, p. 3.

Committee View

6.31 The committee notes with concern the overwhelming evidence presented during this inquiry which suggests that, despite raising no meaningful revenue, the MRRT has increased costs and destroyed value in the resources sector, particularly for the smaller, less established mining companies.

6.32 It is the committee's considered view that the complex, distorting and inefficient MRRT is bad for Australia and must be abolished at the earliest opportunity.

6.33 The committee agrees with evidence presented during this inquiry that the design of the MRRT, and specifically the starting base arrangements that the government agreed during its secret negotiations with the three large miners, discriminates against smaller, less established miners, making it harder for them to become Australia's economic success stories of tomorrow.

6.34 The bigger miners of today started off as smaller miners in the past.

6.35 The smaller miners of today aspire to become bigger miners in the years ahead.

6.36 It is in our national interest that as many of them as possible are successful in that endeavour. Our taxation and regulatory policy settings should provide the sort of globally competitive environment that will help them achieve that instead of imposing unnecessary and unproductive additional cost for no government revenue upside.

6.37 The additional compliance burden imposed on smaller miners for example just so they can prove that they do not in fact have to pay any MRRT, but to preserve protection from future MRRT liabilities is just so counterproductive and counter to our national interest.

6.38 The committee considers that the MRRT has damaged Australia's reputation as an investment destination and made it harder for mining companies to raise the funds they need to get underway and grow.

6.39 Finally, the committee notes that no evidence was provided during this inquiry that suggested that the government had given much if any consideration to those issues or indeed to the views of communities affected or potentially affected by the implications of this tax for the iron ore and coal mining industry.

6.40 It should be obvious to any reasonable observer and policy decision maker that this failed Minerals Resource Rent Tax must be abolished at the earliest possible opportunity.

Senator David Bushby
Chair

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

- Introduction
- Effective policy
- Extensive Consultation
- The design of the MRRT
    - Starting base allowance
    - Smaller miners
    - Other design features
- Investment pipeline
    - Sovereign risk
- Issues raised during the inquiry
    - The nature of rent taxes
    - Revenue collection
    - Royalties
    - Compliance costs
        - Recommendation
- Broader economic benefits of the mining boom
- Conclusion

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…
>
> 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.
>
> 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

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.
>
> 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.
>
> 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—
>
> 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:
>
> - 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

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.
>
> 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?

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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.
>
> 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.

Dissenting Report by Senator Cameron

1.1 I do not agree with the Coalition senators' conclusions and recommendations in the majority report. The coalition senators have accepted, with little scrutiny or critical analysis, the submissions of the Minerals Council of Australia and mining companies. The Minerals Resource Rent Tax, with appropriate amendments, has the potential to deliver over time an appropriate return to the Australian taxpayer as a result of the exploitation of Australia's resources. The MRRT, no matter how high the rate, still only applies in the event that the companies make a profit. Royalties do not give any concession to loss-making firms.

1.2 To ensure that the national interest is protected and appropriate returns for the exploitation of Australia's finite resources are achieved, the government should:

- Develop improved and consistent reporting procedures for mining companies in relation to all aspects of their obligations under the Minerals Resource Rent Tax;
- Undertake a detailed analysis of the sustainability and suitability of various allowances including:
  - Uplift Rates and the implications for government revenue of the LTBR +7% standard;
  - Assessing whether LTBR+7 % is an appropriate standard for the mining loss allowance;
  - Monitor the appropriateness of the 25 % deduction available under the extraction factor;
  - Develop appropriate responses to protect Commonwealth revenue and the principle of horizontal fiscal equalisation when state governments impose royalties in addition to the MRRT;
  - Examining the revenue and social implications of allowing the starting base to be calculated on the market value as distinct from the book value noting the submissions from Professors Peter Carey and Neil Fargher that "depreciating assets based on market valuation is not generally accepted accounting practice";
  - Assessing whether the LTBR+7% and the basic principle and five sub principles applying to the net back calculation are operating in the national interest.

1.3 The government should ensure that the national interest is prioritised and appropriate amendments to allowances, if they are found to be overly generous or unsustainable, should be made.

1.4 In response to questioning from Senator Bishop, Professor Fargher expanded on his joint submission to the committee in relation to the question of market valuation.

> If the question is narrowed to simply comparing the two start-up options available within the MRRT, then both the market value option and the current book value option offer substantial start-up allowances. On average, accounting rules are likely to result in book values understating market value. Further, there is relatively greater flexibility in the procedures used to estimate the market value. The self-assessor is expected to take the higher deduction and so in my opinion is more likely to use the market value option where tax liability needs to be minimised. Both current start-up options however create substantial tax shields. [1]

1.5 I am unconvinced by the submissions of the Minerals Council of Australia and individual miners that there are no downsides to the minerals boom and flow-through benefits are available to all Australians.

1.6 I note the recent decision of the New South Wales Land and Environment Court which casts doubt on the economic modelling used by Rio Tinto's Warkworth mine to justify expansion of its Hunter Valley mining lease.

1.7 In the judgement, Justice Peterson said:

> I accept Dr Denniss' evidence that, to a considerable extent, employment generated from the extension of the Warkworth mine would involve currently employed skilled workers transferring from other industries, but the vacancy thereby created in the other industries may not necessarily be filled.
>
> I am not satisfied that the economic analysis provided on behalf of Warkworth support the conclusions urged by both Warkworth and the Minister, namely that the economic benefits of the project outweigh the environmental, social and other costs. [2]

1.8 In my view the industry has consistently overstated the benefits it confers on the country as a whole and understated the problems it creates. Examples of this include:

- Rio Tinto including PAYG taxation for its employees in its estimation of taxes paid by the company.
- The Minerals Council of Australia and mining companies including royalties in the calculation of tax paid. In this context it is clear that royalties are not taxes but payments for inputs to the company's operations. Royalties should not be included in calculations of tax paid by mining companies. This is being done to provide an impression that taxes are a greater impost on the mining industry than they really are and the industry is paying its "fair share".

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1 Professor Neil Fargher, Responses to questions on notice, received 2 May 2013

2 Bulga Milbrodale Progress Association Inc. v Minister for Planning and Environment and Warkworth Mining Limited [2013] NSWLEC 1948 (15 April 2013) at paragraph 459

- Using a figure of taxation paid since the start of the millennium in an effort to provide a headline figure that creates an impression of the industry paying its "fair share" without taking into account profitability, the time-frame of the headline figure, and the industry's contribution as a percentage of the total tax take in the economy.
- Overestimating and overstating the employment creation of the industry by ignoring the crowding out of existing employment by the mining boom, inflated Australian dollar and the drawing off of skilled workers from existing industries to the mining industries. This has contributed to a significant loss of employment in traditional industries such as manufacturing, engineering, tourism and retail.
- The economic modelling that purports to show benefits assumes that profit is retained and spent in Australia by Australians. In fact, that is not the case given the substantial foreign ownership of mining at 83 per cent.
- The Australian Financial Review on Friday 3 May 2013 quotes Treasurer Swan as saying mining companies account for about 30 per cent of corporate gross operating profits but only around 15 per cent of corporate tax receipts.
- Mining is now about 10 per cent of the Australian economy by value (but only about 2 per cent of employment). The industry claims to have paid $130 billion in tax since the year 2000 (this figure that includes royalties) however total tax receipts since then were $3,210 billion. So mining tax is 4 per cent of the total tax collected at the Commonwealth level.
- In 2010-11 mining’s earnings before interest, tax, depreciation and amortisation was $90.2 billion according to ABS figures. Tax office figures show that the total company tax paid was $14.3 billion that year, a 16 tax rate. They take advantage of various accelerated depreciation allowances etc.
- Miners are extremely profitable, last year BHP Billiton earned profit of $15.5 billion, a 27 per cent return on its equity at the beginning of the year.
- Claiming significant benefits to the Australian economy by pointing to goods and services produced in Australia for the mining industry while maintaining that they do not keep information on sector wide information such as, goods and services sourced from overseas, job displacements in other areas of the economy, the proportion of job vacancies filled in the minerals sector by new entrants to the labour market, and the proportion of job vacancies filled by employees who were unemployed immediately prior to their employment in the sector.

1.9 The mining industry is the beneficiary of significant government subsidisation. This is achieved through generous research and development tax concessions, accelerated depreciation of mines and equipment, fuel tax concessions and enormous infrastructure projects funded by state governments. Some estimates put this as at least a $4 billion public subsidy to the mining industry.

1.10 I note the view of Coalition Senators expressed in the majority report that they are satisfied that the resources sector is “already 'paying its fair share' through among other things, state royalties and that the MRRT “adds an unnecessary, inefficient and ineffective burden” on the mining industry. I further note the opinion of Coalition senators that resource taxation should remain exclusively within the jurisdiction of the States.

1.11 Coalition senators must be about the only people in the country who actually believe this.

1.12 It is almost universally accepted that it is in fact volumetric state-based royalty payments for the extraction of mineral resources which are the least efficient, least effective, most uncertain and least equitable form of taxation on the industry.

1.13 The Minerals Council of Australia has consistently said that resource rent taxes are preferable to royalties on grounds of efficiency and equity.

1.14 The *Australia's Future Tax System* review, headed by former Treasury Secretary Ken Henry (AFTS review) found royalties to be an inefficient and inequitable method of taxing the extraction of finite mineral resources.

1.15 The AFTS review concluded that Australia’s resource charging arrangements were inadequate, both from an efficiency perspective, and in that they “fail to collect an appropriate return for the community from allowing private firms to exploit non-renewable resources”. [3]

1.16 The AFTS review recommended a fundamental overhaul of the way resource revenue is collected, and who it is collected by. It called for the replacement of all existing resource charging arrangements with a single, uniform resource rent tax imposed and administered by the Commonwealth. One of the stated reasons for this recommendation, as well as for the particular form of resource rent tax preferred by the AFTS panel, was to remove the effect of existing royalty and excise regimes, which it saw as distortionary and highly inefficient, on investment and production decisions

1.17 The GST Distribution Review panel in its June 2012 interim report gave unequivocal in principle support for the findings of the AFTS review. It said:

> The Panel accepts the finding of the Australia’s Future Tax System (AFTS) review that well-designed rent-based taxes are likely to be more economically efficient than royalties applied on the basis of value or volume, particularly in periods of low commodity prices or high costs.
>
> The Panel also agrees with the AFTS review’s assessment and States’ views that other factors, such as the size, variability and timing of the return received by government, as well as relative administration and compliance

3 *Australia’s Future Tax System*, Report to the Treasurer, Detailed analysis, page 228.

> costs, are important considerations when evaluating any particular resource charging regime.
>
> The Panel is mindful of the depth of concern amongst States regarding their historical role in charging for the right to mine under their soils. However, the Commonwealth has a similarly well-established position in the field of taxation. The challenge is therefore to find a way to reconcile these two competing interests. [4]

1.18 Coalition senators' views on this are at odds with every reputable review of resource taxation recently undertaken in this country.

1.19 The implementation of an appropriate Minerals Resource Rent Tax is absolutely essential to ensure that the Australian public are properly recompensed for the extraction of their finite, non-renewable resources predominately by overseas owned mining companies.

Senator Doug Cameron

4 GST Review Panel, Interim Report, June 2012 http://www.gstdistributionreview.gov.au/content/Content.aspx?doc=reports/interimjune2012/07Chapter4.htm viewed 5th May 2013.

Dissenting report from the Australian Greens

Executive summary

1.1 China's unprecedented economic growth and its re-engagement with the global economy have seen commodity prices soar over the past decade, bringing vast windfall gains to mining companies operating in Australia. As these mining companies are predominantly foreign-owned, most of these profits have gone to their shareholders overseas. The benefits of the mining boom have been the subject of exaggerated claims and the mining industry pays less than its fair share of tax.

1.2 When the Government introduced the Minerals Resource Rent Tax (MRRT) it was intended to "spread the benefits of the boom". However it is failing to generate any significant revenue. The Australian Greens moved for this inquiry to explore the reasons for the failure of the tax in raising revenue, including its design flaws and the process that lead the government to concede so much to three of the world's biggest mining companies on the design of the tax. Furthermore, the inquiry heard evidence of measures that can be taken to improve the MRRT for the benefit of the Australian community.

1.3 Without reforming the MRRT, the Government is in danger of wasting the mining boom and allowing the mining industry to ride roughshod over the rest of the economy.

1.4 The mining boom has driven the appreciation of the Australian dollar, higher interest rates and shortages of labour in certain regions or with certain skills. This has resulted in lower profits, fewer jobs and lower returns to shareholders in other industries such as manufacturing and tourism.

1.5 The mining boom is also having adverse implications for greenhouse gas emissions, both during mining in Australia and when exported coal is burnt overseas. The mining boom is also putting at risk farmland aquifers. Dredging operations to expand ports and increased shipping are damaging the marine environment, with implications for both the Great Barrier Reef and the fishing industry. It is also damaging community cohesion with its use of fly-in/fly-out workers as explored in the House of Representatives Regional Australia Committee report, *Cancer of the Bush or Salvation for Our Cities? Fly-in, Fly-out and Drive-in, Drive-out Workforce Practices in Regional Australia*. The boom mentality is leading to over-investment in ports and other infrastructure in remote areas which will have little other use.

1.6 The record investment undertaken and proposed by the industry (over $100 billion in both 2012-13 and 2013-14) suggests the mining tax is having little impact on activity, while the big mining companies are still making significant profits, despite lower commodity prices. Rio Tinto made $9 billion profit from Australia's iron ore last year and paid no MRRT.

1.7 Australians have led the world in thinking about the impact of resources booms and their optimal taxation. The Petroleum Resources Rent Tax has operated effectively for many years. Rather than raising the white flag to the mining industry as the majority report recommends, Australia should be setting an example to the world by implementing an efficient tax on minerals to ensure the people get a fair share of the returns from their national natural resources.

1.8 Evidence to the inquiry has made it clear that it is the design flaws in the tax rather than just the recent falls in commodity prices that are responsible for the significantly lower than expected revenue from the MRRT. There is no economic justification for iron ore and coal being taxed at 22½ per cent while oil and gas is taxed at 40 per cent and other minerals have no profit tax applied at all.

1.9 It has become increasingly obvious that the Government agreed to provisions in the tax that have allowed the biggest and most profitable mining companies to minimise the amount of MRRT paid to the detriment of the community. BHP gave evidence that it was well-understood in the negotiations that all royalties, including future royalty increases, were to be fully rebated. While the Government has been saying it will use other means to claw back increased royalty rebates, nothing has yet eventuated. It is also clear from the evidence that the starting base and depreciation provisions have been used by the big mining corporations to minimise their tax liability. BHP, Rio Tinto and Xstrata all gave evidence they had deferred tax assets of over $10 billion. These companies can use these deferred tax assets to write-off their MRRT tax liability well into the future.

1.10 A better designed mining tax could raise a lot more revenue, an additional $26 billion over the next four years alone, which would allow the government to care better for people in areas such as education, relieving poverty, modern public transport, dental health and services for people with disabilities.

1.11 This dissenting report provides in detail the reasons for the major design improvements the Australian Greens are advocating:

- Applying a 40 per cent rate, as applied under the Petroleum Resources Rent Tax;
- Extending the MRRT to all minerals;
- Only rebating royalties in place at July 2011, rather than letting state governments raise royalties that will effectively be paid by federal taxpayers not the mining companies; and
- Only allowing depreciation on the book value of the amounts actually spent on mining infrastructure.

1.12 The Parliamentary Budget Office has costed these proposals as raising an additional $26 billion over the next four years.

1.13 The Government must take responsibility for the flawed design features in the MRRT and work with the Greens to fix the tax for the benefit of all Australians.

Introduction

1.14 This inquiry reviewed the Minerals Resource Rent Tax (MRRT), a tax on the economic rents mining companies make from the extraction of certain non-renewable mineral resources, in the light of the MRRT's failure to capture a significant proportion of the windfall gains accruing to large mining companies.

1.15 It is in a sense a sequel to the Economics Committee's inquiry into the MRRT last year when the legislation was before the parliament.[1] The majority report from that inquiry had suggested 'the most appropriate time to consider amendments to the operation of the MRRT is after it has been in place for a number of years'. The Greens disagreed, arguing presciently in our minority report that 'a review be conducted by March 2013 of the amounts of revenue being raised by the MRRT and suggestions for redesign if it is not on track to collect the budgeted amount'.

1.16 The Government wants to leave the MRRT as it is and the Coalition, as reflected in the majority report, wants to scrap it entirely. The Greens in contrast used the inquiry to refine suggested amendments to the tax so that it will achieve its original goal and these are described in this dissenting report.

Conduct of the inquiry

1.17 The committee held three public hearings, in Canberra, Perth and Melbourne, and heard from a fair range of witnesses. The Greens particularly appreciate the contributions made by the academic witnesses. While acknowledging that the run-up to the Budget is a very busy period for Treasury, it is disappointing that no responses have yet been received for any of the questions they took on notice at the hearing.

The mining boom and the Australian economy

1.18 The unprecedented growth of the Chinese economy and its re-engagement with the global economy have seen commodity prices soar over the past decade. While they have eased back somewhat in the past couple of years, they are still way above historical averages (Chart G1).

1.19 As the expert economic witnesses told the inquiry:

> Today's export prices for the major minerals are very high by historical standards. They are not as high as they were two years ago in 2011, but they are still very high. The profits of the most productive Australian

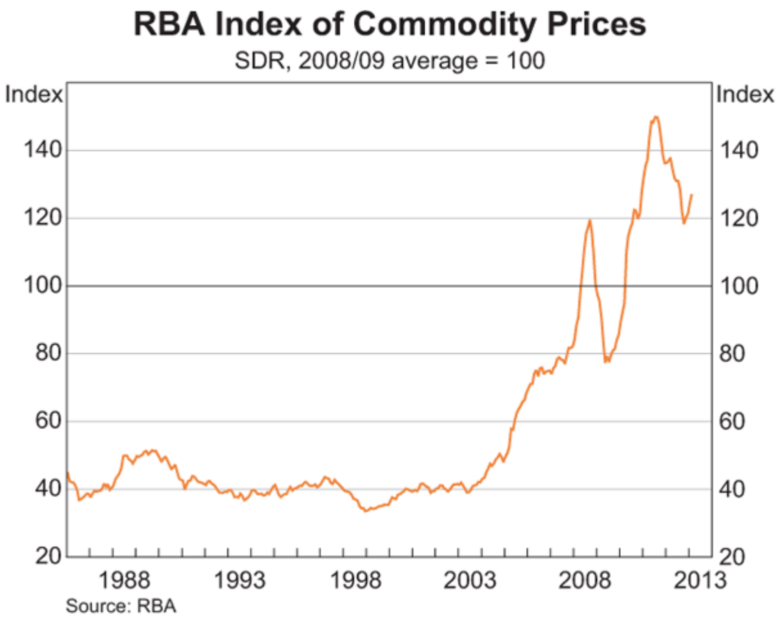
1 That inquiry was by this committee's sister committee, the Senate Economics Legislation Committee. Its report was issued in March 2012.

mines—the established mines—like the great iron ore mines of Western Australia will be higher this year than they will be again in my lifetime.[2]

…while commodity prices are down slightly on their historic highs they are still well above the long-term average,[3]

The benchmark, as set out by the *Henry Review*, is the achievement of normal rates of return to capital. I think it is pretty clear that the mining industry as a whole is doing that and more, so certainly it is still a period of high profits.[4]

Chart G1



1.20 The value of mining production has quadrupled. The contribution to GDP of the mining industry has increased from $35 billion in 2003-04 to $142 billion in 2011-12. Most of this 300 per cent increase has been a windfall gain from higher prices; the corresponding volume measure rose by less than 40 per cent.

1.21 It should be noted, however, that these data on the value 'created' by the mining sector includes the value of minerals put on ships but does not allow for the loss of national wealth from the decreased value of minerals remaining in the ground. It therefore greatly overstates the contribution to national wealth from mining operations.

1.22 Clearly there have been some winners from this mining boom. The most notable have been the shareholders of the companies doing the mining. But, as the Reserve Bank has put it, 'since the mining sector in Australia is majority

2 Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, p 7.

3 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 1.

4 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 14.

foreign-owned, most dividends and retained earnings accrue to foreigners and therefore do not add to national income'.[5] There are no official data on the extent of foreign ownership of Australia's mining industry but 'most estimates suggest that effective foreign ownership of current mining operations in Australia is around four-fifths.'[6]

1.23 The remaining fifth of profits accrue to Australians. While direct share ownership is concentrated among the wealthy, superannuation funds hold some mining share for the benefit of ordinary workers. The mining companies also pay royalties and company tax (discussed further below).

1.24 There are also winners from people who work in the mining sector who would not have got jobs elsewhere or who earn higher wages in mining than in alternative employment. But this is not a large impact: mining employs 2 per cent of the workforce (less than in agriculture, half that of tourism and less than a third of the number employed in manufacturing).[7] There are Australian companies who benefit from providing goods and services to the mining industry, although most of the capital equipment used in mining is imported. Landlords in some regions have also benefited from the sharply increased rents in some regional areas.

1.25 Arguably the main way the bulk of Australian consumers may have benefited from the mining boom is through the associated appreciation of the exchange rate making imported goods and overseas holidays cheaper.[8] But this benefit is denied those such as welfare beneficiaries whose income is tied to the CPI as the cheaper prices also mean their incomes are lower.[9] With consumers paying less for imports they would have more money to spend on services within Australia, providing some benefit for small business.

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5 Reserve Bank of Australia, 'The level and distribution of recent mining sector revenue', *Reserve Bank Bulletin*, January 2009, p 11.

6 Reserve Bank of Australia, *Statement on Monetary Policy*, November 2011, p 43. A study commissioned by the Greens estimated the proportion at 83 per cent; Naomi Edwards, 'Foreign ownership of Australian mining profits', 2011. An Australia Institute study estimated the proportion as around 75 per cent; David Richardson and Richard Denniss, *Mining the Truth*, Australia Institute, September 2011, p 23.

7 Many of these workers apparently do not value their jobs in mining that highly. The mining industry loses around a quarter of its workforce each year, 'suggesting that even the high wages paid are not sufficient to compensate many workers for the risks, social isolation and other negative features often associated with the work'; David Richardson and Richard Denniss, *Mining the Truth*, Australia Institute, September 2011, p 23.

8 Ken Henry, 'Revisiting the policy requirements of the terms-of-trade boom', *Economic Roundup*, Issue 2, 2008, p 45; Glenn Stevens, 'Economic conditions and prospects', *Reserve Bank Bulletin*, September quarter 2011, p 87.

9 David Richardson and Richard Denniss, *Mining the Truth*, Australia Institute, September 2011, p 56.

1.26 Against this must be put the losers from the mining boom. Australia is suffering from what is termed 'Dutch disease' (as the first case examined was the impact of North Sea oil on manufacturing in the Netherlands).[10] This refers to how the boom in the mining sector has led to the large appreciation of the Australian dollar, which has made it harder for other exporters (not just exporters of goods such as farmers and manufacturers, but also exporters of services such as tourism and education) to compete in international markets, and for Australian manufacturers to compete with imports. The strength of the mining sector has also led to the Reserve Bank setting interest rates at higher levels than they otherwise would.[11] This has made life more difficult for many Australian companies, including notably small businesses. Professor Quiggin and Dr Denniss explained:

> …the tourist sector suffers. When the dollar is high, people do not come here and Australians massively increase, as they have done, their overseas travel to take advantage of the strength of the dollar.[12]
>
> So the agriculture industry, the manufacturing industry—all of these industries—are experiencing substantial pain as a result of the mining industry's gain…What happens when the mining industry booms is the exchange rate goes up, and that crowds out other industries. This is what happens. So I think it is odd that an industry that employs such a small percentage of the workforce would make such exaggerated claims about the rest of Australia riding on its back. There is no doubt that imported cars are much cheaper thanks to the mining industry, and I am sure many Australians are happy about that. Similarly, there is no doubt that people employed in making cars in Australia are quite anxious about that…The idea that what is good for mining is good for Australia and what is bad for mining is bad for Australia is simplistic nonsense.[13]

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10 The term 'Dutch disease' was coined by *The Economist*, 26 November 1977. The economic literature on this matter has featured key contributions by two eminent Australian economists: Max Corden and Bob Gregory. In Australia, the 'Dutch disease' is sometimes referred to as the 'Gregory effect'. Key articles include Max Corden and Peter Neary, 'Booming Sector and De-industrialisation in a Small Open Economy', *The Economic Journal*, December 1982, and Bob Gregory, 'Some Implications of the Growth of the Mineral Sector', *The Australian Journal of Agricultural Economics*, 1976.

11 On many occasions when the Reserve Bank increased interest rates between 2006 and 2008 their published statements cited commodity prices as a factor behind the rise; David Richardson and Richard Denniss, *Mining the Truth*, Australia Institute, September 2011, p 48. The higher interest rates also added to pressures on the dollar to appreciate.

12 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 17.

13 Dr Richard Denniss, Australia Institute *Proof Committee Hansard*, 3 April 2013, p 5.

1.27 Dr Denniss was drawing on work by the Australia Institute which showed:

> While mining exports have increased by around five per cent of GDP over the period since the beginning of the mining boom, non-mining exports have declined by around five per cent of GDP over the same period.[14]

1.28 Treasury had been asked earlier this year about the impact on other sectors of the economy had the mining sector extracted resources at a more moderate rate. Treasury replied that the consequences would have included:

> Lower exchange rate…faster growth elsewhere in the economy…you would not see as much evidence of skills shortages…[15]

1.29 The impacts from the mining boom on other industries have led to less activity, less exports, lower profits and lower returns to shareholders (including investors in superannuation funds) in many non-mining industries than would have been the case in the absence of a mining boom. In turn these companies have employed fewer people and contributed less tax to government coffers.[16] Those manufacturing workers who have lost their jobs may not agree with the Minerals Council's insouciant claim that:

> Clearly, the benefits of this boom are washing through the economy to the benefit of all Australians.[17]

1.30 The Minerals Council further claimed:

> …any move to further increase the tax burden on the iron ore and coal sectors…would undercut the very foundations of modern Australian prosperity.[18]

1.31 Asked to respond, Professor Quiggin told the Committee:

> I think that is a nonsensical claim. It is clear that, on the contrary, while the mining sector has generated very substantial returns to investors in the industry and some significant benefits, but not gigantic ones, to employees,

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14 David Richardson and Richard Denniss, *Mining the Truth*, Australia Institute, September 2011, p 27.

15 Dr Martin Parkinson, Secretary, Department of the Treasury, *Economics Estimates Hansard*, 14 February, pp 59-61.

16 As an example, the economic impact statement for Waratah Coal's $8 billion 'Galilee Coal' or 'China First' coal mine, estimated that the mine will lead to the loss of over 2,000 jobs in manufacturing. A recent court case found that 'employment generated from the extension of the Warkworth mine would involve currently employed skilled workers transferring from other industries', rejecting modelling presented by mining interests; Rio Tinto, *Response to questions on notice 2*, p 1.

17 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 29 April 2013, p 17.

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

> the foundations of our prosperity are as they always have been, in the productivity of Australian workers generally, of whom people associated with the mining sector are only a very small proportion.[19]

1.32 Balancing up the above factors, Professor Quiggin concluded:

> The mining boom has already reached or passed its peak, and most Australians have seen little or no benefit as a result.[20]

1.33 As mining is concentrated in Western Australia and Queensland, the 'Dutch disease' effects have also led to a 'two-speed' economy geographically, with the northern and western parts of Australia growing faster than the southern and eastern. While the distribution of the GST revenue based on the Grants Commission's application of 'horizontal fiscal equalisation' distributes some of the windfall gains from mining to the non-mining states, they are clearly not sharing equally in the benefits.

Table G1: Gross state product and per capita income

Annual average percentage change, 2003-04 to 2011-12

	Real Gross State Product	Real State Gross Domestic Income per capita	*(Mining share of GSP, %)*
Western Australia	4.6	7.2	*(35)*
Northern Territory	4.0	3.6	*(20)*
Queensland	3.7	2.6	*(10)*
ACT	3.2	1.7	*(0)*
Victoria	2.6	1.4	*(2)*
South Australia	2.3	1.8	*(5)*
New South Wales	2.1	1.9	*(3)*
Tasmania	1.7	1.2	*(1)*

Source: derived from ABS, *Australian National Accounts: State Accounts 2011-12* (5220.0).
Final column is Mining's share of gross state product in the state in 2010-11.

1.34 The mining industry has been extraordinarily successful in exaggerating their contribution to the economy. An opinion poll showed that while mining actually employs 2 per cent of the workforce, the average person thinks it employs 16 per cent;

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19 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 14.

20 Professor John Quiggin, *Proof Committee Hansard*, 3 April 2013, p 12.

and while mining actually accounts for less than a tenth of economic activity, the average person thinks it accounts for more than a third.[21]

1.35 The Minerals Council made its usual exaggerated claims to the Committee:

> Direct employment in the mineral resources industry has increased by more than 200,000 over the period of the boom.[22]

1.36 The actual increase is more like 160,000, a little over 1 per cent of the workforce.[23]

1.37 When it is put to the mining industry that they are actually a relatively small employer, they often try to take credit for jobs in other industries. For example, the Minerals Council told the Committee:

> The multiplier effects are in the order of three times and even up to eight to 10 times in some remote and regional communities.[24]

1.38 Treasury have been asked about such claims. The exchange puts the mining industry's claims in a true light:

> Senator WATERS:…are you aware of claims that each new job in mining creates three other jobs in the rest of the economy? Do you find those claims plausible?
>
> Dr Gruen: If you add up all the jobs created by all the industries, you will find that we have many more jobs than there are in Australia.
>
> Senator WATERS: Exactly; that is my point. Is that one/three claim plausible?
>
> Dr Gruen: It depends on how you do these calculations. The right way to think about it is that, in a well functioning economy in which unemployment is close to the lowest rate that is sustainable…any given industry that is creating jobs is doing that only to the extent that other industries are employing fewer people.[25]

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21 David Richardson and Richard Denniss, *Mining the Truth*, Australia Institute, September 2011, pp 54-55.

22 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 29 April 2013, p 18.

23 Employment in mining was around 100,000 in 2003-04 and is 260,000 now; Australian Bureau of Statistics, Labour Force, Australia, Detailed Quarterly, February 2013; http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6291.0.55.003Feb%202013?OpenDocument.

24 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 29 April 2013, p 18.

25 Dr David Gruen, Executive Director (Macroeconomic Group), Department of the Treasury, *Economics Estimates Hansard*, 16 February 2012, p 17.

1.39 Aside from the adverse economic impacts that must be set against the economic benefits from mining are the social and environmental costs. The process of mining in many areas has significant environmental impacts, including being a highly energy (and hence greenhouse emissions) intensive industry. The burning of coal by customers of our ever expanding coal exports, add greatly to global emissions of greenhouse gases. Australia will have to leave much of the coal in the ground if we are to contribute our fair share to limiting global temperature increases to under 2 degrees.

1.40 Communities, both host and source, and family life are being disrupted by fly-in/fly-out workforces.[26] Some of our highest quality farmland is being damaged by miners. The increased tapping of coal seam gas risks serious and irreversible damage to aquifers. The amenity of life, and in some cases the health of residents, can be damaged by dust from mining. Roads can become more congested. Dredging operations to expand ports and increased shipping are damaging the marine environment, with implications for both the Great Barrier Reef and the fishing industry. These factors also need to be thoroughly evaluated when decisions are taken both on individual mining projects, and the economy wide questions on the optimal amount or pace of mining activity.

1.41 The mining sector is notorious for its boom and bust mentality. The Minerals Council claims that it:

> ,,,helped to cushion Australia's economy from recession in the wake of the Global Financial Crisis.[27]

1.42 The reality was somewhat different. As Ken Henry has pointed out:

> In the first six months of 2009…the Australian mining industry shed 15.2 per cent of its employees. Had every industry in Australia behaved in the same way, our unemployment rate would have increased from 4.6 per cent to 19 per cent in six months. Mining investment collapsed; mining output collapsed. So the Australian mining industry had quite a deep recession while the Australian economy did not have a recession. Suggestions that the Australian mining industry saved the Australian economy from recession are curious, to say the least. [28]

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26 The House of Representatives Standing Committee on Regional Australia recently held an inquiry into the use of 'fly-in, fly-out' workforce practices, which described 'the damage that the practice is doing to the prosperity of some of those in regional communities'; *Cancer of the Bush or Salvation for Our Cities?*, February 2013.

27 Minerals Council of Australia, *Submission 10*, pp 7, 13 and 14.

28 Dr Ken Henry, then secretary of the Treasury, *Senate Economics Committee Estimates Hansard*, 27 May 2010, p 17.

The taxes and royalties paid by mining companies

1.43 The majority report unquestioningly repeats the mining industry's propaganda, arguing that an effective mining tax is unnecessary 'because the mining industry already pays its fair share of tax'.[29] It is therefore important to place on record the facts.

Company tax

1.44 The three largest mining companies are very large companies and like the big banks and the big retailers pay quite large amounts of company tax in absolute dollar terms.[30] Both BHP Billiton and Rio Tinto claim to be Australia's largest taxpayer.[31]

1.45 More relevant is what they pay relative to the size of their profits, particularly when much of their high profits are the result of windfall gains from commodity prices which are now much higher than when they planned their investment projects.

1.46 The Minerals Council continues to refer to a spurious and discredited analysis by Sinclair Davidson of the Institute of Public Affairs,[32] which compares company tax paid by mining companies to their taxable income rather than to their profits.[33]

1.47 As then Treasury secretary Dr Ken Henry has pointed out, this calculation is:

> …not very meaningful or enlightening either. We could remove all of the mining industry's tax concessions and not change its effective rate of tax calculated in the way that the MCA has…the MCA numbers…do not actually provide any information at all about the effective rate of tax applying to the economic income of any particular industry.[34]

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29 See majority report, paragraph 2.131, p 39.

30 This not true of all large mining companies. Fortescue Metals Group did not pay any company tax until December 2011; Mr Marcus Hughes, Head of Tax, Fortescue Metals Group, *House Economics Committee Hansard*, 9 November 2011, p 6.

31 Rio Tinto, *Submission 8*, p 1; BHP Billiton, *Submission 13*, p 3; Mr Mark O'Neill, Chief Adviser, Government Relations, Rio Tinto, *Proof Committee Hansard*, 29 April 2013, p 36.

32 The IPA has had close links with the Liberal Party since both were established in the 1940s. The mining industry is believed to be a significant funder of its operations; Clive Hamilton, 'The shadowy world of IPA finances'; *ABC The Drum*, 24 February 2012. Asked to set the record clear on this, the IPA refused to do so; *Senate Economics Committee Hansard*, 21 February 2012, p 16.

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

34 Dr Ken Henry, then secretary of Treasury, *Economics Estimates Hansard*, 27 May 2010, pp 13-14.

1.48 Professor Quiggin presented essentially the same rebuttal:

> Senator CAMERON: Professor Quiggin, I am not sure if you have read the Minerals Council submission to this inquiry…On page 12 there is a graph compiled by Professor Sinclair Davidson that shows the average effect of net company tax rate for all industries and mining, and it shows mining sitting above the average of all industries…
>
> Prof. Quiggin:…I think it essentially comes down to a statement that, of course, as applied to taxable income and once all deductions et cetera are taken into account, all companies pay a rate of 30 per cent. If you take some of those deductions into account, as Professor Davidson has done, and not others, you will get differences in the rate, but it will be near 30 per cent. I think the point that is being obscured here is that, as a proportion of total profits, the rate of company tax paid by mining companies is relatively low. That reflects the availability of very large deductions for depreciation, the tax treatment of that kind of expenditure and so forth.
>
> Senator CAMERON: So we should not use the Sinclair Davidson graph as a reason to say that the mining industry should not pay more tax on high profits?
>
> Prof. Quiggin: No, there is no justification for that. All it shows really is that the company tax rate is 30 per cent and that taxable income is different from profits, but none of that really addresses the question of whether and how much the mining industry should be paying for access to valuable Australian owned resources.[35]

1.49 The current Treasury Secretary has observed:

> Mining companies account for about a fifth of gross operating surplus, yet only around a tenth of company tax receipts…[36]

1.50 His predecessor remarked:

> …the tax paid by the mining sector of the economy is a relatively small proportion of profit.[37]

1.51 Two studies by Treasury economists examined alternative measures of average company tax rates by industry, which consistently showed mining as below average.[38]

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35 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 16.

36 Dr Martin Parkinson, 'Introductory remarks to Australia-Israel Chamber of Commerce', Sydney, 7 March 2012, p 9.

37 Dr Ken Henry, *Senate Select Committee on New Taxes Hansard*, 22 November 2010, p 39.

38 Peter Greagg, Parham and Stojanovsk, 'Disparities in average rates of company tax across industries', *Economic Roundup*, Winter 2010; and John Clark, Peter Greagg and Amy Leaver, 'Average rates of company tax across industries revisited', *Economic Roundup*, 2011, Issue 2.

1.52 Even some mining company executives have conceded the sector should be making a larger contribution:

> In April 2010, before the RSPT was announced, I am on the record as having said…those [mining] companies who are making a really high profit actually could afford to pay more tax and that they should.[39]

Company tax and royalties

1.53 The minerals industry bulks up their claimed tax payments by adding in the royalties they pay. Royalties are not strictly a tax, but are the payment the mining industry makes for its raw materials.

> …the royalty is not a tax, it is actually a charge for taking the material from the state.[40]

> an essential feature of a tax is that there is no clear quid pro quo.[41]

> Royalties are the price paid by the mining industry for the right to extract mineral resources…[42]

1.54 Including MRRT, royalties and company tax, the contribution to the public purse from the mining industry now is still below that in previous mining booms:

> Senator MILNE: Just on that issue, during the resource booms in the early 1970s and early 1980s, company tax rates were higher, there was no dividend imputation and personal income tax rates were also higher. Does this suggest that even now with the MRRT, or even if we put in place the super profits tax, the effective tax on mining shareholders in Australia is now much lower than it was then?
>
> Prof. Quiggin: I think that would be correct, yes.[43]

1.55 A further example of exaggeration comes from Rio Tinto who includes the income tax paid by their employees as part of what they claim the company pays in tax.[44]

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39 Mr David Flanagan, Managing Director, Atlas Iron Ltd, *Senate Economics Committee Hansard*, 22 February 2012, p 8.

40 Mr Rob Heferen, Executive Director, Revenue Group, Department of the Treasury, *Senate Economics Committee Hansard*, 21 February 2012, p 71.

41 Henry Ergas, Mark Harrison and Professor Jonathan Pincus, 'Some economics of mining taxation', *Economic Papers*, December 2010, p 372.

42 Mr Tim Marney, Under Treasurer, Western Australia Department of Treasury, *Proof Committee Hansard*, 8 April 2013, p 35.

43 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 15.

44 Rio Tinto includes in its *Taxes Paid* report, attached to its *Submission 8*, under the heading 'payroll tax' the income tax that is paid by its employees as though it were paid by the company; *Proof Committee Hansard*, 29 April 2013, pp 34-35.

International competitiveness and 'sovereign risk'

1.56 The mining industry makes apocalyptic predictions of the impact of higher taxes on their international competitiveness, backed by negligible empirical support.

1.57 An international comparison of taxes and royalties paid by the mining industry found that Australian taxes and royalties are among the lowest in the world. Even if the Minerals Council's claims that the MRRT would push the effective tax rate up to 46 per cent[45] were right, this would still be below the global average (see Chart G2 on following page).

1.58 In a crowded field, possibly the most ridiculous hyperbole on the subject of the mining tax was former Rio Tinto chief Tom Albanese's comment in 2010 that Australia's prospective mining tax was 'the biggest sovereign risk issue we were facing anywhere in the world'.[46] Rio has since written off $14 billion on various activities outside Australia, such as a coal project in Mozambique. Rio is currently involved in a dispute with the Mongolian government about royalties on a copper mine there, after having been required to lend the government funds to buy a one-third stake in the mine, a loan that does not have to be repaid unless the project is profitable.[47] This compares to no mining tax paid in Australia in 2012 and an unspecified small amount in 2013.

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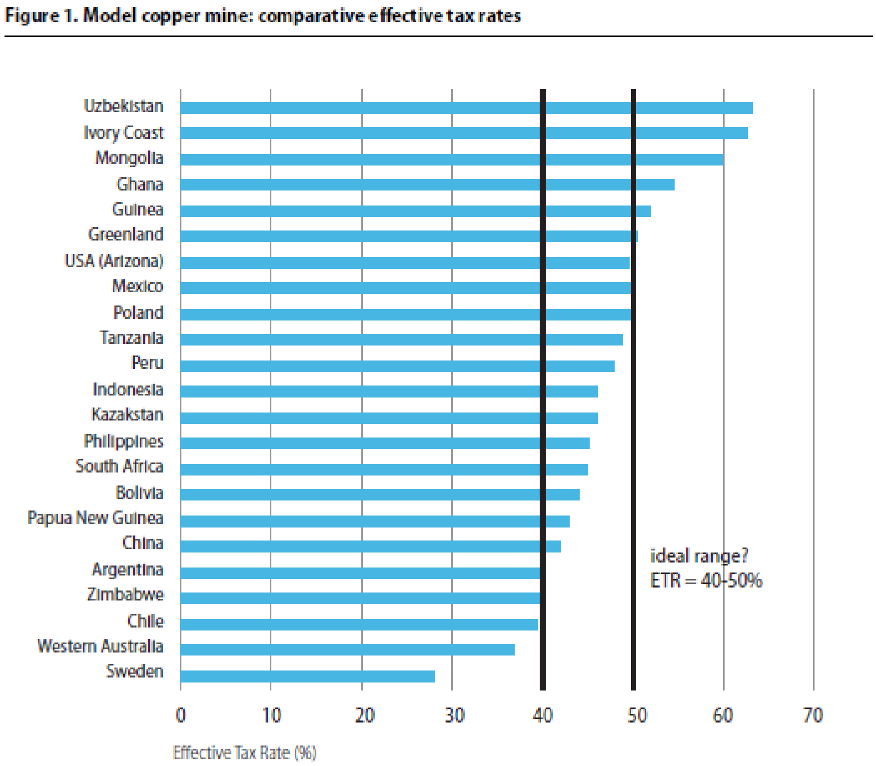
45 Minerals Council, *Submission 10*, p 15. This is presumably calculated as (1-0.30)*0.225 + 0.30 = 0.458, where the company tax is 30% and the MRRT rate 22.5%.

46 Mr Mark O'Neill, Rio Tinto, *Proof Committee Hansard*, 29 April 2013, p 32. The original comment was reported in the *Sydney Morning Herald*, 24 May 2010.

47 Stephen Bartholomeusz, 'Rio Tinto's careful Mongolian courtship', *Business Spectator*, 6 February 2013.

Chart G2



Source: Paul Mitchell, 'Taxation and investment issues in mining', in Extractive Industries Transparency Initiative, *Advancing the EITI in the Mining Sector*, 2009, p 30.

1.59 Professor Ross Garnaut told the Committee:

> 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.[48]

1.60 Asked to compare Australia's treatment of the minerals industry compared to that around the world, Professor John Quiggin told the Committee:

> We are much more generous to the mining companies. A number of other developed countries, of course, have asserted complete public ownership over those minerals, as well as many others. I think a relevant consideration here is the continued threats by the mining industry that activity will move overseas. The nominated countries typically have been places, first, that do not provide anything like the range of public goods to the mining industry that Australia does—not only, obviously, things like infrastructure but also other benefits of a secure legal framework and so forth—and then many of those countries have sought to raise taxation along similar lines. So I think the mining industry is getting a very sweet deal here in Australia.[49]

48 Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, p 5.

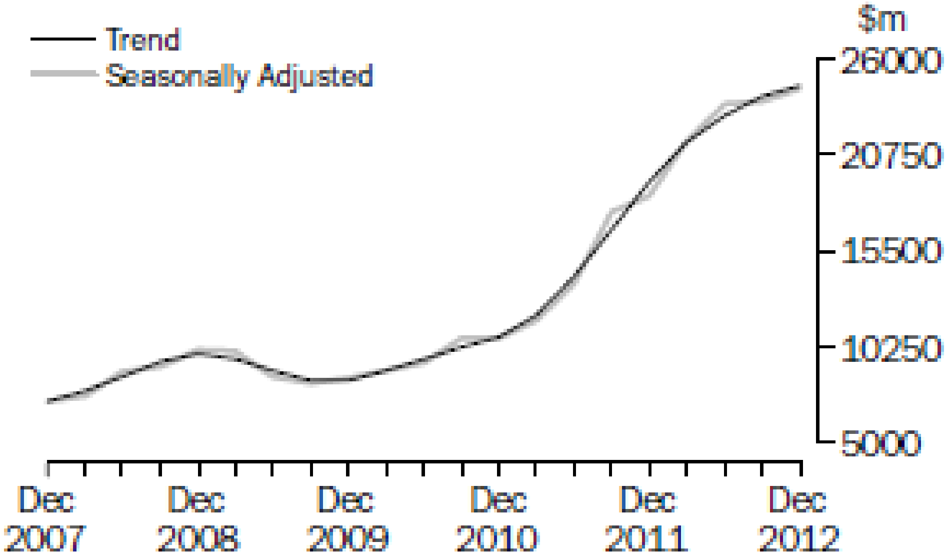
49 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 15.

1.61 A recent report by the Behre Dolbear Group, minerals industry advisors for over a century, ranks Australia as the best place in the world for mining investment.[50] In marked contrast to the supposed 'sovereign risk' from Australia's proposed tax reforms are the reality of events in other parts of the world. As *The Economist* pointed out,

> The list of African governments that have miners in their sights is a long one. South Africa…is considering imposing a swingeing 50 per cent windfall tax on mining "super profits"…[Ghana] plans to raise taxes on mining companies, from 25 to 35 per cent, and a windfall tax of 10 per cent on "super profits" in addition to existing royalties…[51]

1.62 The latest data show that mining investment in Australia reached another record high in the December quarter of 2012.

Chart G3: Capital expenditure by the mining industry



Source: Australian Bureau of Statistics, *Private New Capital Expenditure and Expected Expenditure*, December 2012.

50 http://www.dolbear.com/news-resources/documents.

51 *The Economist*, 11 February 2012, p 45.

1.63 Furthermore, the mining industry expects to invest around $100 billion in 2013-14 alone, far above their annual investment before the MRRT was introduced.[52] There are over $250 billion in large committed investment projects, which is a record high, and another similar amount at the feasibility stage.[53]

1.64 Just one company, BHP Billiton, told the Committee:

> …since the introduction of the MRRT we have announced a couple of investments in Australia to the order of $28 billion gross…they are substantial investments which have been made post the introduction of the MRRT.[54]

1.65 The Australia Institute's Dr Richard Denniss, told the Committee:

> As for the idea that, if a super profits tax were to be improved, enhanced, broadened, changed, tinkered with, whatever word you want to use, mining would flee Australia and go to lower tax environments: it is demonstrably untrue…If we look around the world we see that mining activity goes where it is profitable and where the risks are minimised…In the scheme of things, tinkering with our mining tax is small beer compared to the massive fluctuations we see in commodity prices and the potential for things to go very wrong in some countries… the idea that, if their taxes went up, they would leave en masse is demonstrably untrue and begs the question: why do they operate in Australia at all? We are not the lowest-taxing place in the world to do mining—why aren't they all off in the lowest taxed places? The answer is that we have the resources, they are close to the surface, they are cheap to get out of the ground, we have the skills and know-how to do it and the infrastructure is there to transport it.[55]

1.66 The mining industry, when arguing against paying more tax, often make statements such as 'costs have risen sharply in recent years'[56], as though this is nothing to do with them. But increases in costs are the result of the industry's own manic boom-and-bust approach. The outgoing BHP Billiton CEO Marius Kloppers said last year:

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52 Australian Bureau of Statistics, *Private New Capital Expenditure and Expected Expenditure* (5625.0), December quarter 2012, p 9.

53 Bureau of Resources and Energy Economics, *Resources and Energy Major Projects*, October 2012.

54 Mr Christian Bennett, Vice President, Government Relations, BHP Billiton, *Proof Committee Hansard*, 29 April 2013, p 26.

55 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 5.

56 Mr Mitch Hooke, CEO, Minerals Council of Australia, *Proof Committee Hansard*, 29 April 2013, p 19.

> In the broader mining industry…most miners took a "volume over cost" approach; the benefits of being able to produce more outweighed the increased costs that resulted.[57]

1.67 Professor Garnaut recalled to the Committee:

> I have had a conversation with Marius Kloppers in which he said exactly that to me... Sometimes putting more effort into reducing costs could compromise output in the very short term.[58]

1.68 Treasury secretary Martin Parkinson has referred to:

> The miners could see massive profit opportunities. They were less focused on cost containment...[59]

Designing a better tax regime: Resources rent taxes

1.69 A survey of over 500 of its members by the Economic Society of Australia in 2011 found that 74 per cent agreed that 'a national excess profits tax should be levied on mining industries'.[60] Two of the Economics Society's distinguished fellows, Professors Garnaut and Quiggin, gave evidence to the Committee.[61] Professor Garnaut, one of the world's leading authorities on resources taxation, told the Committee:

> For Australia as a whole an efficient structure would have a version of the MRRT, not necessarily with these parameters…[62]

1.70 He explained that one if its virtues is:

> …the inherent flexibility of the resource rent tax. When a project is very profitable it generates more revenue and when it is not so profitable it generates less. That inherently contributes to stability.…[63]

1.71 Professor Quiggin put a similar view to the Committee:

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57 Marius Kloppers, 'Presentation to the Brisbane Mining Club', 17 October 2012, p 2.

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

59 Dr Martin Parkinson, Secretary, Department of the Treasury, *Economics Estimates Hansard*, 14 February2013, p 61.

60 37 per cent strongly agreed, whereas only 9 per cent strongly disagreed. http://www.ecosoc.org.au/files/File/CC/Survey%20summary%205%20categories.pdf.

61 Professor Garnaut was chosen as the distinguished fellow for 2009 and Professor Quiggin for 2011.

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

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

> The most efficient way to secure such returns would have been through the adoption of a general resource rent tax, similar to that now applied to petroleum resources. Such a tax was proposed in the *Henry Review* and announced as the resource super profits tax, and then a watered-down version referred to as the MRRT was introduced.[64]

1.72 Another respected economist, the Australia Institute's Dr Richard Denniss, told the Committee:

> …the idea of introducing a resource rent tax, a super profits tax, is a good one. I think that the vast majority of academic economists would agree that it is an effective and efficient tax base…[65]

1.73 The Greens had called for a resources rent tax even before the *Henry Tax Review* was released.[66]

1.74 It is likely that the reason the large mining companies were so opposed to the original RSPT was not that this resources rent tax would not work but that it would have worked very well and been adopted around the world.

> …it is true that some of the multinational mining companies are concerned about Africa…they are worried that those jurisdictions may follow our example and also seek to secure a better and more efficient return, reducing international profitability.[67]

1.75 A good point about the balance of risks in setting tax rates on mining has been made by Fortescue:

> …projects that are deterred by the effect of being required to make royalty payments do not result in the resource being lost or deteriorating in any way – the resources remains in the ground…[68]

1.76 While Fortescue is referring to royalties, exactly the same point applies to a resources rent tax (or indeed to mining taxes in general). If an excessively low tax regime is applied, then money is lost to the community forever. If an excessively high tax is applied, the resources are still there later when a more appropriate rate can be set.

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64 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 12.

65 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 1.

66 See, for example, Senator Bob Brown, 'A tax on resources profits would benefit all of us', *Sydney Morning Herald*, 6 April 2010.

67 Professor John Quiggin, *Senate Economics Committee Hansard*, 22 February 2012, p 14.

68 Fortescue Metals Group, *Submission 26 to 2012 inquiry by Senate Economics Committee*, p 5.

The Minerals Resource Rent Tax

Process issues

1.77 The *Henry Tax Review* proposed a resources rent tax to replace the patchwork of inefficient state royalties which were failing to capture a fair share for Australians of the windfall gains accruing to largely foreign-owned mining companies. The Rudd Government proposed the Resources Super Profits Tax (RSPT) in May 2010, which incorporated many of the features of the tax proposed by Henry and was similar to the Petroleum Resources Rent Tax which has operated successfully in Australia for twenty years.

1.78 The mining companies, however, responded with a ferocious advertising campaign costing around $20 million. After 'negotiating' rather than just consulting with the three largest mining companies, BHP Billiton, Rio Tinto and Xstrata, Prime Minister Gillard announced in July 2010 that the RSPT would be replaced with a watered down Minerals Resource Rent Tax. Details were referred to an advisory Policy Transition Group, co-chaired by former BHP chairman Don Argus and Minister Ferguson. The Government agreed to all the Group's recommendations in March 2011 and released draft MRRT legislation in June 2011. The bills passed the Senate in 2012.

1.79 This process is a very poor precedent for policy design. A government should consult with stakeholders in the development of taxation measures. But it should not be forced to 'negotiate' with them. Even worse was that the discussions were not with representatives of the mining industry as a whole but with the three largest firms who designed a tax that favoured them over the smaller companies.[69] There were no Treasury or ATO officers present during the negotiations.[70]

1.80 Asked about this process, Professor Quiggin commented:

> Obviously the process was problematic. In political terms, the mining companies at the time exerted significant political power, and the government was in a position where it felt it had to negotiate with them… I do not see any justification other than that of political necessity for the concessions that were made to get the MRRT through. I would certainly favour withdrawing those concessions if it were possible to do so.[71]

1.81 In rather evasive evidence, BHP Billiton suggested that they saw themselves as representing the mining industry as a whole – or at least arguing for principles that the whole industry supported – but apparently did not consult with any of the smaller

69 Association of Mining and Exploration Companies, *Submission 5*, pp 2-3.

70 Mr Rob Heferen, Department of the Treasury, *Proof Committee Hansard*, 3 April 2013, p 43.

71 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, pp 14-15.

companies in the industry.[72] AMEC, the industry body for smaller miners, states that BHP, Rio and Xstrata 'had no mandate to act on behalf of the hundreds of mining and exploration companies with Australian projects' and it 'was not consulted in any way'.[73]

1.82 Asked specifically whether BHP had drafted the 'heads of agreement' under which the Government committed itself to the main features of the MRRT, BHP's representative dissembled at the hearing:

> It could be. I just do not know whether we started it off or not. There were discussions and there was a written version.[74]

1.83 Its written response refers to 'iterative discussions' but does not explicitly deny preparing a draft.[75]

1.84 BHP denied that in signing the heads of agreement they were implicitly promising not to resume the advertising campaign against the Government.[76] This leaves unclear what they were committing to by signing the agreement.

1.85 There was some semantic debate during the hearings about whether the aspects of the MRRT that have led to it raising little revenue were 'design features' or 'loopholes'.[77] The Greens would argue that unless it was the Government's intention not to raise much revenue, they can legitimately be described as 'loopholes'. Professor Fargher put it quite well:

> …it was surprising how many choices and estimates were involved in the MRRT. It is taken for granted that taxpayers will choose their methods, within reasonable allowances, to minimise their taxes. In designing a good tax policy, some of these choices are sometimes eliminated to get to an effective tax.[78]

1.86 Given the inter-relationship between royalties and the mining tax, it would have been better had the Government discussed with the state governments before introducing the tax.

72 Mr Brian Purdy, Senior Manager, Finance, BHP Billiton, *Proof Committee Hansard*, 29 April 2013, pp 29-30.

73 Association of Mining and Exploration Companies, *Submission 5*, p 1.

74 Mr Brian Purdy, BHP Billiton, *Proof Committee Hansard*, 29 April 2013, p 30.

75 BHP Billiton, *Responses to questions on notice 6*, p 1.

76 Mr Brian Purdy, BHP Billiton, *Proof Committee Hansard*, 29 April 2013, p 30.

77 See the discussion in the majority report, paragraphs 3.23-3.27, pp 45-46.

78 Professor Neil Fargher, *Proof Committee Hansard*, 3 April 2013, p 11.

> …a well-designed scheme would have started with both the federal government and the state government in the room.[79]

1.87 Isaac Regional Council's submission says:

> No formal consultation was undertaken with communities affected by mining.[80]

This is another important deviation from best practice policy design.

1.88 It shows both the Government's fear of the mining companies and their embarrassment of how this led them to introduce so many flaws into the tax that the new resources minister recently tried to discourage even discussion of the tax, saying:

> even to discuss changes to that tax right now would create uncertainty. [81]

1.89 The expert witnesses found this rather odd:

> As for the suggestion that parliament should provide certainty, whatever that might mean, in perpetuity to the mining or any other industry, I am not quite sure what on earth he means. No parliament makes decisions that bind subsequent parliaments. Laws are changed all the time. It is often the mining industry itself that is proposing changes to laws, so clearly they support legislative change that is advantageous to them.[82]

> There is already uncertainty given that the opposition party has promised the removal of the tax, so I think obviously there was always uncertainty about taxation. To use that as a basis for shutting down debate is, I think, nonsensical.[83]

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79 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 2.

80 Isaac Regional Council, *Submission 6*, p 2.

81 Mr Gary Gray, cited approvingly by Minerals Council, *Submission 10*, p 2, and by Mr Mitch Hooke, Minerals Council of Australia, *Proof Committee Hansard*, 29 April 2013, p 37.

82 Dr Richard Denniss, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 5.

83 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 14.

Estimates of revenues from MRRT and RSPT

1.90 The sorry story of the decline and fall of mining tax revenue projections is told in Table G2. It should be noted that the first MRRT projections were based on stronger assumptions about commodity prices than were the RSPT projections.[84] The reduction in revenue between the RSPT and the MRRT is therefore understated in the table. A study commissioned by the Greens estimated that the reduction (on an 'apples with apples' basis) is between $73 billion and $115 billion.[85] An AFR journalist estimated that the reduction is at least $100 billion.[86] Asked about estimates that the revenue foregone in the transition from the RSPT to the MRRT was around $100 billion, Treasury replied 'I recall a figure of that sort of magnitude, yes'.[87]

Table G2: RSPT and MRRT revenue projections, $ billion

	RSPT		**MRRT**							
	2010-11 Budget	FoI	Econ. State. 2010	FoI	MYEFO 20101-11	2011-12 Budget	MYEFO 2011-12	2012-13 Budget	MYEFO 2012-13	PBO April 2013
2012-13	3.0	3.0	4.0	4.0	3.3	3.7	3.7	3.0	2.0	0.8
2013-14	9.0	9.0	6.5	6.5	4.1	4.0	3.8	3.5	2.4	1.3
2014-15		12.5		6.5		3.4	3.1	3.2	2.1	1.7
2015-16		12.5		5.5				3.7	2.6	1.6
2016-17		12.5		4.0						1.8
2017-18		14.5		3.0						
2018-19		13.5		3.0						
2019-20		11.5		3.0						
2020-21		10		3.0						
total		*99*		*38½*						

Sources: *2010-11 Budget Paper No. 1*, p 5-15; *Economic Statement 2010*, p 32; Treasury, Freedom of Information request, 14 Feb 2011; *MYEFO 2010-11*, p. 283; *2011-12 Budget Paper No. 1*, pp 5-35; *MYEFO 2011-12*, p 319; *2012-13 Budget Paper No. 1*, pp 5-29; *MYEFO 2012-13*, p 305; Parliamentary Budget Office costing, 24 April 2013. The numbers are the net contribution to revenue after allowing for the deductibility of MRRT lowering company tax collections.

84 This was not made clear at the time, leading to surprise about how little the apparent drop in revenue was between the RSPT and MRRT in the first two years. Interviewed on *Lateline* on 14 July 2010, Treasurer Swan conceded that higher commodity prices had increased the revenue over the first two years by $6 billion.

85 Naomi Edwards, 'An analysis of the impact of switching from the RSPT to the MRRT', 28 March 2011.

86 John Kehoe, 'Mining tax hole tops $100bn', *Australian Financial Review*, 24 February 2011.

87 Mr Matthew Maloney, Manager, Costings and Quantitative Tax Analysis Unit, Department of the Treasury, *Proof Committee Hansard*, 3 April 2013, p 42.

1.91 Treasury told the Committee that the declines in the projections for 2012-13 collections between the $4 billion forecast in 2010 and the $2 billion in the latest MYEFO were solely due to less favourable assumptions about commodity prices, exchange rate and royalties.[88] They were not the result of rethinking how the tax would operate.

1.92 Given that in the first half of 2012-13 the MRRT has raised only $0.1 billion,[89] the $2 billion MYEFO forecast for the year is extremely unlikely to be realised. While BHP-Billiton and Rio Tinto have made some payments in the most recent quarter, Xstrata has not.[90]

1.93 Rio Tinto have booked a deferred tax asset of $1.1 billion and an unbooked deferred tax asset of $12 billion.[91] BHP Billiton have booked a deferred tax asset of under $1 billion but have an unbooked deferred tax asset of around $10 billion.[92] Xstrata have an unrecognised deferred tax asset of $11 billion.[93] Fortescue Metals have said that they do not anticipate paying any MRRT for at least five years and have a deferred tax asset of $3½ billion which they have not booked and to which they will be able to add $4 billion in royalties over five years, compounded at the uplift rate (currently around 10 per cent).[94] Few commentators would expect commodity prices to be higher on average over the coming decade than they have been over the past year.[95] It appears that, notwithstanding they continue to make billions of dollars profits from mining in Australia, the large mining companies will not be paying much MRRT any time soon.

1.94 Professor Garnaut told the Committee of his concerns about whether the MRRT will ever raise significant amounts:

> Your question was whether the tax in this form will ever raise revenue: it may not, especially because of two design features. There are others as well, and in my introductory remarks before you came I mentioned a couple of other features, but the critical ones for these purposes are the shielding of

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88 Dr Martin Parkinson, Treasury, *Proof Committee Hansard*, 3April 2013, pp 28, 40.

89 Memo from Commissioner of Taxation to Treasurer, 8 February 2013.

90 *Proof Committee Hansard*, 29 April 2013, p 21.

91 Mr Ross Lyons, Rio Tinto, *Proof Committee Hansard*, 29 April 2013, p 22.

92 Mr Brian Purdy, BHP Billiton Iron Ore, *Proof Committee Hansard*, 29 April 2013, p 22.

93 Mr Dominic Smith, Tax Manager, Xstrata Coal, *Proof Committee Hansard*, 29 April 2013, p 23.

94 Mr Stephen Pearce, Chief Financial Officer, Fortescue Metals Group, *Proof Committee Hansard*, 8 April 2013, pp 2 and 4.

95 The Bureau of Resource and Energy Economics, for example, expects the iron ore price to decline from around US $150 a tonne in the March quarter of 2013 to around US$90 by 2018; BREE, *Resources and Energy Quarterly*, March 2013, p 58.

> past expenditure and the way in which that is done; and the interaction with state royalties.[96]

Concerns about volatility of revenue

1.95 Concerns have been expressed about the volatility of the revenue from the MRRT:

> …because the tax base is so volatile the value of that tax revenue to the community is less than the dollars it involves might suggest…[97]

1.96 These concerns are exaggerated. Firstly, the MRRT only represents around 1 per cent of government revenue so volatility in it will not translate into large volatility in overall government revenue. Secondly, a tax that raises more money during a boom and less during a slump acts as a useful counter-cyclical 'automatic stabiliser' for the economy. As Professor Quiggin put it:

> I do not see a problem with governments taxing volatile income sources.[98]

Linking the MRRT to other budget measures

1.97 The Coalition senators that form the 'majority' of this committee have claimed that the MRRT 'actually leaves the budget worse off'.[99] Their argument is that with its current flaws (which of course the Coalition is opposed to fixing) the MRRT will not be able to fund 'promises the current government has attached to it'.[100] There are no government programmes which the MRRT is hypothecated to fund. The main proposal which the Government has mentioned in this context is the cost to government revenue from increasing superannuation contributions. The Coalition do not specifically refer to this as they are in the embarrassing position of also committing to the superannuation increase, leaving them in effect arguing that funding a programme from a low-yielding tax is bad but it is perfectly reasonable to fund it from nothing at all.

The MRRT rate

1.98 The tax rate in the RSPT was 40 per cent. This is the same as that recommended in the *Henry Tax Review*.[101] It is also the rate that has applied to

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96 Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, p 7.

97 Professors Henry Ergas and Jonathan Pincus, *Submission 2*. This point was also made in an article Professors Ergas and Pincus wrote with Mark Harrison, 'Some economics of mining taxation', *Economic Papers*, December 2010.

98 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 13.

99 See majority report, paragraph 3.48, p 50.

100 See majority report, paragraph 3.47, p 48.

101 *Australia's Future Tax System*, December 2009, recommendation 45, p 231.

offshore oilfields under the Petroleum Resources Rent Tax and even the harshest critics of the MRRT have offered no evidence that the PRRT has significantly stifled investment.[102]

1.99 The MRRT has seen the rate slashed to an effective rate of 22½ per cent (obfuscated as a 30 per cent rate less an 'extraction allowance'). No economic reason was given for the reduction.

1.100 As the OECD commented, 'the proposed tax is set at a relatively low level and therefore the taxation of profits of mining companies is likely to remain much lower than before the mining boom'.[103] Professor Ross Garnaut, a global expert on resource taxation, told the committee:

> I do not think that 40 is too high, and it has been shown in the gas industry and oil industry that it is consistent with efficient operation.[104]

1.101 Other countries with resources rent taxes often apply higher rates.

Table G3: Resource rent taxes

Australia (petroleum)	40
Norway (petroleum)	50
United Kingdom (petroleum)	50
Timor Leste (petroleum)	22½
Namibia (petroleum)	25 minimum
Malawi (mining)	10
PNG (mining)	70 less standard company tax rate
Ghana (mining)	35
Liberia (mining)	20
Mongolia (copper, gold mining)	68

Sources: Land, B 'Resource rent taxes' in Daniel, Keen and McPherson (eds) *The Taxation of Petroleum and Minerals*, Routledge, 2010; Treasury, 'International Comparison – Mining Taxation', 9 November 2011.

1.102 Even without making any other changes, restoring the MRRT rate to 40 per cent would raise almost an additional $18 billion over the forward estimates.[105]

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102 For example, Dr Alan Moran, Institute of Public Affairs, *Senate Economics Committee Hansard*, 21 February 2012, p 13.

103 OECD, *Economic Surveys: Australia*, November 2010.

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

105 Parliamentary Budget Office, 24 April 2013.

Recommendation G1

1.103 **That the rate of MRRT be set at the 40 per cent proposed in the *Henry Tax Review* rather than an effective 22½ per cent.**

Minerals covered by the MRRT

1.104 While the RSPT applied to almost all minerals, the MRRT only covers iron ore and coal.[106] The exclusions mean that Australia now has in effect three rates of resources rent tax: 40 per cent for oil and gas, 22½ per cent for iron ore and coal and zero for other minerals. This will distort investment away from iron ore and coal towards other minerals.

1.105 No cogent argument has been put for this treatment. The Minerals Council vaguely said:

> Firstly, the economic argument centres around internationally competitive tax rates. Secondly, there is an economic argument about the flatter capital and return profile of minerals resources as distinct from petroleum….So, yes, there is an economic argument and it centres around whether you are going to impose tax rates that put this country's minerals resources into an uncompetitive position, way over what our competitors are facing in those emerging resource rich countries which I referred to earlier. That then is the fundamental economic argument. Treasury itself argues that the 40 per cent under the RSPT was an arbitrary figure plucked from the air. There is a very strong case to be made for a differentiation in resource rent taxes.[107]

1.106 The Minerals Council were asked to elaborate in writing on what this meant but have not done so.

1.107 The restriction to iron ore and coal has been criticised by the IMF, the OECD and academic experts. For example, the OECD has argued:

> …the MRRT is likely to distort investment incentives between mining projects of coal and iron ore and those on other resources that are not subject to the tax.[108]

1.108 The Committee heard from its expert witnesses (with a unanimity rare for economists, extending even to strong opponents of the MRRT):

> A very profitable goldmine or copper mine or uranium mine generates resource rents in exactly the same way as a very profitable coal or iron ore or gas project.[109]

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106 The Parliamentary Budget Office estimates that iron ore will contribute about three-quarters of the revenue in 2012-13; PBO, 24 April 2013.

107 Mr Mitch Hooke, CEO. Minerals Council of Australia, *Proof Committee Hansard*. 29 April 2013, p 32.

108 OECD, *Economic Surveys: Australia*, November 2010.

> The most obvious change would be to remove the limitation to coal and iron ore. There is no obvious justification for that exclusion, so, whatever the political feasibility of it, it would certainly be the obvious route in terms of horizontal equity within the mining industry. The rationale that is applied to coal and iron ore applies equally well to a number of other high-value minerals.[110]
>
> There is no good economic reason at all for excluding copper, uranium or gold. The economic argument for why you would have tax on iron ore and coal is exactly the same argument that applies to those other resources. It is more efficient and equitable to have a broader tax base.[111]
>
> …if there is a case for an MRRT, which is already on three sorts of products, with petroleum also, then the same case should be thought of as 'on any minerals that you like'. There is no distinction in my mind between one and another.[112]

1.109 There was a telling admission from Treasury at the hearing:

> Senator MILNE: Are you aware of any independent research or reports that recommend that it should be restricted to just iron ore and coal?
>
> Dr Parkinson: I am not aware, no.[113]

1.110 The only argument being put for specifically taxing iron ore and coal is that they have been very profitable in recent years and so would contribute the most revenue. Calculations by the Parliamentary Budget Office, however, suggest that taxing gold would actually raise more revenue than taxing coal in the next couple of years.[114] But, more fundamentally, it is very hard to predict in advance which commodity prices will rise sharply and generate windfall profits. Rather than waiting for the price of a particular mineral to go up, then starting the process of introducing a tax which may not apply until the price is coming down again, the prudent approach is to set a uniform taxation regime for all minerals so that super profits are taxed wherever they may occur in the future. As Dr Denniss put it:

> … you put the tax regime in that is a good and fair tax regime and then you let the commodity cycle determine how much revenue to

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109 Professor Ross Garnaut, *Proof Committee Hansard*, 3 April 2013, p 7.

110 Professor John Quiggin, *Proof Committee Hansard*, 3 April 2013, p 14.

111 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 1.

112 Professor Jonathan Pincus, *Proof Committee Hansard*, 3 April 2013, p 24.

113 Dr Martin Parkinson, Secretary, Department of the Treasury, *Proof Committee Hansard*, 3April 2013, p 44. This is consistent with Treasury's response to question on notice no. 667 from supplementary budget estimates, October 2011.

114 The PBO estimates that an MRRT on gold would raise $0.9 billion in 2013-14 compared to $0.4 billion from coal; and $0.8 billion in 2014-15 compared to $0.6 billion from coal; Parliamentary Budget Office, 24 April 2013.

> collect. You do not look at the commodity cycle and ask yourself, 'Is it a good time to introduce the tax?' I would suggest that the causation is entirely the other way around. [115]

1.111 The Parliamentary Budget Office estimate the cost to revenue of excluding minerals other than coal and iron ore at $3 billion over the forward estimates.[116]

Recommendation G2

1.112 **That the MRRT's coverage be extended to that proposed for the RSPT, including gold, silver, diamonds, uranium, rare earths, nickel, copper, zinc and bauxite.**

Recommendation G3

1.113 **That while minerals other than iron ore and coal are excluded from the MRRT, this be treated as a 'tax expenditure' and the cost to revenue be disclosed annually in Treasury's *Tax Expenditure Statement.***

The MRRT and state royalties

1.114 Royalties are never likely to capture a fair share of the profits generated from the minerals. There is an understandable desire not to set royalties so high that they lead to projects being abandoned. They are therefore typically set at a level that leaves even the highest cost projects profitable in years of low commodity prices. This inevitably means that the tax on the lower cost projects is a very small proportion of profits when commodity prices are high.

1.115 Furthermore, the setting of royalty rates for individual minerals is essentially arbitrary. It would obviously not make sense to charge the same for a tonne of iron ore as for a tonne of gold. In practice, though, even with ad valorem royalties different percentages of revenue are charged for different minerals. These may be partly related to past average profitability of the mineral but likely also reflects the lobbying ability of various companies or the marginality of the electorates in which the mines lie. This is even more likely when royalties vary between individual companies or mines under ‘state agreements’.[117] Changing royalties in response to changes in profitability of various minerals would give rise to the charges of creating ‘uncertainty’ and ‘retrospectivity’ that are raised against the MRRT, but with more validity.

1.116 While royalties are often described as simple,[118] in practice there is a complicated variation in rates imposed in Australia. Taking coal for example, the

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115 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard,* 3 April 2013, p 4.

116 Parliamentary Budget Office, 24 April 2013.

117 See discussion in *Proof Committee Hansard*, 8 April 2013, pp 42-44.

118 See for example Mr Tim Marney, Under Treasurer, Western Australia Department of Treasury, *Proof Committee Hansard,* 8 April 2013, pp 35-36.

situation in 2009 was that in NSW the royalty rate was 8.2 per cent for open cut mining but 7.2 per cent for underground mining, and if the mine was regarded as ‘deep underground’ this fell further to 6.2 per cent; whereas in Queensland the rate was 7 per cent unless the coal was valued at over $100 per tonne in which case it rose to 10 per cent; in Victoria differing rates applied to brown and black coal and in Western Australia different regimes applied depending on whether the coal was exported.[119] And of course there is a different rate scale for every other mineral.

1.117 As noted above, most economists believe that royalties are an inefficient tax unable to capture windfall gains while a resources rent tax is a very efficient tax.[120] This is why the *Henry Tax Review* recommended replacing royalties by a 40 per cent resources rent tax. The MRRT in its current form, however, rather than replacing royalties leaves them being paid but then rebates them.[121] For companies not paying the MRRT in a given year any royalties paid that year can be carried forward at the generous ‘uplift rate’ of 7 per cent above the bond rate and deducted in future years.

The treatment of future royalty increases

1.118 While the *Henry Review* recommended replacing royalties, it also considered, as a second-best option, crediting the companies for royalties paid. It was very clear, however, that if the latter option is adopted, 'the state royalty regimes would need to be fixed at a particular point in time to ensure that the Australian government does not automatically fund future increases in royalties'.[122]

1.119 Under the RSPT it was also clearly stated that 'the refundable credit will be available at least up to the amount of royalties imposed at the time of announcement, including scheduled increases and appropriate indexation factors'.[123]

1.120 Given this, it would be expected that the large mining companies would have ensured when negotiating the MRRT that references to royalties explicitly stated whether it meant current royalties or encompassed all future increases. But the wording used in the heads of agreement between the new Gillard Government and big

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119 The data are taken from a table in Senate Select Committee on New Taxes, *The Mining Tax: a Bad Tax Out of a Flawed Process*, June 2011, p 128.

120 A study commissioned for the *Henry Tax Review* suggested that royalties involved marginal welfare losses of around 70 per cent of the revenue raised, the highest of the 12 types of taxes examined whereas resource rent taxes involved no welfare loss; *Australia’s Future Tax System*, December 2009, Part 1, p 13.

121 An additional $100 of royalties paid decreases a company’s MRRT by $100, not by the $22.50 implied by the Minerals Council’s description of royalties as ‘a cost of doing business and therefore, like any business cost, are deductible from tax-subject revenues’; Mr Mitch Hooke, Minerals Council of Australia, *Proof Committee Hansard*, 29 April 2013, p 20 and repeated on p 21.

122 *Australia's Future Tax System*, December 2009, p 240.

123 *The Resources Super Profits Tax*, 2010, p 31.

three mining companies just said 'all state and territory royalties will be creditable…', leaving this unclear.

1.121 BHP Billiton told the Committee they had clarified the matter with Treasury:

> Senator MILNE: Did you clarify with Treasury or with the government whether the references to 'all royalties' encompassed all future royalty increases?
>
> Mr Purdy: Yes. It was always intended that it covered all royalties.
>
> Senator MILNE: Yes, but did Treasury understand—was there a clear understanding in negotiation between you and Treasury—that 'all royalties' encompassed all future royalty increases?
>
> Mr Purdy: Certainly we believe so. It was a point that was unclear in the RSPT. It was a point that we felt was made very clear in the MRRT.
>
> Senator MILNE: So—just to be absolutely certain—all the ministers in the room understood that, as did Treasury?
>
> Mr Purdy: That was certainly our understanding. I cannot speak for their understanding, but it was our understanding clearly. It was unclear in the super tax how future royalty increases would be treated. Therefore it was made very clear, we believe, in the MRRT by the use of the word 'all'.[124]

1.122 Rio Tinto’s written evidence was:

> From the announcement of the RSPT to the signing of the MRRT agreement, there were numerous discussions about most aspects including royalties. These discussions at various times involved ministers, ministerial staff and Treasury officials. The MRRT Heads of Agreement specified that all royalties would be included. If the intention had been that royalties would be capped in some way, this would have been made explicit in the Heads of Agreement. Treasury officials were aware of the wording. There was no uncertainty among the mining companies that the reference to all royalties meant just that. This was a fundamental principle and the Heads of Agreement would not have been signed without this element.[125]

124 Mr Brian Purdy, Senior Manager, Finance, BHP Billiton Iron Ore, *Proof Committee Hansard*, 29 April 2013, p 31. In their written response BHP Billiton says it was their ‘clear understanding’ that the agreement covered future royalty increases; *Responses to questions on notice 6*, p 2.

125 Rio Tinto, *Response to questions on notice 3*, p 3.

1.123 This seems to conflict with Dr Henry's evidence in 2010 that:

> …it is my understanding that there would be no credit provided under the MRRT for those future increases... it does not say 'all future royalties'…[126]

1.124 After the election the Policy Transition Group (chaired by former BHP chair Don Argus and then Resources Minister Martin Ferguson) recommended 'all current and future state and territory royalties on coal and iron ore should be credited', which the Government accepted. There is also a vague reference that governments 'should put in place arrangements to ensure that the states and territories do not have an incentive to increase royalties', but no detail on what form such arrangements might take.

1.125 The Western Australian, New South Wales, Queensland, South Australian and Tasmanian governments have subsequently announced royalty increases. Under the terms of its current policy the Gillard Government will have to refund these additional royalty payments to the companies paying them.

1.126 It is clearly intolerable to allow the states to erode the revenue of the MRRT in this way. They have effectively been given a "blank cheque". Independent experts have been critical of this provision. For example, the OECD recommended:

> royalties should also be eliminated, rather than credited to MRRT payers by the federal government, to simplify the tax system and remove states' incentives to raise royalty rates further, with counterproductive effects.[127]

1.127 The Senate Economics Legislation Committee, in examining the MRRT bills, expressed their view 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 knowledge that, long-term, the miners will be compensated for the increased royalties under the design of the MRRT.[128]

1.128 Professor Quiggin has commented:

> A situation where the governments of mineral-rich states can gain revenue at the expense of the Commonwealth, and therefore ultimately at the expense of other states is antithetical to the principles of fiscal equalization.[129]

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126 Dr Ken Henry, Secretary, Department of the Treasury, *Senate Committee on New Taxes Hansard*, 22 November 2010, pp 9 and 12.

127 OECD, *Economic Surveys: Australia,* November 2010.

128 Senate Economics Legislation Committee, *Minerals Resource Rent Tax Bill 2011 [Provisions] and related bills,* March 2012, p 33.

129 Professor John Quiggin, *Submission 1 to Senate Economics Committee inquiry into the MRRT Amendment (Protecting Revenue) Bill 2012*, p 1.

1.129 Professor Quiggin noted that the introduction of fiscal equalisation was:

> …in part, a response to dissatisfaction with existing arrangements among residents of Western Australia, reflected in the passage of a referendum advocating secession from the Commonwealth.[130]

1.130 He observed that:

> Historically, fiscal equalization has worked to the benefit of WA and Queensland, offsetting the high costs of providing services to a sparsely distributed population.[131]

1.131 Professor Garnaut told the Committee:

> The shielding of liability for MRRT through credits for new state royalties invites instability in the overall mineral taxation regime and can be expected to remove the tax's capacity to raise revenue.[132]

1.132 Even conservative economic commentators concede this point:

> …they [the states] seem to have a free ride… It has this tremendously large incentive for the states to try to bid away any revenue by increasing royalties.[133]

1.133 Indeed at an extreme;

> …it is conceivable that the increases in those royalties could do much to reduce the Commonwealth revenue take not merely for the MRRT but also in company tax. In other words, the MRRT could not only itself not raise much revenue for the Commonwealth but it might reduce its tax take overall if the increases in royalties are sufficient to reduce company tax payable.[134]

1.134 The Government has threatened to cut grants to states which increase royalties after July 2011 but this may prove politically difficult. This threat may, moreover, be circumvented by the Commonwealth Grants Commission's principles of horizontal fiscal equalisation. A state receiving a smaller grant would have less financial capacity and so would receive a larger share of the GST revenue allocated between the states.

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130 Professor John Quiggin, *Submission 1 to Senate Economics Committee inquiry into the MRRT Amendment (Protecting Revenue) Bill 2012*, p 1.

131 Professor John Quiggin, *Submission 1 to Senate Economics Committee inquiry into the MRRT Amendment (Protecting Revenue) Bill 2012*, p 1. According to Treasury, Western Australia was a ‘claimant state’ in 33 out of 48 years and a beneficiary of the current revenue-sharing arrangements for 18 out of 30 years while Queensland has benefited from the current arrangements in 26 out of 30 years; *response to question on notice SBT 311, Economics supplementary budget estimates*, October 2011.

132 Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, p 1.

133 Professor Jonathan Pincus, *Proof Committee Hansard*, 3 April 2013, p 20.

134 Professor Jonathan Pincus, *Proof Committee Hansard*, 3 April 2013, p 17.

1.135 The Government added this problem to the terms of reference for the GST Distribution Review conducted by Nick Greiner, John Brumby and Bruce Carter.[135] The Review members agreed with the Greens, finding that 'the Commonwealth's decision to fully credit State royalties under the MRRT and PRRT has created an incentive for States to increase these royalties. This situation is neither desirable nor sustainable'.[136] While the Review members' preference is for the problem to be sorted out by negotiation between the Australian and state governments, they recognise this would not be easy, and find 'if the Commonwealth and the States are unwilling or unable to reach an accommodation regarding resource charging, the Commonwealth should amend the design of the MRRT and PRRT to remove the open-ended crediting of all royalties imposed by the States'.[137]

1.136 A better response would be to restrict it to royalties that were in place when the MRRT was first announced. The Greens introduced a bill in the Senate on 12 September 2012 and into the House of Representatives on 11 February 2013 which would amend section 60-25 of the *Minerals Resource Rent Tax Act 2012* to provide that any increase in royalties after 1 July 2011 should be disregarded when calculating royalty credits for the MRRT.

1.137 The PBO estimated that limiting the royalties that could be credited to those in place at 1 July 2011 would raise an additional $3 billion over the forward estimates.[138] This costing assumes the other parameters of the MRRT are unchanged. If other design features are also improved, the revenue from limiting the rebating of royalties would rise.

Recommendation G4

1.138 **That royalties not be rebated for that component of state royalties increased after 1 July 2011 and that the parliament passes the Minerals Resource Rent Tax (Protecting Revenue) Bill 2012.**

The uplift rate

1.139 The 'uplift rate' incorporated in the RSPT was the long bond yield and this was increased in the MRRT to the bond rate plus 7 per cent. By comparison the PRRT has an uplift rate of the bond rate plus 5 per cent.

1.140 To understand where the uplift rate comes from, it is necessary to go back to the 'Brown tax'. US academic Cary Brown proposed that essentially the government

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135 Australian Government, GST Distribution Review, Terms of Reference, www.gstdistributionreview.gov.au/content/Content.aspx?doc=tor.htm. See the discussion in the majority report and also in the *Australian Financial Review*, 9 January 2012.

136 *GST Distribution Review – Final Report*, page 123.

137 *GST Distribution Review – Final Report*, page 130.

138 Parliamentary Budget Office, 24 April 2013.

be a 'silent partner' with the mining company, sharing both the profits and the losses. In a typical mining project there are losses in the early years as the mine is developed before production starts, so initially the government will be contributing rather than raising revenue. The *Henry Tax Review* did not go quite this far. Instead it proposed that losses could be carried forward and offset against tax payments when the project became profitable (or offset against profits from other projects by the same company). Deferring the government's contribution to losses in this way would, however, effectively reduce the contribution in present value terms. To avoid this, the *Henry Tax Review* recommended that an uplift rate be applied. As the deferral is 'akin to a loan from the investors to the government'[139], the *Henry Review* argued the appropriate rate was that paid on government bonds, rather than any rate related to the riskiness of the investment project.

1.141 The RSPT scheme essentially accepted the *Henry Review's* argument. It set the 'uplift rate' at the government bond rate. Perhaps due to the term 'super profit' in the RSPT, this was then (mis)interpreted as indicating that the government viewed any rate of profits above the government bond rate as 'super' or 'excessive' profits.

1.142 When the MRRT was announced, the uplift rate had itself been uplifted to the bond rate plus 7 per cent. There was no explanation given as to why 7 per cent was chosen. It has been criticised as too high. For example, Professor Fane said the 'credits have been carried forward at much too high a rate…That is a very substantial incentive to delay projects, to hold these credits for as long as possible. That is a kind of subsidy to the mining companies.'[140] Professor Fane argued the appropriate interest rate would be around 3 per cent, the after-tax equivalent of the then prevailing bond rate.[141]

1.143 A range of economic and accounting experts suggested to the Committee that the uplift rate is too high:

> …it is not obvious why … the uplift rate higher than for the PRRT.[142]

> …a number more like 2 to 3 per cent would at least have some economic justification based on those bond yields rather than, again, the seven per cent for which I have seen pretty flimsy justification.[143]

> In the world we are in today it [the uplift rate] seems very high.[144]

139 *Australia's Future Tax System*, December 2009, p 234.

140 Professor George Fane, *Senate Select Committee on New Taxes Hansard*, 30 March 2011, p 26.

141 Professor George Fane, *Senate Select Committee on New Taxes Hansard*, 30 March 2011, p 26.

142 Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, p 1.

143 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 6.

144 Professor Neil Fargher, *Proof Committee Hansard*, 3 April 2013, p 14.

It is certainly a relatively high rate.[145]

1.144 Treasury gave the clear impression that the uplift rate was not determined by any economic reasoning:

> Senator MILNE: I want to go to the high uplift rate—the bond rate plus seven per cent. Has Treasury formed a view about whether that is an incentive to stretch out projects or not? Therefore, are you able to assess how much that high uplift rate is actually costing us? Do you have an estimate of how much additional revenue could be raised if the uplift rate, the bond rate, was cut back, say, to two or three per cent?
>
> Mr Heferen: Those settings of the uplift are policy issues; they are about the design of the tax.
>
> Senator MILNE: I understand that. But I am asking you whether you have done any estimate of how much additional revenue would be achieved if you changed the uplift rate.
>
> Mr Heferen: No.[146]

1.145 Some have argued that a premium needs to be added to the uplift rate to allow for the risk that the government does not meet its promise to allow past losses to be offset against profits. But the bond rate already includes a small premium for the small possibility that the government will default on its obligations. So the only appropriate margin to add to the bond rate on this basis would be a reflection of any additional risk that the government is more likely to abandon retrospectively its promise to allow losses to be offset than it is to default on a bond.

1.146 There is a case for an uplift rate higher than the government bond yield on the grounds that a company may need to borrow while it waits for the deferred tax benefit. It could be argued that the appropriate rate would be that charged to a company on a secured loan to buy a government bond. This would be a higher rate than the bond rate but well below the rate charged a company undertaking a risky project. Currently AA-rated companies can issue bonds with interest rates around 1 per cent above that on government bonds while for BBB-rated companies the spread is a little over 2 per cent.

1.147 The 'tops down' model used by the PBO does not lend itself to costing the generous uplift rate.[147] Treasury acknowledges that applying an uplift rate higher than the bond rate to past losses, to unused royalty credits and to unused starting base

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145 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 15.

146 Mr Rob Heferen, Department of the Treasury, *Proof Committee Hansard*, 3 April 2013, p 45.

147 Parliamentary Budget Office. 24 April 2013.

allowances are all forms of tax concession and costs each at $10-$100 million a year.[148]

Recommendation G5

1.148 **That the uplift rate be reduced to the bond rate plus 2 per cent.**

Starting base and depreciation arrangements for existing projects

1.149 For existing projects, companies are able to calculate a 'base value' and the company can deduct depreciation on this base value when calculating its profit on which the mining tax is levied. Under the RSPT, the starting base for project assets was accounting book value, the depreciated value of the investment carried in the accounts. This was changed in the MRRT to allow the company to choose either a book value which would be uplifted or a market valuation which is not uplifted. For long-lived infrastructure that was bought or developed before the mining boom and has been depreciated for a long while, the market value may be much higher than the book value. While book value is known and audited, the market value is not. The Argus-Ferguson Group's report 'notes that market valuation of the starting base could have a significant bearing on taxpayer liabilities for MRRT, and that different valuation methodologies and assumptions can produce quite different results'. There is a need to ensure that valuations are done by approved independent valuers under clear guidelines.

1.150 There is also a conceptual inconsistency in allowing a company to claim that the value of mine infrastructure has fallen over time when claiming depreciation deductions to reduce company tax payments and then turning around and saying its value has increased so that it can be depreciated again to reduce payments of MRRT.

1.151 It is likely that all the large mining companies will elect to use the market value approach.[149] The value is at May 2010, a time when commodity prices were very high. Treasury estimates that the total starting base value is $360 billion.[150] If depreciated over the maximum 25 years this would result in an annual allowance of $14 billion, and if it is depreciated over Treasury's assumed 19 years it would result in an annual allowance of $19 billion but if the average effective life of existing mines is, for example, ten years then the annual allowance would be $36 billion. These are large amounts which mining company profits must exceed before they will start paying significant amounts of MRRT.

1.152 To give an example for an individual company, Fortescue has estimated that they may have a starting base of around $14-15 billion which they could depreciate

148 Treasury, *Tax Expenditures Statement 2012*, p 45.

149 This is the view of the Parliamentary Budget Office and of Professor Neil Fargher, *Proof Committee Hansard*, 3 April 2013, p 14.

150 Mr Rob Heferen, Department of the Treasury, *Proof Committee Hansard*, 3 April 2013, p 30.

over a period of 'well under 25 years'.[151] To use round numbers, if this is $15 billion over 15 years, it would be an allowance of around $1 billion a year. This is a large proportion of Fortescue's operating profit in 2011 of $2.6 billion and almost the equivalent of their operating profit in 2010 of $1.1 billion.

1.153 Companies electing to use book value will be provided with what the Government calls 'generous accelerated depreciation'; they are allowed to depreciate it over five years, giving a ‘substantial tax shield’.[152] The reason for this generosity is not clear. The *Ralph Report* had recommended the abolition of accelerated depreciation and a cut in the company tax rate from 36 to 30 per cent because of the distorting effects of accelerated depreciation, and this argument seemed to have won bipartisan support.

1.154 Mining companies had argued that the mining tax was a 'retrospective tax' as it applied to revenues from mines developed before it was introduced. This conflicts with the normal idea that retrospectivity refers to taxing revenue earned before a tax is introduced. Indeed on the mining companies' definition, any increase in income tax would be retrospective as it taxed the returns to earlier education. Nonetheless, it appears that fear of the MRRT being labelled retrospective may be why these concessions were allowed.[153]

1.155 Disturbingly the base value includes not just the cost of mining infrastructure but the value of the minerals themselves. This means the base value, and so the amount of depreciation that can be claimed, will have been inflated by the run up in commodity prices. So at the same time as the Government is claiming to be taxing these windfall gains it is allowing deductions that increase with the windfall gains. Furthermore, if the starting base is calculated on the current high commodity prices, and the commodity prices then fall, the depreciation on the starting base may wipe out any tax liability.[154] As Fortescue put it:

> …with the concessions that have been given that relate to the market valuation and the ability to write them off there has been an underestimate in how quickly they can be written off. The tax shield is much larger than Treasury believes…[155]

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151 Mr Marcus Hughes, Group Manager, taxation, Fortescue Metals Group, *Senate Economics Committee Hansard*, 21 February 2012, p 40.

152 Professor Neil Fargher, *Answers to questions on notice 1*, p 1.

153 The majority report takes this view; ‘The objective of the deliberate MRRT design feature providing for market value based depreciation arrangements is well understood. It helps ensure existing projects are not subject to retrospective taxation’; paragraph 2.4, p. 13.

154 BDO Accountants, *Submission 3 to Senate Economics Committee inquiry into MRRT Bill 2011*, pp 4-5, make this point. Fortescue Metals Group, *Submission 26 to Senate Economics Committee inquiry into MRRT Bill 2011*, make a similar argument.

155 Mr Julian Tapp, Director, Strategy, Fortescue Metals Group, *Senate Economics Committee Hansard*, 21 February 2012, p 43. A similar point was made by Mr John Murray, Director, BDO Accountants, *Senate Economics Committee Hansard*, 21 February 2012.

1.156 Economist Professor Pincus argued that:

> …expected profits will be fully capitalised in the market price of an asset. The value of an asset in the market should be equal to the present value of the cash flows anticipated from the asset, discounted at a rate that takes account of risk…Two factors lead to payment or a liability for an MRRT: first of all, that long-term rate plus seven per cent is less than what the markets used to discount those profits; second, the profits turn out to be better than the market expected.[156]

1.157 Economist Richard Denniss elaborated on the problem this causes:

> …it is unusual and counterproductive to have allowed the market valuation of the asset to be used, and allow me to try to explain why. If I spend $100 million building a mine, that is the capital that I have invested—that is what I am risking. I presumably spend that $100 million because I think at commodity prices today, or the commodity prices I expect, I will be able to make a decent return on that $100 million. By definition, I would not have built it or convinced someone to give me the money if that was not the case. Now, if commodity prices double after I build the mine my profits will obviously go up substantially—probably more than double—and in turn, if I were to sell that mine I would obviously be able to get a lot more for it than I spent on it because I am not selling what I built, I am selling the flow of profits. So when we allow the mining companies to value their investment at the new market price rather than the depreciated actual expenditure, we have already wiped out, for the taxpayer, most of the super profit because the super profit is now built into this new market price. So if the purpose of the superprofits tax is to collect windfall revenue for the owners of the resource—you and I—then to let the miner use today's valuation of their mine, rather than what they actually spent on the mine, as the base is an incredibly generous gift from us, the owner to them, the miner.[157]

1.158 Professor Garnaut told the Committee:

> The transitional arrangements for the MRRT are extreme in their generosity to highly profitable established mines…The assessment of market value to assess the offset or deduction for past investment is problematic on a number of accounts…If you genuinely were allowing for a deduction for the market value of an asset, the current market value of those assets includes the value of the untaxed rent. If you are genuinely deducting the market value, almost by definition you are giving away the revenue from established projects.[158]

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156 Professor Jonathan Pincus, *Proof Committee Hansard*, 3 April 2013, pp 17-18.

157 Dr Richard Denniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 3 April 2013, p 6.

158 Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, pp 1, 3 and 6.

1.159 There has also been criticism of this approach from accounting experts:

> …depreciating assets based on market valuation is not generally accepted accounting practice, yet it is allowed in the legislation. In simple terms, a mining asset that cost $100 million to bring to production might today be worth $350 million if sold on the open market. A miner could use this higher valuation to calculate depreciation, which would reduce the profit subject to the tax.[159]

> some assets have been depreciated down to zero, and my understanding is that they can now be reinstated at a higher value and then depreciated again for the purpose of their starting base. That seems quite a generous allowance.…writing the tax on unobservable market values does not seem reasonable—or at least seems dangerous.[160]

> 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 and probably longer… If substantial revenue was expected under the MRRT in the initial years of operation then a well calibrated start-up allowance would likely not have included the full market value of existing reserves.[161]

1.160 Treasury did not give an impression that the starting base definition was based on any strong economic analysis:

> Senator MILNE: can you explain to me why the starting base should include the value of the minerals in the ground rather than just the depreciated cost of the infrastructure at the mine?

> Mr Heferen: Again, that is a policy issue. Conceptually, the starting base could be a whole range of things and that is the one that was chosen for this particular tax…

> Senator MILNE: Can you explain to me what the rationale was for allowing the mining companies to choose whether they use book value or market value when calculating the starting base?

> Mr Heferen: They are elements that are specifically mentioned in the heads of agreement so they go to the design of the tax.[162]

1.161 The argument has been well summarised by the CFMEU:

> Using current market value…enables companies to claim a deduction for costs they have never incurred. This is clearly a rort. That mining assets experience capital gains is already a benefit for resource companies;

159 The comment comes from two professors of accounting, Professor Peter Carey and Professor Neil Fargher, *The Age*, 16 February 2012.

160 Professor Neil Fargher, *Proof Committee Hansard*, 3 April 2013, p 14.

161 Professor Neil Fargher, *Answers to questions on notice 1*, p 1.

162 Mr Rob Heferen, Executive Director (Revenue Group), Department of the Treasury, *Proof Committee Hansard*, 3 April 2013, p 45.

> allowing them to claim starting base losses based on that capital gain is extraordinarily and unnecessarily generous.[163]

1.162 The market value starting base is also a very complicated calculation.

> …you have to take the starting base on 2 May 2010 and you are not allowed to use knowledge since that time for to for the evaluation basis. So, again, it is a very, very complex process to work out the value that you are allowed to deduct as a starting base.[164]

> …there are some particular aspects of the MRRT that generate particular challenges for compliance, one of which is the calculation of the market value of pre-existing assets…I would hate to have to go about calculating that… Nowhere have I been able to read…a very clear definition of how market value of past investments is actually going to be calculated.[165]

1.163 Senator Bishop attempted to defend these arrangements, and the resultant lack of revenue raised by the MRRT in its early years, as 'arguably the intended design feature of the scheme, to allow new projects to come on time, to recoup their costs' but as Professor Garnaut pointed out, 'if that was the intention, it is inconsistent with the budget papers having shown a rather large amount of revenue in the early years'.[166]

1.164 There seems to be a strong case for restricting the starting base for depreciation allowances to the depreciated book value.[167]

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163 Construction, Forestry, Mining & Energy Union, *Submission 16 to Senate Economics Committee inquiry into MRRT Bill 2011*, p 12.

164 Mr Stephen Pearce, Chief Financial Officer, Fortescue Metals Group, *Proof Committee Hansard*, 8 April 2013, p 5.

165 Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, pp 3- 6.

166 Senator Mark Bishop and Professor Ross Garnaut, *Proof Committee Hansard*, 29 April 2013, p 6.

167 Professor Pietro Guj raised a possible anomaly that could arise; 'if an explorer finds a mineral resource, spends $30 million in proving it up, it will carry that project in the books at $30 million as a tangible asset. However, if big brother, BHP Billiton, comes along and buys that asset from the explorer for, say, $150 million, then the BHP books would show $30 million as a tangible asset, being the project money that was actually spent in drilling, digging and whatever, plus the difference between the price paid and the tangible asset of $120 million as an intangible asset called 'mining rights'. So, depending on how you get to own the project, you may or may not have in your balance sheet the value of the resources'; *Proof Committee Hansard*, 8 April, p 18. Professor Neil Fargher, however, explained that this problem could be avoided by using the methodology of division 43 of the *Income Tax Assessment Act 1997*, under which 'no matter how many times a building has been sold the successive owners can only claim a percentage of the historical construction cost.'; *Response to questions on notice 1*, p 2.

Recommendation G6

1.165 **That the starting base for existing projects be restricted to the depreciated book value of what the companies have actually spent on mining infrastructure, rather than including the inflated market value, as this is a more prudent option to avoid the risk of eroding the revenue.**

Recommendation G7

1.166 **That consideration be given to the book value of the starting base for existing projects be depreciated over the expected remaining life of the mine rather than allowing an accelerated depreciation period of five years.**

The taxing point and the 'netback' arrangements

1.167 The MRRT is applied at the 'run of mine stockpile' (colloquially the 'mine gate') rather than the point of sale, which may be when the minerals are loaded onto a ship at the Australian port or delivered to a foreign port. This is conceptually correct as the MRRT is meant to be a tax on the resources themselves rather than also on the value added in processing (such as crushing, washing, sorting, separating and refining) and transport. The challenge this poses, however, is that the taxing point price is not directly observable but must be calculated by subtracting relevant items from the sale price.

1.168 Treasury has said that large vertically integrated companies with their own railways lines cannot deduct the amount they charge third parties for access to it, which may contain a monopoly rent component, but can only deduct the amount that would be charged in a competitive market. Again this is conceptually right but in practice hard to calculate and potentially open to challenge.

1.169 Fortescue told the Committee that:

> Both calculations and the principles embedded in both the netback and the starting base are incredibly complex. It has taken us, as I say, the better part of two years to work through our own circumstances with the assistance of outside experts and consultants to help us firm up the opinions, the facts and the database that will support our positions opposite the tax office… You have to take the sole [sold?] price of a tonne of iron ore in our case and deduct the shipping or transport costs to get it from the mine to rail and port. Then you take back the processing costs right back to the point where you extracted the ore from the ground. There is no natural reference point for that calculation, so as a taxpayer you need to be very certain of the positions that you are taking through every step of that process because you know the tax office will come and look at the books in due course…they are incredibly complex principles that you are trying to overlay to artificially create taxing points.[168]

168 Mr Stephen Pearce, Chief Financial Officer, Fortescue Metals Group, *Proof Committee Hansard*, 8 April 2013, pp 3, 5 and 8.

1.170 One of the smaller mining companies affected had said there is a:

> …lot of subjectivity as to how you calculate those…[169]

1.171 Professor Fargher explained to the Committee:

> The mining companies have a choice of at least half a dozen methods that could be considered appropriate. To make it clear, we have got an observable market price somewhere down the value chain. We are estimating costs to get back to the tax point. The more that we can include in that further down the vertically integrated chain, the less tax base we are going to have. In accounting, wherever that problem occurs, it generally eventually results in problems between the tax office and the taxpayer. Basically, joint costs have to be somewhat arbitrarily allocated at the end of the day. Therefore, because there is an arbitrary allocation there, the taxing authority might consider reducing the choices available to the taxpayer to one or two that seem reasonable rather than giving them the option to take five or six, working out the best one from their perspective and then using that.[170]

1.172 Similar concerns have been raised by other groups in the community:

> There will be ongoing tension, and no doubt disputes and/or litigation over a system where the taxing point is some distance (geographically and in the value chain) from the point at which a market price is more readily determined…the design of the taxing point should seek to maximise tax raised…[171]

> …we are concerned with the potential for abuse within this section of the legislation. We do not believe that the wording precludes companies from transferring loss between partner and/or associated entities in order to avoid their obligations under law.[172]

1.173 Professor Ergas warned:

> …the issues that will arise…will include timing issues, revenue recognition issues and particularly cost allocation issues; what the allowed rate of return on the downstream assets should be; how that allowed rate of return should be allocated; what the relevant asset base downstream is; and at what pace those downstream assets should be depreciated.[173]

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169 Mr David Richardson, Chief Financial Officer, Gindalbie Metals, *Senate Economics Committee Hansard*, 21 February 2012, p 54.

170 Professor Neil Fargher, *Proof Committee Hansard*, 3 April 2013, p. 14.

171 Construction, Forestry, Mining & Energy Union, *Submission 16 to Senate Economics Committee inquiry into MRRT Bill 2011*, p 9.

172 Uniting Justice Australia, *Submission 28 to Senate Economics Committee inquiry into MRRT Bill 2011*, p 5.

173 Professor Henry Ergas, *Senate Economics Committee Hansard*, 21 February 2012, p 8.

Recommendation G8

1.174 **That consideration be given to the MRRT being calculated on the sale price of the minerals, as is done for royalties, removing the complex 'netback' provisions.**

The threshold

1.175 Companies with a group mining profit below $50 million had been effectively exempted from the tax (through being eligible for a 'low profit offset') on the grounds they should not be subjected to the compliance costs when they were making relatively small payments. Companies with a group mining profit of between $50 million and $100 million received a partial reduction in MRRT.

1.176 Under pressure from Andrew Wilkie MHR, this threshold was lifted to $75 million phasing out at $125 million. The cost of increasing the threshold was estimated at $20 million a year.[174]

1.177 But it appears that many small companies are doing the paperwork for the MRRT anyway, because they aspire to become large companies (or to be sold to large companies) and need the information to claim the starting base and other allowances once they start paying MRRT.

1.178 The Minerals Council told the Committee:

> …there are a lot of small to mid caps out there who are having to make a decision about whether—and we went through this last time—they take advantage of the de minimus provision of $50 million cut-off phasing up to $100 million, or whether they in fact invest a fair amount of compliance cost upfront today with the prospect that they might grow in the future.[175]

1.179 This raises the question of whether the threshold is achieving its objective or is just needlessly reducing the revenue collected by the tax. A company with profits of $50 million is much larger than what would normally be considered a 'small business'.

Recommendation G9

1.180 **That consideration be given to a lower threshold for payment of the MRRT.**

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174 *Mid-Year Economic and Fiscal Outlook, 2011-12*, p 167.

175 Mr Mitch Hooke, Minerals Council of Australia, *Proof Committee Hansard*, 29 April 2013, p 24.

Conclusion

1.181 The majority report describes the MRRT as a 'tax which doesn't even raise any meaningful revenue'.[176] The Greens would agree, with the addition of the words 'in its current form'. This dissenting report has suggested a range of modifications which will mean that the mining tax does raise significant revenue, is simpler and therefore less costly to administer and comply with, and retains the economic efficiency advantages that lead most economists to favour resource rent taxes in principle.

1.182 At a time when both the old parties are struggling to explain how they will meet new spending initiatives when revenue is a smaller proportion to GDP than it had been during the Howard/Costello years, fixing the MRRT in the manner we suggest should command the support of them both. The government needs to answer why it will cut university funding and single parents payments rather than fix the tax and the Coalition needs to address the challenge posed by Professor Quiggin:

> …anybody advocating removal of the MRRT… have to say what other taxes are going to increase or what expenditure is going to be withdrawn in the long term to finance that.[177]

Senator Christine Milne
Australian Greens

176 See majority report, paragraph 2.131, p 39.

177 Professor John Quiggin, *Proof Committee Hansard*, 29 April 2013, p 16.

APPENDIX 1

Submissions received

Submission Number	Submitter
1	Dr John Weldon
2	Professor Jonathan Pincus and Professor Henry Ergas
3	Queensland Government
4	Fortescue Metals Group Limited
5	Association of Mining and Exploration Companies Inc
6	Isaac Regional Council
7	Mr John Passant
8	Rio Tinto
9	The Treasury
10	Minerals Council of Australia
11	Professor Neville Norman
12	Professor John Rolfe
13	BHP Billiton
14	Xstrata Coal
15	Saving Our Sustainability
16	Mr Philip Kirchlechner

Questions on Notice

- Received from Professor Neil Fargher on 2 May 2013; answers to Questions on Notice taken at a public hearing on 3 April 2013 and from Senator Milne on 30 April 2013
- Received from the Australian Taxation Office on 3 May 2013; answers to Questions on Notice taken at a public hearing on 3 April 2013
- Received from Rio Tinto on 3 May 2013; answers to Questions on Notice taken at a public hearing on 29 April 2013
- Received from the Minerals Council of Australia on 3 May 2013; answer to a Question on Notice from Senator Cameron on 1 May 2013
- Received from Xstrata Coal on 3 May 2013; answers to Questions on Notice taken at a public hearing on 29 April
- Received from BHP Billiton on 4 May 2013; answers to Questions on Notice taken at a public hearing on 29 April

Tabled documents

- Document tabled by Treasury at a public hearing in Canberra on 3 April 2013

APPENDIX 2

Public hearings and witnesses

CANBERRA, 3 APRIL 2013

BERKELEY, Ms Brenda, General Manager, Indirect, Philanthropy and Resource Tax Division, Treasury

DENNISS, Dr Richard, Executive Director, The Australia Institute, Australian National University

ENGLAND, Mr Andrew, Chief Tax Counsel, Australian Taxation Office

ERGAS, Professor Henry, SMART Infrastructure Facility, University of Wollongong

FARGHER, Professor Neil, College of Business and Economics, Australian National University

HEFEREN, Mr Rob, Executive Director, Treasury

MALONEY, Mr Matthew, Manager, Tax Analysis Division, Treasury

MARTIN, Ms Stephanie, Deputy Commissioner, Resource Rent Tax, Australian Taxation Office

O'TOOLE, Mr James, Manager, Indirect, Philanthropy and Resource Tax Division, Treasury

PARKINSON, Dr Martin, Secretary, Treasury

PINCUS, Professor Jonathan James, School of Economics, University of Adelaide

SEDGLEY, Mr Patrick Rory, Principal Adviser, Indirect, Philanthropy and Resource Tax Division, Treasury

PERTH, 8 APRIL 2013

BARNES, Mr Michael, Deputy Under Treasurer, Department of Treasury, Western Australia

BENNISON, Mr Simon, Chief Executive Officer, Association of Mining and Exploration Companies

FERRIER, Mr Craig, Executive General Manager, Golden West Resources

GUJ, Professor Pietro, Research Professor, Centre for Exploration Targeting, University of Western Australia, and Adjunct Professor in Mineral Economics, Graduate School of Business and Western Australian School of Mines, Curtin University

HUGHES, Mr Marcus, Group Manager, Taxation, Fortescue Metals Group

MARNEY, Mr Timothy, Under Treasurer, Department of Treasury, Western Australia

PEARCE, Mr Stephen, Chief Financial Officer, Fortescue Metals Group

SHORT, Mr Graham, National Policy Manager, Association of Mining and Exploration Companies

UTTING, Mr David, Chief Executive Officer, Yilgarn Iron Producers Association

WARD, Dr Stephen, Chief Executive Officer, Mindax Ltd

MELBOURNE, 29 APRIL 2013

BENNETT, Mr Christian David, Vice President, Government Relations, BHP Billiton

GARNAUT, Professor Ross, AO, Professorial Fellow in Economics, University of Melbourne

HOOKE, Mr Mitchell H, Chief Executive Officer, Minerals Council of Australia

KUNKEL, Dr John, Deputy Chief Executive, Minerals Council of Australia

LYONS, Mr Ross, General Manager, Taxation, Rio Tinto

McCARTHY, Ms Cassandra, Group Manager, Government Relations and Climate Change, Xstrata Coal

O'NEILL, Mr Mark, Chief Adviser, Government Relations, Rio Tinto

PURDY, Mr Brian Robert, Senior Manager Finance, BHP Billiton Iron Ore, BHP Billiton

QUIGGIN, Professor John, School of Economics, University of Queensland

SMITH, Mr Dominic, Tax Manager, Xstrata Coal