Chapter 3

How the Minerals Resource Rent Tax works

3.1 This chapter will set out, in brief, how a miner would calculate its Minerals Resource Rent Tax (MRRT) liability under the Minerals Resource Rent Tax Bill 2011 (MRRT Bill).

3.2 It should be noted that this is a short overview of an extremely complex matter. Further information on how the MRRT works and the calculation of MRRT liability can be found in the Revised Explanatory Memorandum. The committee will confine itself in this report to a brief summary of the operation of the MRRT, sufficient to allow an understanding of the matters addressed in it.

Overview of the MRRT

3.3 The MRRT Bill imposes an effective 22.5 per cent tax[1] on the above-normal profits earned by the mining of a **taxable resource**.[2] Clause 20-5 of the MRRT Bill defines a taxable resource as:

(a) iron ore;

(b) coal;

(c) anything produced from a process that results in iron ore or coal being consumed or destroyed without extraction;

(d) coal seam gas extracted as a necessary incident of mining coal.

3.4 Simply stated, under the MRRT the government will take a share of both the profits and the risks earned by the iron ore and coal industries from their exploitation of natural resources owned by the Australian people, and use that share to benefit the community as a whole.

3.5 The Revised Explanatory Memorandum provides 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).

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1 The nominal rate of tax is 30 per cent, however, this is discounted by a 25 per cent extraction allowance.

2 All **bolded** terms are defined terms in the MRRT bills.

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.

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.[3]

3.6 The MRRT is designed to deal with three project cases:

(a) The project did not exist on 1 May 2010, that is, at the time the MRRT was first announced (this is referred to in the Revised Explanatory Memorandum as the 'vanilla case').[4]

(b) The project was invested in on 1 May 2010 and is transitioning into the MRRT.[5]

(c) The project is one of multiple projects in which a miner has an interest, which usually involves considerable pre-mining expenditure.[6]

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

4 See Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 12–17, for a more detailed explanation of the vanilla case.

5 See Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 17–20, for a more detailed explanation of the existing investments case.

6 See Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, pp. 20–26, for a more detailed explanation of the multiple projects case and pre-mining expenditure rules.

Calculating a miner's liability under the MRRT

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

3.8 The steps to working out the amount a miner (i.e., the holder of a **mining project interest**) would pay under the MRRT are:

(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 they are:

(i) **royalty credits**

(ii) **pre-mining losses**

(iii) **mining losses**

(iv) **starting base losses**;.

(d) subtract the total of the mining allowances from the mining profit;

(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

3.9 The revenue from a **mining project** is calculated in a two-step process:

(a) calculation of the ‘revenue amount’ for the **mining revenue event** is determined; and

(b) calculation of 'so much of the revenue amount as is reasonably attributable to the taxable resource in the form and place the resource was in when it was at its valuation point'.[7]

3.10 The **valuation point**, therefore, is 'the point in the mining production chain that separates upstream and downstream operations'.[8]

3.11 There is no method for calculating the revenue amounts expressly outlined in the MRRT Bill, except that it:

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7 Minerals Resource Rent Tax Bill 2011, subclause 30-25(1).

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

> … 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'.[9] [emphasis added]

Mining expenditure

3.12 Mining expenditure includes expenditure 'necessarily incurred … in that year, in the carrying on (by the miner or another **entity**) of **upstream mining operations** for that mining project interest' and is restricted to expenditure 'of either a capital or revenue nature'.[10] It does not, therefore, include the expenditure of assets, which are dealt with as upfront deductions under depreciation.

Upstream and downstream mining operations

3.13 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**.

3.14 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.[11]

3.15 This includes:

- 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, maintaining transport.[12]

3.16 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:

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9 Minerals Resource Rent Tax Bill 2011, subclause 30-25(3).

10 Minerals Resource Rent Tax Bill 2011, clause 35-10.

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

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

> … requires taxpayers to determine the amount of those proceeds that are reasonably attributable to the resource and upstream operations for tax purposes.[13]

Allowances

3.17 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.

3.18 Allowances differ depending on the particular case into which the mining project falls. The four allowance types are set out in paragraph 3.8(c) above and must be applied in that order.[14]

The uplift rate

3.19 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[15] is the long-term bond rate (LTBR) plus seven per cent.

3.20 The uplift rate is an essential feature of the design of the MRRT. It is the mechanism by which the government contributes to the cost of innovation, exploration, research and development. In this way the government addresses any disincentive arising from the MRRT for miners and prospective miners to engage in those activities, thus encouraging future growth in the sector.

The starting base allowance and alternative valuation methods

3.21 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 … starting base losses are never transferable to other mining project interests.[16]

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

14 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.

15 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.

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

3.22 **Staring base assets** can be valued using either

- the **market value** method, based on 'the market value of the mining project interest's upstream assets at 1 May 2010'; or
- the book value method based on 'the most recent audited accounting value of those assets at 1 May 2010'.[17]

3.23 The Revised Explanatory Memorandum to the MRRT bills points out 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.[18]

3.24 The issue of how starting base allowances are calculated is one of the most contentious aspects of the MRRT. In summary, it is argued by small miners that the market valuation approach provides large miners with a significantly larger 'tax shield', as they have greater assets that can be deducted from their revenues. This issue is discussed in chapter 5 of the report.

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

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