Dissenting Report by Coalition Senators

Mining tax: a bad tax out of a bad process

1.1 The mining tax legislation before the Senate is deeply flawed and should not be passed.

1.2 The Gillard government's mining tax is divisive, complex, unfair, fiscally irresponsible and distorting, reduces our international competitiveness and was developed through a highly flawed and improper process.

1.3 It is widely acknowledged, even by supporters of the tax, that the government's mining tax proposal was developed through a profoundly flawed process. The flaws in this legislation are so fundamental that it cannot be fixed through amendments. This legislation should be scrapped altogether. The government should start from scratch with a more serious, more considered, more competent and more open, transparent and inclusive effort to pursue genuine root and branch reform of our tax system to make it simpler and fairer.

1.4 The many flaws in the mining tax proposal have been canvassed extensively over the past eighteen months. This Dissenting Report by Coalition Senators provides a summary of the most serious flaws.

1.5 The Mining Tax Deal entered into by the Gillard government gives an unfair competitive advantage to the three largest miners who were given exclusive access to secret negotiations on the new tax design, makes federal Budget outcomes hostage to decisions about royalties by state and territory governments and raises serious and unresolved constitutional issues.

1.6 Alarmingly, the mining tax package would significantly worsen Australia's structural budget deficit over time. The cost of Labor's related commitments is higher – and increasing over time – than the revenue the MRRT is expected to raise. This situation is expected to get worse and worse over time.

1.7 The decision to link a highly volatile and downward trending revenue stream to the increasing cost of a number of related proposals is a recipe for another Labor Party fiscal policy disaster.

1.8 The proposed increase in compulsory super alone will cost more every year, once fully implemented, than the MRRT would raise according to Treasury modelling conducted at the time of the mining tax deal.

1.9 Adding a new tax on profits from iron ore and coal production, on top of the existing royalty and company tax arrangements is more distorting than the status quo and should not be supported.

1.10 Moreover, these new taxes would impose substantial compliance costs, even on sectors which may not necessarily have a large liability, such as the onshore oil and gas sector.

1.11 The Gillard mining tax not only creates distortions it divides Australia.

1.12 The government has divided the mining industry by giving the three biggest miners the exclusive opportunity to help design the tax while all their competitors were locked out of that process. Smaller and mid-tier mining companies feel understandably aggrieved that the proposed mining tax will make it harder for them to compete with those big multi-national, multi-commodity companies.

1.13 They also divided Australia by exclusively targeting resource rich states with a new Canberra tax grab. Resource rich states rely to a larger degree on revenue from mining royalties to help fund important services like health, law and order, education and transport where other states rely to a larger degree on revenue from gambling taxes. Moreover, securing rising tax revenues is crucial if those states are to gear up to the demands of the resource boom, thereby avoiding capacity constraints and ensuring the benefits of that boom flow to Australia's economy.

1.14 The Gillard government signed the mining tax deal expecting to raise a massive $25 billion in mining tax revenue from iron ore production in Western Australia over the next decade. That's 65 percent of the total $38.5 billion in revenue Treasury expected the MRRT to raise over that time. This is effectively a tax on Western Australia and Queensland, used to fund what are little better than unsustainable spending commitments by the Gillard government.

1.15 The government has made a mess of its attempts to reform our tax system. It should cut its losses and start again. Genuine tax reform can only be achieved through an open, transparent and inclusive process involving all stakeholders, including state and territory governments.

How it all started

1.16 When the Henry Tax Review was commissioned, Australians were told that it would provide root and branch reform of our tax system to make it simpler and fairer. The Henry Tax Review recommendations about resource taxation reform were supposed to make resource taxation arrangements less distorting for smaller and newer mining projects, thus encouraging the development of the next generation of mining ventures.

1.17 We were told that State and territory royalties imposed on production distorted investment and production decisions making it harder for smaller and more marginal projects to survive and that a profit based resource rent tax would be more efficient and less distorting.

1.18 The government's proposed MRRT and expanded PRRT does the exact opposite.

1.19 This mining tax legislation before the Senate would make our tax system more complex, more distorting and less fair than the status quo. Rather than a replacement tax, as had been recommended by the Henry Tax Review, the mining tax is a top-up tax (on top of State and Territory royalties which will continue) and the way it is designed makes it even harder for smaller projects to be economic, thus effectively favouring the bigger well established mines.

1.20 One of the fundamental flaws of the MRRT design is that it makes it harder for smaller miners of today to become the larger miners of tomorrow. This is because the MRRT taxes projects on the basis of their rates of return, so high risk projects – which require high rates of return to be economic – are taxed more heavily than the typically larger and more mature projects, which require a lower rate of return. By thus imposing a higher effective marginal tax rate on new, entrepreneurial mining ventures, it undermines Australia's capacity to make full and efficient use of its potential.

1.21 The government also completely ignored the related Henry Tax Review recommendation that the Australian government should negotiate with State and Territory governments about the federal-state financial relations implications of changes to resource taxation arrangements they had proposed.

1.22 This never happened. Rather, the proposed tax was simply announced to the States and Territories as a fait accompli.

1.23 Changes to resource taxation arrangements as envisaged in this legislation have significant implications for State and Territory governments – in particular States like Western Australia, Queensland and NSW. These States rely on revenue from royalties from iron ore and coal for a significant proportion of their own-source revenue.

1.24 Changes to resource taxation arrangements as proposed in this legislation also have the potential to have significant implications for GST sharing arrangements. The Gillard government signed a mining tax deal promising to credit all State and Territory royalties against any MRRT liability without even having a conversation with any of the relevant States about what their intentions were in relation to royalties on iron ore or coal into the future. Clearly, the Australian Government should have included relevant States and Territories in the negotiations about the mining tax deal before signing on the dotted line.

1.25 The mining tax legislation before the Senate is a complex mess because of the flaws that have dogged its development from the start.

Process

1.26 The government announced its Resource Super Profits Tax proposal on 2 May 2010. This was at the same time the government first publicly released the Henry Tax Review report. The Treasurer had sat on the Henry Tax Review report and recommendations since December 2009. Instead of releasing it to the public to generate debate and kick off an open and transparent tax reform process, the Treasurer had kept it hidden. The original Resource Super Profits Tax proposal was announced without any consultation. The general outcry from stakeholders which followed contributed to a Prime Minister losing his job, while the Treasurer who was responsible for the whole mess got a promotion.

1.27 Advised directly by the Treasurer (without involvement of departmental officials), the new Prime Minister entered into negotiations with the three biggest mining companies. The Prime Minister, Treasurer and Minister for Resources and Energy conducted those negotiations exclusively and in secret with the three biggest miners, excluding their competitors and State and Territory governments from the process.

1.28 The result is a poorly designed tax which gives larger established miners a massive competitive advantage compared to the smaller competitors.

1.29 Even though the government has re-drafted its mining tax legislation again and again we already know that the government agrees that the current Bills before the Senate are deficient.

1.30 Indeed the Minerals Council of Australia made a submission to the Senate that:

> …processes of review by Treasury and Resource Tax Implementation Group members have identified errors in both the legislation and the explanatory material that, if left unresolved, would have material and unintended impacts on companies. Among those areas where clarification is needed to avoid departure from the policy intent is in relation to the uplift of starting base losses. The MCA understands that it is the intention of the Government to deal with MRRT technical corrections in the first available Tax Laws Amendment Bill in 2012 with a view to ensuring these errors are addressed before the MRRT begins to operate.[1] (emphasis added)

1.31 Surely if the mining tax legislation is deficient (and the government agrees that it is deficient) it should fix the legislation currently before the Senate rather than to ask the Senate to pass deficient legislation to be fixed later.

1.32 This is just another illustration of the incompetent and messy process the government has followed in trying to sort out its mining tax fiasco.

Ongoing secrecy and lack of basic transparency

1.33 Having negotiated the mining tax exclusively and in secret with the three biggest miners, the public was presented with the outcome of those negotiations in the form of an MRRT Heads of Agreement. That agreement was signed by the Prime

1 Minerals Council of Australia, Submission 20, p. 24.

Minister, Treasurer and Resource Minister on behalf of the government and the three Managing Directors of BHP Billiton, Rio Tinto and Xstrata.

1.34 Substantial changes to the RSPT had been agreed, including a lowering of the rate and a significant reduction of the scope of the proposed tax – to iron ore, coal and petroleum.

1.35 Yet we were told the net fiscal impact of the changes would be minor – only $1.5 billion over the then forward estimates.

1.36 It seemed unbelievable and it was.

1.37 The government had made significant changes to its underlying mining tax revenue assumptions – in particular to the commodity price assumptions.

1.38 Asked what those commodity price and production volume assumptions were before and after the mining tax deal we were told that information was secret. The reason was that it was 'in part' based on information provided by the big three miners and as such was commercial in confidence.

1.39 It is important to note here that State governments in Western Australia and Queensland publish this information as a matter of course in their budget papers – to enable their royalty revenue estimates to be properly scrutinised.

1.40 What the Gillard government is saying here is that not only were the big three miners the only ones given exclusive access to help the government design this tax (in a way that gives them a competitive advantage compared to smaller emerging miners), but they're also the only ones allowed to know the government's revenue assumptions underpinning their mining tax revenue estimates.

1.41 In our view this is highly inappropriate.

1.42 The government should immediately release all its modelling, assumptions and outcomes that underpin this mining tax proposal before the Senate has to pass judgement on this legislation.

Fiscal train wreck in the making

1.43 The mining tax package is also a fiscal train wreck in the making.

1.44 The government is linking the increasing cost of a series of promises to the highly volatile and – according to published Treasury projections downward trending – MRRT revenue.

1.45 Even on the government's own figures the mining tax will raise about $4 billion less over the forward estimates than the various promises the government has attached to the mining tax will cost the budget.

1.46 This situation will become worse as the cost of all the related measures continue to increase – some sharply – while the volatile MRRT revenue will continue to reduce over time as the current 'mining boom' eases.

1.47 There are serious question marks whether the mining tax will raise the $10.6 billion estimated in the Budget.

1.48 When changing the RSPT into the MRRT the government significantly upgraded its commodity price expectations. That upgrade in commodity price expectations went against market trends and was, according to the government at the time, based on information provided by the big three miners involved in the exclusive MRRT negotiations.

1.49 To this day the government has refused to release its mining tax revenue assumptions, including the commodity price and production volume assumptions it has used. This does raise the question what the government has got to hide.

1.50 The government also agreed to a number of features in their mining tax deal which leave their mining tax revenue estimates exposed.

1.51 For example, the government's promise to credit all State and Territory royalties against the resources liability – without first reaching agreement with the States and Territories about their intentions in relation to royalties on iron ore and coal – leaves the federal Budget exposed and hostage to decisions about state royalty arrangements into the future.

1.52 Decisions by State governments in Western Australia, NSW, South Australia and Tasmania to increase royalties on iron ore or coal have already had an impact on expected MRRT revenue and are likely to have more of an impact into the future.

1.53 The government has factored the decisions by the WA State government to remove a royalty concession on iron ore fines into its MRRT revenue estimates but has so far not taken the impact of the decision by the NSW government to increase royalties on coal into account. According to NSW budget papers the NSW government expects to raise $944 million over the forward estimates from that decision. Given the royalty increase is limited to companies and projects subject to the MRRT it is clear that this revenue is expected to come straight off the MRRT revenue.

1.54 In its MRRT Heads of Agreement, the government also agreed to allow relevant mining companies to opt for a market valuation method to determine the starting base for relevant project assets. According to the MRRT *"where market value is used to calculate starting base… depreciation will be based on an appropriate effective life of assets, not exceeding 25 years"*. The opportunity to depreciate the significant market value of relevant project assets over a period of up to 25 years gives the bigger mining companies involved in the MRRT Heads of Agreement a significant upfront tax shelter.

1.55 It is highly questionable whether they will be required to pay any MRRT for years.

1.56 In contrast, smaller less established projects will pay MRRT sooner and be exposed to a higher effective marginal tax rate than the larger more established miners.

1.57 This is hardly fairer than the status quo.

1.58 Treasury told Senate Estimates and the Committee that they had costed the overall value (and cost to the MRRT revenue) of the upfront tax deduction but were not prepared to reveal it.

1.59 This is another unanswered question.

1.60 Coalition Senators have assessed all of the publicly available information about MRRT revenue estimates and the cost of the related measures. Our assessment is summarised in the attached table. Where the government did not provide any information we have made reasonable assumptions. Where that is the case it is clearly identified.

MINING TAX FISCAL IMPACT – 2011/12 – 2014/15

COST OF MRRT RELATED MEASURES[2]	2011-12 $m	2012-13 $m	2013-14 $m	2014-15 $m	Total $m
Superannuation Guarantee increase (9-12%)	**7.0**	**14.0**	**251.0**	**510.0**	**782.0**
Superannuation tax rebate for low income earners	**1.0**	**20.0**	**892.0**	**976.0**	**1,889.0**
50% discount on interest income	**0.0**	**7.0**	**37.0**	**323.0**	**367.0**
Increasing Concessional Contribution caps for over 50s	**16.0**	**573.0**	**745.0**	**745.0***	**2,079.0**
Raising super guarantee age limit from 70 to 75[3]	**0.0**	**0.0**	**(22.0)**	**27.0**	**5.0**
Phasing down interest withholding on financial institutions	**0.1**	**0.1**	**0.1**	**80.0**	**80.3**

2 All figures taken from material tabled in the Senate by Senator Arbib on behalf of the Treasurer on 9 February 2012 unless otherwise noted.

3 Originally announced in 2010-11 Budget Paper No 2, p. 44. Updated forecasts from Explanatory Memorandum to Superannuation Guarantee (Administration Amendment) Bill 2011, p. 4.

Early company tax cut for small business	**55.0**	**101.0**	**51.0**	**0.0**	**207.0**
Small business instant asset write-off	**0.0**	**2.0**	**1,060.0**	**1,040.0**	**2,102.0**
Standard deduction for work related expenses	**0.0**	**3.0**	**92.0**	**600.0**	**695.0**
Lowering company tax rate	**0.0**	**300.0**	**1,400.0**	**1,400.0***	**3,100.0**
Regional Infrastructure fund	**42.0**	**704.0**	**867.0**	**665.0**	**2,278.0**
Other Costs[4]	**60.0**	**65.0**	**65.0**	**45.0**	**235.0**
TOTAL	**181.1**	**1,789.1**	**5,482.1**	**6,411.0**	**13,819.3**
MRRT REVENUE[5]	**0.0**	**3,700.0**	**3,800.0**	**3,100.0**	**10,600.0**
NET FISCAL IMPACT	**(181.1)**	**1,910.9**	**(1,638.1)**	**(3,311.0)**	**(3,219.3)**
STATE ROYALTY INCREASE NSW[6]	**0.0**	**(235.0)**	**(244.0)**	**(465.0)**	**(944.0)**
TOTAL NET FISCAL IMPACT	**(181.1)**	**1,675.9**	**(1,882.1)**	**(3,776.0)**	**(4,163.3)**

* No cost estimate provided by government for 2014-15. Straight-line projection from previous year used as a conservative estimate of costs for 2014-15 where appropriate.

1.61 Given these concerning fiscal implications of the government's mining tax package the Senate should insist the government provide answers to a number of outstanding questions:

- What are the MRRT revenue assumptions the government has used to estimate its expected revenue from the MRRT including but not limited to the commodity price and production volume assumptions. Why has the government so far refused to provide that information when both Labor and

4 Other costs include the Expert Scientific Committee, COAG funding, and other minor changes announced in MYEFO 2011-12.

5 Mid-Year Economics and Fiscal Outlook 2011-12, p. 364.

6 New South Wales Budget 2011-12, Budget Paper No. 2, p. 5-2, 5-3 and Senate Economics Committee, Transcript of Inquiry into Minerals Resource Rent Tax Bill 2011, 21 February 2012, pp 65–66.

Coalition governments in Western Australia and Queensland publish this information as a matter of course in their State Budget papers?

- How much has the government factored in for the cost of crediting any increases in state and territory royalties announced since the 2 July 2010 mining tax deal? In short, what has been the impact on MRRT revenue estimates of the government's commitment to credit all state and territory royalties against any resources tax liabilities given the decisions by various State governments to increase royalties on either iron ore or coal.
- What is the expected impact on MRRT revenue from upfront tax deductions claimed by mining projects subject to the MRRT on the basis of the market valuation method negotiated between the Gillard government and the three big miners?
- Why the government has not provided full costings of all associated measures relating to the mining tax? These include costings of the proposed company tax cut, the early start of company tax cut for small business and the changes to superannuation contribution caps over the whole forward estimates period. When will the government provide that information? This should happen before the Senate is asked to pass judgement on the MRRT.

In conclusion, Coalition senators' concerns about the mining tax are that:

- It is a poorly designed tax, which instead of reforming existing resource taxation arrangements imposes a new additional tax on an important industry on top of the existing royalty and income tax arrangements making our tax system more complex and less fair;
- reduces Australia's international competitiveness as an attractive investment destination;
- gives an unfair competitive advantage to the three big multi-national, multi-commodity and multi-project companies who were given the exclusive opportunity by the government to negotiate the design of this new tax with all their competitors and other stakeholders locked out of the process;
- makes federal Budget outcomes hostage to decisions by State and Territory governments about their royalty arrangements;
- raises serious and unresolved constitutional issues; and
- links a highly volatile and downward trending revenue stream to a projected increasing cost of related budget measures, which will worsen the Commonwealth Budget's structural deficit over time.

1.62 In short, the MRRT and expanded PRRT would impose more economic distortions than the existing royalty arrangements. The MRRT is imposed on a narrow base which penalises some resource sectors (iron ore and coal). Moreover, these new taxes would impose substantial compliance costs even on a sector which is highly unlikely to have a large liability (such as the onshore gas and petroleum sector). Overall, the government's response to the Henry Tax Review has exposed the federal budget to a higher degree of risk. The government has proposed various associated measures which will become increasingly costly over time to be funded by a tax which could be dramatically impacted at any time by increases in royalties by state governments. These deficiencies completely refute the government's argument that their proposed changes create a more efficient tax system.

1.63 To ensure that the big companies of tomorrow can emerge and grow into the BHP Billiton's and Rio Tinto's of the future, we need to get the policy settings right today. The MRRT favours today's big majors over the small and mid-tier industry players aspiring and having the opportunity to be among the big majors of tomorrow. The MRRT is not competitively neutral. New taxes introduced by government should be.

1.64 Australia is enjoying its best terms of trade in 140 years and the government should not take the continued strength of the mining industry for granted. The economic development of India and China continues to fuel a strong demand for Australia's resources. However, Australia will face increased competition from other minerals and energy suppliers. In these circumstances policy settings must be carefully calibrated to ensure the international competitiveness of Australia as a mining investment destination and growing employment is preserved. This proposed national mining tax is a dagger at the heart of Australia's continued prosperity which should be avoided.

Dire fiscal consequences and a strain on federal–state financial relations

1.65 While the original concept of a Resource Rent Tax contained in the Henry Tax Review recommended negotiations with the states and territories, the Commonwealth conducted its negotiations with the 'big three' without them. Under Australia's constitutional arrangements, royalties are the responsibility of the states and territories. Ignoring this reality, the Commonwealth agreed with the big three miners to credit all state and territory royalties apparently completely oblivious of the flow-on consequences for the Commonwealth Budget.

1.66 The combination of a highly volatile revenue from the MRRT expected to reduce over time, the increasing cost of associated measures over time, as well as state and territory royalties being credited by the Commonwealth, create a fiscally irresponsible combination. As the best terms of trade in 140 years ease and the projected cost of related measures increases, a structural deficit will put more pressure on the Commonwealth Budget.

1.67 At the time the government signed the deal with the big three miners, Treasury assessed that the MRRT would raise around $38.5 billion. About 65 percent of that revenue or $25 billion is expected to come from iron ore production. With almost all the iron ore production taking place in Western Australia, the MRRT is a massive and disproportionate national tax impost on one state economy. Along with Western Australia, Queensland and New South Wales would bear the brunt of this tax.

1.68 The RSPT, the MRRT and expanded PRRT are a further intrusion of the Commonwealth into the revenue sphere of the states and territories. The Government of Western Australia raised its royalties in its 2011-12 Budget by phasing out royalty concessions on iron ore fines, as did Tasmania. The Gillard Government had known for some time about the Western Australian government's intentions to phase out royalty concessions on iron ore fines. Importantly, the states of New South Wales and Queensland have reserved their right to also raise their royalties. In the absence of a negotiated agreement involving the states and territories, the Commonwealth will be forced to cover these royalty rate rises. Already this amounts to about $2 billion over the current forward estimates and that cost could well rise into the future.

1.69 Businesses and the Western Australian Government have flagged the possibility of a constitutional challenge to the proposed MRRT and expanded PRRT.

Way forward

1.70 The Government's proposed new national mining tax arrangements are more complex, less efficient and less fair than the status quo. The process for the development of the MRRT and expanded PRRT was inappropriately secretive and exclusive.

1.71 The design of the MRRT and expanded PRRT which came out of that process is irretrievably broken. Any attempt to 'fix' the defects in these taxes would sucker a government into a series of quid-pro-quos with affected companies, which could never be the foundation of enduring taxation reform. Instead, the government should scrap its failed attempt to respond to the Henry tax review and start again.

1.72 Genuine tax reform is best delivered through an open, transparent and inclusive process, not by negotiation behind closed doors with a chosen few given the privileged opportunity to pursue their particular interests.

1.73 Taxation reform must be an ongoing process. It should not be targeted at one industry in isolation as is the case with the MRRT and expanded PRRT. Australia needs genuine taxation reform not lazy tax grabs. Australia needs taxation reform which is focused on delivering lower, simpler and fairer taxes. Australia needs tax reform aimed at improving our productivity and international competitiveness, to encourage increased workforce participation, enterprise and to attract investment. To achieve all that, more needs to be done, in particular on the spending side of the budget. Future taxation reforms must also focus on making the system more user friendly, efficient and on reducing red tape for households and business instead of increasing it.

1.74 Finally, any genuine tax reform must also be focused on and address the implications for federal-state financial relations.

1.75 Coalition senators recommend that the Government scrap its proposals for an MRRT and expanded PRRT. The Coalition members of the committee recommend that the uncoordinated, incoherent and ad hoc taxation processes currently underway be replaced by one genuine tax reform process focused on delivering lower, simpler and fairer taxes, through an open, transparent and inclusive process.

Recommendation 1

1.76 That the Senate:

- **(a) Not pass this deeply flawed, poorly designed and fiscally irresponsible mining tax package; and**
- **(b) Call on the government to engage in a fresh, more serious, more considered, more competent and more open, transparent and inclusive effort to pursue genuine root and branch reform of our tax system to make it simpler and fairer.**

Senator David Bushby
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Senator Mathias Cormann
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Senator Alan Eggleston
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