Minority report by the Australian Greens

Executive summary

1.1 The unprecedented growth of the Chinese economy and its re-engagement with the global economy have seen commodity prices soar over the past decade, bringing vast windfall gains to mining companies from their operations 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 Furthermore, the mining boom has led to an appreciation of the Australian dollar, higher interest rates and shortages of labour in certain regions or with certain skills. These impacts are in turn leading to lower profits and lower returns to shareholders in other industries such as manufacturing and tourism.

1.3 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. The boom mentality is leading to over-investment in ports and other infrastructure in remote areas which will have little other use.

1.4 While the record investment undertaken and proposed by the industry ($120 billion next year alone) suggests the prospect of the mining tax is having little impact on activity, were it to lead to some cooling in the feverish expansion of the mining industry this could be desirable rather than a problem.

1.5 Australians have led the world in thinking about the impact of resources booms and the optimal taxation treatment of them. Australia should also be setting an example to the world in implementation of an efficient tax to ensure the people get a fair share of the returns from their national natural resources.

1.6 A better designed mining tax could raise a lot more revenue than the Minerals Resource Rent Tax (MRRT) – in the order of an additional $100 billion over the next decade – which could fund needed initiatives in areas such as education, modern public transport and dental health. Some of the funds raised could be placed in a sovereign wealth fund to share the benefits with future generations.

1.7 Such design improvements would include broadening the coverage of the tax and restoring the MRRT rate to the 40 per cent recommended by the Henry Tax Review, so that there would be a uniform (and hence non-distortionary) resource rent tax of 40 per cent. Other design features, such as the uplift rate and the starting base, should be returned to be close to those recommended in the Henry Review, and royalties (especially increased royalties) should not be rebated.

1.8 The Government has linked the mining tax to a proposed increase in the superannuation guarantee (SG) from 9 to 12 per cent, as the mining tax proceeds will partly be used to make up the cost to the budget resulting from some wage increases being replaced with concessionally taxed superannuation. The Greens are supportive of the SG increase but want to take this opportunity to address inequities in those tax concessions. Tax concessions should not be giving more benefits to high income earners making superannuation contributions than they do to low income earners.

1.9 The Government is also reducing and simplifying some tax arrangements for small business. The Greens support this simplification but would like to see examination of whether it would be preferable to extend the small business instant asset write-off threshold from $6 500 to $10 000 instead of the accelerated initial deductions for motor vehicles.

1.10 While not part of this package of bills before this inquiry, the Government has said that the MRRT will fund a cut in the company tax rate from 30 to 29 per cent, with small businesses receiving the cut from July 2012 and larger businesses from July 2013. As it is small rather than large businesses who have most suffered from the effects of the mining boom, the Greens would prefer not to proceed with the latter cut but to consider more benefits for small business.

Introduction

1.11 The package of bills seeks to introduce the Minerals Resource Rent Tax (MRRT), a tax on the economic rents mining companies make from the extraction of certain non-renewable mineral resources; extend the coverage of the existing Petroleum Resource Rent Tax to all offshore and onshore petroleum projects; increase the superannuation guarantee (SG) charge from 9 per cent to 12 per cent; and lower and simplify some small business taxation arrangements. The Greens support these goals but seek to improve and extend the bills with a series of amendments described in this minority report.

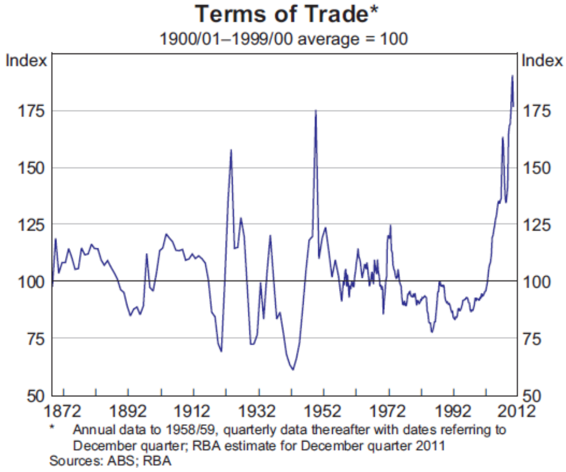
Conduct of the inquiry

1.12 The committee held only two public hearings, and both were in Canberra. While evidence was taken from public policy think tanks, academics, trade unions, superannuation funds, superannuation industry bodies, Treasury and the Australian Taxation Office; there was an overrepresentation from mining industry representatives and other opponents of the bills. It would also have been desirable given the importance of the issues to have held more hearings in other locations.

The mining boom and the Australian economy

1.13 The unprecedented growth of the Chinese economy and its re-engagement with the global economy have seen commodity prices soar over the past decade, taking Australia's terms of trade to their highest point on record (Chart G1).[1]

Chart G1



Source: Reserve Bank of Australia, *Statement on Monetary Policy*, February 2012.

1 Reserve Bank Governor Glenn Stevens gave an interesting example to illustrate this point: 'five years ago, a ship load of iron ore was worth about the same as about 2,200 flat screen television sets. Today it is worth about 22,000 flat-screen TV sets – partly due to TV prices falling but more due to the price of iron ore rising by a factor of six'; *Reserve Bank Bulletin*, December 2010, p. 70.

1.14 The value of mining production has soared. The contribution to GDP of the mining industry has increased from $35 billion in 2003-04 to $123 billion in 2010-11. Most of this 250 per cent increase has been a windfall gain from higher prices; the corresponding volume measure rose by less than 30 per cent.

1.15 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.

1.16 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 foreign-owned, most dividends and retained earnings accrue to foreigners and therefore do not add to national income'.[2] 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.'[3]

1.17 The remaining fifth of profits accrue to Australians. While direct share ownership is concentrated among the wealthy, some of it is in superannuation funds. The mining companies also pay royalties and company tax (discussed further below).

1.18 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 and about a quarter of the number employed in manufacturing).[4] 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.

1.19 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

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

3 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.

4 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.

making imported goods and overseas holidays cheaper.[5] 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.[6]

1.20 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).[7] This refers to the 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.[8] This has made life more difficult for many Australian companies, including notably small businesses.

> …the high Australian dollar is having a negative effect on manufacturing, it is having a negative effect on tourism, and there are other things as well that are impacting on the finance industry. We are very concerned that the Australian economy is being unbalanced as a result of the mining boom.[9]
>
> We certainly are in a position where the expansion of the mineral sector has led to an appreciation of the exchange rate which is damaging to other traded goods sectors.[10]

1.21 The mining boom has led to shortages of skilled labour and increased costs for many other industries:

> Someone who sits on a tractor out in western New South Wales at $25 an hour can go into the mining industry at something like double that rate.[11]

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5 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.

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

7 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.

8 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.

9 Mr Jeff Lawrence, Secretary, Australian Council of Trade Unions, *Proof Committee Hansard*, 22 February 2012, p. 7.

10 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, p. 7.

1.22 The mining boom has also bid up the prices of raw materials used in mining.

1.23 These 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. As the Australia Institute observe:

> 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.[12]

1.24 As mining is concentrated in Western Australia and Queensland, these '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.

Table G1: Gross state product

	average annual % change, 1999-00 to 2010-11.
Western Australia	4.6
Queensland	4.2
Northern Territory	3.6
Victoria	3.1
ACT	3.0
South Australia	2.7
Tasmania	2.5
New South Wales	2.0

Sources: ABS, *Australian National Accounts: State Accounts* (5220.0).

1.25 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; and while mining actually accounts for less than a tenth of economic activity, the average person thinks it accounts for more than a third.[13]

11 Mr John McKillop, National Farmers' Federation, *Proof Committee Hansard*, 22 February 2012, p. 49.

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

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

1.26 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:

> …we are a massive knock-on employer; the multiplier effect is anything from two and a half to three, all the way up to eight or nine or 10…[14]

1.27 The week before, Treasury had 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.[15]

1.28 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. Communities, both host and source, and family life are being disrupted by fly-in/fly-out workforces. 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.

1.29 The mining sector is notorious for its boom and bust mentality. For those commodities where Australia provides a significant proportion of the global supply, rushing to increase production is going to lower the prices received. A sharp rise in

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14 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 21 February 2012, p. 34.

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

production also increases the number of people, and physical resources, that will need to be shifted back to other sectors, either when the minerals run out or when there is a price drop that ends the period of super profits. It may also be leading us as a nation to over-invest in ports and freight rail in remote areas that could have little value after a mining boom. So even if the mining tax does lead to some slowing in the rate of exploitation of Australia's minerals, this may be no bad thing.[16]

1.30 As Professor Quiggin told the Committee:

> …to the extent that the proposed tax deviates from an ideal rent tax and tends to constrain the growth of the minerals sector, it is unlikely to be economically damaging in Australia's current economic circumstances, given the great strength of the mining sector and the corresponding pressure that high exchange rates are putting on other sectors of the economy.[17]

The tax paid by mining companies

Company tax

1.31 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.[18] 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.

1.32 The Treasury Secretary has recently observed:

> Mining companies account for about a fifth of gross operating surplus, yet only around a tenth of company tax receipts…[19]

1.33 His predecessor remarked:

> …the tax paid by the mining sector of the economy is a relatively small proportion of profit.[20]

1.34 Two studies by Treasury economists examined alternative measures of average company tax rates by industry, which consistently showed mining as below average.[21]

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16 Dr David Day, 'Miners might not dig a coal delay, but it makes sense', *Sydney Morning Herald*, 8 March 2012.

17 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, p. 1.

18 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.

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

20 Dr Ken Henry, *Senate Select Committee on the Scrutiny of New Taxes Hansard*, 22 November 2010, p. 39.

1.35 Even some mining company executives concede 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.[22]

Rents and royalties

1.36 There was an assertion by some opponents of the MRRT that there are no 'rents' or 'super profits' in mining.[23] This is clearly not the case. Mining is very different to the typical industry. Take the example of a suburban pizza restaurant. If it attempts to take advantage of a rise in demand for pizzas by markedly increasing prices to earn abnormal profits, it is a simple matter for someone else to establish a rival restaurant. If the currently operating restaurant is operating very inefficiently, a more efficient newcomer can enter the market and offer cheaper pizzas and make a good profit. In contrast, once a mining company is mining a particular ore body, no other company can come along and mine the same deposit, no matter how profitable the project has become or how inefficient is the existing miner. This lack of 'contestability' is magnified by the sheer size of the major mining companies and their control over the transport infrastructure.

1.37 Furthermore, unlike pizza restaurants or retailers or manufacturers who must pay for the goods they sell and their raw materials, mining companies are essentially selling non-renewable resources owned by the people. The only payment they make for these at present are royalties imposed by state governments.

1.38 Royalties, however, 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.

International competitiveness

1.39 The mining industry makes apocalyptic predictions of the impact of higher taxes on their international competitiveness, backed by negligible empirical support.[24]

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21 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.

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

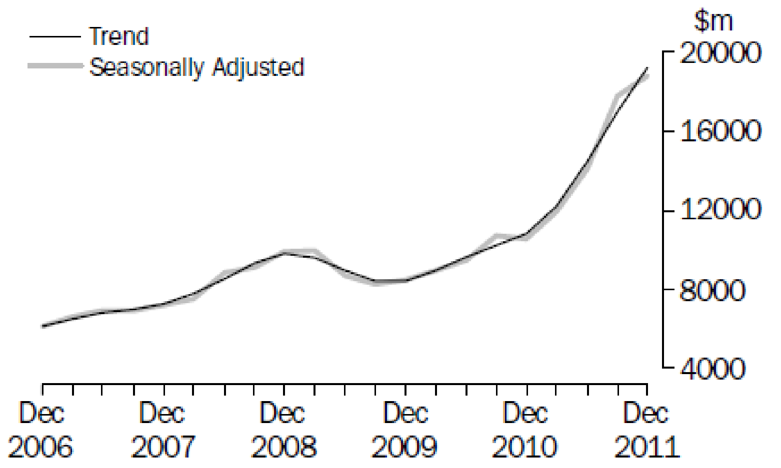
23 Dr Alan Moran, Institute of Public Affairs, *Proof Committee Hansard*, 21 February 2012, p. 13. Fortescue Metals Group refers to 'alleged economic rents'; *Submission 26*, p. 1.

24 For examples, see Chamber of Minerals & Energy of Western Australia, *Submission 2*, p. 4.

1.40 Mining companies are currently earning above normal or 'super' profits, or 'rents' well in excess of the returns necessary for them to attract capital, undertake investments and continue production. There is no indication that the prospect of the MRRT, which in one form or another has been discussed publicly for at least three years, is proving any significant deterrent to mining companies increasing their operations in Australia.

1.41 The latest data show that mining investment in Australia reached another record high in the December quarter of 2011.

Chart G2: Capital expenditure by the mining industry



Source: Australian Bureau of Statistics, *Private New Capital Expenditure and Expected Expenditure*, December 2011.

1.42 Furthermore, the mining industry's expectations of how much investment they will do in 2011-12 as a whole has been revised up. And they expect another large increase in investment in 2012-13. Investment next year is projected at $120 billion, compared to the $80 billion they expected for 2011-12 at this time last year.[25] A similar picture is shown by the list of proposed projects long published by the Australian Bureau of Agricultural and Resource Economics and Sciences.

1.43 Even if the MRRT were to deter a mining company from undertaking a project in Australia, there are plenty of rival firms who would be keen to enter:

> …there are any number of willing investors in the Australian mining industry that are willing to invest on the basis of making good profits rather than super profits. Chinese and Indian investors in particular are falling over themselves to invest in Australia. Even various American mining

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25 Australian Bureau of Statistics, *Private New Capital Expenditure and Expected Expenditure* (5625.0), December quarter 2011.

> companies are keen to invest in Australia, despite their difficulties back home.[26]

1.44 While the inquiry heard about the supposedly more welcoming tax regimes in developing countries in Africa and South America, and the supposed 'sovereign risk' from Australia's proposed tax reforms, in reality Australia is a much safer and secure environment for mining companies. As *The Economist* points 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…[27]

1.45 Worldwide there are 25 countries announcing plans to boost their share of profits, and these extra taxes are moderate compared to countries such as Indonesia that are forcing companies to cede a majority stake in their mines to locals.[28] Some examples of other countries with resource rent taxes are given in Table G4 below.

Designing a better tax regime

1.46 A good point about the balance of risks in setting tax rates on mining is made in the Fortescue submission:

> …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…[29]

1.47 While Fortescue is referring to royalties, exactly the same point applies to a resource 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.

The Minerals Resource Rent Tax

1.48 The Henry Tax Review proposed a resource 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. These gains were as a result of the commodity price boom resulting from the sustained rapid growth in the Chinese economy. The Rudd Government proposed the Resource Super

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26 Mr Peter Colley, National Research Director, Construction, Forestry, Mining and Energy Union *Proof Committee Hansard*, 22 February 2012, p. 33.

27 *The Economist*, 11 February 2012, p. 45; provided as additional information 4.

28 Mr David Richardson, Australia Institute, additional information 11; *The Economist*, 11 February 2012, pp 45–46.

29 Fortescue Metals Group, *Submission 26*, p. 5.

Profits Tax (RSPT) in May 2010, which incorporated many of the features of the tax proposed by Henry and was similar to the Petroleum Resource Rent Tax which has operated successfully in Australia for twenty years. The mining companies, however, responded with an advertising campaign costing around $20 million. Prime Minister Gillard announced in July 2010 that the RSPT would be replaced with a watered down Minerals Resource Rent Tax (MRRT). The outline of the MRRT had been developed in 'negotiations' with the three largest miners; BHP-Billiton, Rio Tinto and Xstrata. 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. After a short inquiry by the House Economics Committee, the bills were passed by the House of Representatives in November 2011.

1.49 The majority report comments:

> The consensus from industry, even from opponents to any resource rent tax being imposed on the minerals sector, is that it represents a significant improvement on the RSPT.

1.50 That is a fair representation of the *industry's* view. But the industry holds this view just because the MRRT imposes much less tax on them than would have the RSPT. All industries would regard it as an improvement to halve a prospective tax on them. This is not a reason to think that in a public policy sense the MRRT is preferable to the RSPT.

1.51 As Professor Quiggin noted:

> The original [RSPT] proposal was designed more in line with the theoretical ideal… It would have been better to raise substantially more with the original proposal for the RSPT and to use that to finance the various tax reductions that were proposed…It would certainly be desirable to go back to the original RSPT proposal.[30]

1.52 There have been claims that the resource rent tax should have been subject to lengthy consultations with mining companies and a green paper/white paper process.[31] This ignores the extensive consultation on the theory of the tax done by the Henry Tax Review and the extensive consultation by the Ferguson-Argus group on the details of the implementation. If mining companies chose not to put their views to these reviews about the best mechanisms for returning a fair share of mining profits to the community, this is their own fault.

Resource rent taxes

1.53 The majority report is quite right when it comments:

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30 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, pp 1–2 and 7.

31 For example, Dr Alan Moran, Institute of Public Affairs, *Proof Committee Hansard*, 21 February 2012, p. 14.

> Rent taxes have a noteworthy history in Australia and have an accepted place in Australian tax policy. They are widely acknowledged by academics and tax experts as being more efficient methods of taxation than output-based royalties.

1.54 This view has been reiterated by academic experts:

> Resource rents are larger in this economy than in any other developed country except Norway. A resource rent is potentially a source of taxation that has relatively little distortion of economic activity, so it is a lower cost form of taxation than most of the ways in which we raise taxation.[32]

> …a tax targeted at rents, at the profit in excess of the normal rate of profit gained from access to these mineral resources, is the most efficient basis for taxing minerals.[33]

1.55 The Greens had called for a resources rent tax even before the Henry Tax Review was released.[34]

1.56 Even the mining industry lobby and some trenchant critics of the MRRT acknowledge the merits of a resources rent tax:

> We have conceptually…argued that there is a strong case for…a shift from output based royalties to profits based where there is a better sharing of risk and reward.[35]

> …in theory, resource rent taxes are a very good idea…if you were designing a system ab initio you would actually use a combination of taxes, so in theory you would use properly designed royalties, properly designed resource taxes and properly designed upfront auctions.[36]

> …the normal economics profession generally would say a profits rated tax is better than a royalty…[37]

1.57 It is likely that the reason the large mining companies were so opposed to the original RSPT was not that this resource rent tax would not work but that it would have worked very well and been adopted around the world. As Professor Quiggin put it:

> …it is true that some of the multinational mining companies are concerned about Africa…they are worried that those jurisdictions may follow our

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32 Internationally regarded expert on mining taxes Professor Ross Garnaut, *Senate Select Committee on the Scrutiny of New Taxes Hansard*, 19 November 2010, p. 26.

33 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, p. 1.

34 See, for example, Senator Bob Brown, 'A tax on resources profits would benefit all of us', *Sydney Morning Herald*, 6 April 2010.

35 Mr Mitch Hooke, Minerals Council of Australia, *Proof Committee Hansard*, 21 February 2012, p. 30.

36 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, pp 4 and 9.

37 Dr Alan Moran, Institute of Public Affairs, *Proof Committee Hansard*, 21 February 2012, p. 17.

example and also seek to secure a better and more efficient return, reducing international profitability.[38]

Estimates of revenues from MRRT and RSPT

1.58 It has increasingly become apparent that the MRRT not only foregoes much of the revenue the RSPT would have raised, but that design flaws may mean that it will not cover the cost of programmes intended to be funded from it. Over 40 per cent of the revenue may be returned to the mining industry through cuts in company tax and infrastructure spending to benefit the mining sector.

1.59 The table below summarises revenue projections. It should be noted that the first MRRT projections were based on stronger assumptions about commodity prices than were the RSPT projections.[39] 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.[40] An AFR journalist estimated that the reduction is at least $100 billion.[41]

1.60 The Treasurer questioned these estimates at his recent appearance at the National Press Club.[42] If he wants these criticisms to have credibility he should release Treasury calculations on the different amounts of revenue based on the same assumptions on exchange rate, commodity prices and volumes, instead of just saying that the RSPT is no longer government policy.[43]

1.61 Given the reduction in revenue projections for 2014-15 revealed in the 2011-12 Budget and MYEFO, it is likely projected revenue from the MRRT has also fallen for the subsequent years. If revenue projections for the out-years are scaled down as much as for the forward estimates, then the cumulative revenue to be collected by 2020-21 would now have dropped from $39 billion to around $25 billion.

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38 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, p. 2.

39 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, Treasurer Swan conceded that higher commodity prices had increased the revenue over the first two years by $6 billion.

40 Naomi Edwards, 'An analysis of the impact of switching from the RSPT to the MRRT', 28 March 2011.

41 John Kehoe, 'Mining tax hole tops $100bn', *Australian Financial Review*, 24 February 2011.

42 In responding to a question after his speech, the Treasurer said 'this nonsense argument that all of this revenue was lost by the change of the design from the RSPT to the MRRT, it is simply rubbish. It is based on 10-year projections which are unreliable. It is based on a whole set of assumptions'; 5 March 2012.

43 Treasury response to questions on notice from supplementary budget estimates, October 2011, no. 668.

Table G2: RSPT and MRRT revenue projections, $ billion

	RSPT		MRRT				
	2010-11 Budget	FoI	Economic Statement 2010	FoI	MYEFO 20101-11	2011-12 Budget	MYEFO 2011-12
2012-13	3.0	3.0	4.0	4.0	3.3	3.7	3.7
2013-14	9.0	9.0	6.5	6.5	4.1	4.0	3.8
2014-15		12.5		6.5		3.4	3.1
2015-16		12.5		5.5			
2016-17		12.5		4.0			
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*, pp 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.

1.62 The projections above do not include the impact of the increases in royalties announced by the NSW Government last year, which is projected to raise $0.9 billion over the forward estimates for the state government and will be rebated to the companies paying the MRRT.

1.63 Many commentators have become increasingly concerned about the generous provisions in some of the details of the MRRT, leading them to lower their view of the likely revenue.[44] The definitions of mining expenditure which can be deducted from revenue seem quite broad. For example, they extend to provision of a community aquatic centre in a nearby town.[45] Native title payments are also deductible.

Budgetary impact of the package of bills

1.64 On available information the package of bills will result in a net addition to government revenue over the forward estimates period (Table G3). It appears, however, unlikely that there will be enough net revenue to fund the company tax cut and regional infrastructure fund which the Government has also linked to the MRRT. It is arguable that as the MRRT is only around 1 per cent of government revenue it does not matter unduly whether the revenue from the MRRT matches the cost of the

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44 For example, scepticism about revenue projections is expressed by BDO accountants, *Submission 3*.

45 *MRRT Explanatory Memorandum*, pp 61–62.

other initiatives and that 'what matters is the overall fiscal balance'[46] which is budgeted to be in surplus over the forward estimates. But it would still assist in having an informed debate for the Government to clarify their intentions regarding the company tax cut.

Table G3: Budgetary impact of the MRRT package

	2012-13	2013-14	2014-15
Minerals resource rent tax	3.8	3.7	3.1
Superannuation guarantee increase	0	-0.2	-0.5
Superannuation rebate for low income earners	0	-0.9	-1.0
Higher superannuation contribution cap for >50s	-0.6	-0.7	Not available
Small business instant asset write-off and pooling	0	-1.1	-1.0
Total	3.2	0.8	<0.6
Other initiatives			
Company tax cut	-0.3	-1.4	Not available
Early company tax cut for small business	-0.1	-0.1	Not available
Regional infrastructure fund	-0.7	-0.9	-0.7

Sources: MYEFO; budget papers; Treasurer, 'Documents for Senate Order Relating to the Mineral Resource Rent Tax', 8 February 2012.

1.65 There have been concerns expressed that in the longer term commodity prices may fall back from their current highs, and so the revenue raised from the MRRT will be on a downward trend. One countervailing factor will be the increasing volumes that should flow from the vast amount of investment currently underway.

1.66 Professor Quiggin pointed out another countervailing force:

> …as the mineral sector declines, we can expect to see expansions in other parts of the traded goods sector that have been constrained by the strong growth in the mineral sector.[47]

1.67 Another area of contention is the extent to which increases in the superannuation guarantee reduce the cost of age pensions. On the one hand, Mercer claims 'higher short term tax concessions are more than offset by long term savings in funding the age pension'.[48] On the other hand, ACCI claim 'projected budget savings on pension outlays are grossly outweighed by the cost to the budget from the increase

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46 Mr Rob Heferen, Executive Director (Revenue Group), Department of the Treasury, *Proof Committee Hansard*, 22 February 2012, p. 67.

47 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, pp 3–4.

48 Mercer, *Submission 13*, p. 2.

in the superannuation guarantee'.[49] A Treasury memo says that 'only part of the revenue foregone in tax concessions in superannuation will be offset by a reduction in pension outlays'.[50]

Concerns about volatility of revenue

1.68 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…[51]

1.69 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.

The MRRT rate

1.70 The tax rate in the RSPT was 40 per cent. This is the same as that recommended in the Henry Tax Review.[52] It is also the rate that has applied to offshore oilfields under the Petroleum Resource Rent Tax and even the harshest critics of the MRRT have offered no evidence that the PRRT has significantly stifled investment.[53]

1.71 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.

1.72 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'.[54] Professor Ross Garnaut, a global expert on resource taxation, commented '22½ per cent tax is not too high. And it could be higher without distorting investment.'[55]

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49 Australian Chamber of Commerce and Industry, *Submission 14*, pp 10–11.

50 http://www.treasury.gov.au/documents/1956/PDF/Information_briefing_national_savings.pdf

51 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, p. 11. This point was also made in article Professor Ergas wrote with Mark Harrison and Jonathan Pincus, 'Some economics of mining taxation', *Economic Papers*, December 2010.

52 *Australia's Future Tax System*, December 2009, recommendation 45, p. 231.

53 Dr Alan Moran, Institute of Public Affairs, *Proof Committee Hansard*, 21 February 2012, p. 15.

54 OECD, *Economic Surveys: Australia*, November 2010.

55 Professor Garnaut, *Senate Select Committee on the Scrutiny of New Taxes Hansard*, 19 November 2010, p. 34.

1.73 Other countries with resource rent taxes often apply higher rates.

Table G4: 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.

1.74 Even without making any other changes, restoring the MRRT to 40 per cent would raise almost an additional $20 billion over the forward estimates.

Recommendation G1

1.75 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

1.76 While the RSPT applied to almost all minerals, the MRRT only covers iron ore and coal.[56] An example of a project now excluded is the Olympic Dam, the world's largest uranium deposit and fourth largest copper deposit.

1.77 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. No cogent argument has been put for this treatment. Indeed, Treasury has said:

56 In the early years at least the revenue raised will predominantly come from iron ore; Senate Select Committee on the Scrutiny of New Taxes, *The Mining Tax: a Bad Tax out of a Flawed Process*, June 2011, pp 70–71; based on Treasury, spreadsheet released under Freedom of Information, 14 February 2011.

> Treasury is not aware of any independent research or reports recommending the restriction of the Minerals Resource Rent Tax to iron ore and coal.[57]

1.78 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.[58]

1.79 A global expert on resource rent taxes commented:

> …if two mines are equally profitable, are the same size, take the same length of time and the same amount of exploration to bring into production there is no economic reason to tax iron ore more heavily than uranium, for example…not every iron ore mine is large and profitable, and not every other kind of mine is small and unprofitable.[59]

1.80 At the Committee's hearings, a number of witnesses, from across the political spectrum, questioned the restriction to just coal and iron ore:

> I see no reason for exempting these other commodities.[60]

> The fact of taxing those resources while not taxing others will distort investment as between coal and iron ore on the one hand and untaxed resources on the other.[61]

> …we have introduced it for just two industries…one should treat all corporations in a similar way…[62]

> …plenty of other sectors of the mining industry are also hugely profitable, and I think of copper and gold. A more consistent tax would be applied more broadly.[63]

1.81 The only justifications proffered for this restriction is reducing the number of companies paying the tax and the statement in the majority report that:

> …it focuses on the most profitable resources—iron ore and coal—significantly reducing the number of companies that would be affected by the new taxation arrangements.

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57 Treasury, response to question on notice no. 667 from supplementary budget estimates, October 2011.

58 OECD, *Economic Surveys: Australia*, November 2010.

59 Professor Ross Garnaut, *Senate Select Committee on Scrutiny of New Taxes Hansard,* 19 November 2010, pp 30–31.

60 Mr David Richardson, Australia Institute, *Proof Committee Hansard*, 21 February 2012, p. 26.

61 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, p. 3.

62 Dr Alan Moran, Institute of Public Affairs, *Proof Committee Hansard*, 21 February 2012, p. 15.

63 Mr Peter Colley, National Research Director, Construction, Forestry, Mining and Energy Union, *Proof Committee Hansard*, 21 February 2012, p. 32.

1.82 Where it says 'most profitable', it should read '*currently* most profitable'. It is hard to predict in advance which commodity prices will rise sharply and generate windfall profits. For example, there is discussion currently about the prospects for prices of rare earths rising very high. This is another reason why 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.

1.83 A particular anomaly is gold. The price of gold is, even after some recent decline, near an all-time high. An analysis commissioned by the Greens estimates that removing gold's exemption from the MRRT would restore around $2 billion to revenue collected over the next decade.[64]

1.84 Asked to defend the restriction to iron ore and coal at the hearing, the Minerals Council's CEO, Mr Mitch Hooke's response was:

> At the risk of appearing flippant, oils ain't oils and minerals ain't minerals.[65]

1.85 When then asked specifically about the exclusion of gold, Mr Hooke asserted:

> …there is no money in it, in putting a resource rent tax on gold... [66]

1.86 Asked to justify this, Mr Hooke claimed there was modelling of the gold sector in the Minerals Council's submission.[67] The submission contains no such modelling.[68] There is a reference in a footnote in the submission to a paper prepared at the request of the Minerals Council by KPMG.[69] A Google search for this title produced a short paper asserting a result from modelling but no details of this modelling. The Minerals Council should provide an explanation to the Committee for this discrepancy.

1.87 When Treasury were asked to justify the exclusion of gold, Treasury argued 'if you just chose to apply a rent tax on gold, which is often found in deposits with a number of other minerals, and you were not intending to tax those other minerals, then

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64 Naomi Edwards, 'Golden Daze: estimated revenue impact from extending MRRT to gold', 11 August 2011. The author conservatively assumed the gold price would ease back from US$1,600 per ounce in 2011 to $1,450 in 2016. The latest forecast from the Bureau of Resources and Energy Economics is that the gold price will average US$1,850 in 2012; *Resources and Energy Quarterly*, December quarter 2011, p. 47.

65 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 21 February 2012, p. 32.

66 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 21 February 2012, p. 32.

67 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 21 February 2012, p. 32.

68 Minerals Council of Australia, *Submission 20*.

69 KPMG, 'Potential financial impacts of the Resource Super Profits Tax on new mining projects in Australia', June 2010.

there would be complexities associated with apportioning revenue and expenses to work out the profits that are attributable to the gold as opposed to the other resources that are found in the same mine'.[70] This would not be an argument against taxing *all* minerals. It also seems inconsistent with the fact that for decades gold mining was exempt from tax.

1.88 Treasury have not disclosed the cost to revenue of excluding minerals other than coal and iron ore but they should. The excluded minerals account for about a quarter of the value of mining exports but it is not known what proportion they comprise of mining profits. For illustrative purposes, if their exclusion cuts the MRRT revenue by a quarter, then this alone reduces revenue over the forward estimates by around $3½ billion.

Recommendation G2

1.89 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. At an absolute minimum, gold miners, who are garnering windfall profits from an unanticipated near record price for gold, should be brought under the MRRT along with coal and iron ore miners.

Recommendation G3

1.90 That if 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 Expenditures Statement*.

The MRRT and state royalties

1.91 Many economists believe that royalties are an inefficient tax while a resources rent tax is a very efficient tax. This is why the Henry Tax Review recommended replacing royalties by a 40 per cent resource rent tax.

1.92 The MRRT in its current form, however, rather than replacing royalties leaves them being paid but then rebates them for some projects. The administrative and compliance costs of collecting royalties remain.

1.93 Given these problems it would now be better to remove totally from the bill the refund of royalties. This would leave the states able to set royalties as they see fit but be answerable for doing so rather than having the Australian taxpayer meet the bill. It would also increase the amount of revenue raised by the MRRT by perhaps around $7-8 billion, depending on how much of the $8.6 billion in state royalties on coal and iron ore come from projects below the MRRT threshold.

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70 Mr Patrick Sedgley, Manager, Resource Tax Unit, Department of the Treasury, *House Economics Committee Hansard*, 8 November 2011, p. 9. Fortescue Metals Group make a similar point; *Submission 26*, p. 8.

Table G5: State Mining Royalties, 2011-12, $ billion

	NSW	Vic	Qld	WA	SA	Tas	NT	Total
Coal	1.7		2.8					4.5
Iron Ore				4.1				4.1
Other	0.1		0.5	0.7	0.2		0.2	1.7
Total	1.8	0.05	3.3	4.8	0.2	0.05	0.2	10.3

Source: State budget papers.

Recommendation G4

1.94 That royalties are not rebated under the MRRT.

The treatment of future royalty increases

1.95 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'. [71]

1.96 Under the RSPT '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'.[72]

1.97 Given this, it is very odd that the large mining companies apparently assumed when negotiating the MRRT that 'all royalties' included all future increases, rather than seeking that this be clarified. The wording used in the heads of agreement between the new Gillard Government and big three mining companies said 'all state and territory royalties will be creditable…', leaving this unclear. Dr Henry's interpretation was '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'…'[73]

1.98 After the election the Policy Transition Group (chaired by former BHP chair Don Argus and 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

71 *Australia's Future Tax System*, December 2009, p. 240.

72 *The Resources Super Profits Tax*, 2010, p. 31.

73 Dr Hen Henry, Secretary, Department of the Treasury, *Senate Committee on the Scrutiny of New Taxes Hansard*, 22 November 2010, pp 9 and 12.

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.

1.99 The Western Australian, New South Wales and Tasmanian Governments have already 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, which could reduce revenue from the MRRT by a further $3 billion over the next few years, and possibly a cumulative reduction approaching $10 billion by 2020.

1.100 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". As the OECD put it, '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'.[74]

1.101 This point was made by a number of witnesses:

> The tax invites state governments to increase royalty rates, thus exacerbating any inefficiencies those royalties cause…[75]

1.102 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.

1.103 The Government has now added this problem to the terms of reference for the GST Distribution Review being conducted by Nick Greiner, John Brumby and Bruce Carter.[76]

1.104 A better response if royalty rebating is not removed totally would be to restrict it to royalties that were in place when the MRRT was first announced.

Recommendation G5

1.105 That if royalty rebating is not totally removed from the MRRT, it should at least be removed for that component of state royalties increased after 1 July 2011.

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74 OECD, *Economic Surveys: Australia*, November 2010.

75 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, p. 3.

76 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.

The uplift rate

1.106 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. (The 'uplift rate' is also known as the 'allowance for corporate capital'.)

1.107 To understand where it comes from, it is necessary to go back to the 'Brown tax'. US academic Cary Brown proposed that essentially the government 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'[77], 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.

1.108 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.

1.109 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.'[78]

1.110 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.

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77 *Australia's Future Tax System*, December 2009, p. 234.

78 Professor George Fane, *Senate Select Committee on the Scrutiny of New Taxes Hansard*, 30 March 2011, p. 26.

1.111 The CFMEU argue that:

> The restriction of the uplift rate in the RSPT to the long term bond rate was possible overly restrictive relative to the cost of funds to mining companies. However the major increase in the uplift rate in the MRRT to the LTBR + 7% is overly generous. So much so that at several points in the Issues Paper of the Policy Transition Group there is discussion of measures to minimise potential company practice of holding on to MRRT deductions/losses in order to simply derive profits from the uplift rate.[79]

Starting base and depreciation arrangements

1.112 For new mining projects starting after July 2012, the initial investment can be written off immediately rather than depreciated over years. This means companies will pay no MRRT until they have made enough profit to cover the initial investment (compounded at the uplift rate).

1.113 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.

1.114 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.

1.115 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. 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.

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79 Construction, Forestry, Mining & Energy Union, *Submission 16*, pp 4–5.

1.116 Mining companies had argued that the MRRT 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.

1.117 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.[80] 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…[81]

1.118 There has also been criticism of this approach from academics:

> …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.[82]

1.119 There is very little information publicly available about the likely size of these allowances. Fortescue at the hearing estimated that they may have a starting base of around $14-15 billion which they could depreciate over a period of 'well under 25 years'.[83] 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.

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80 BDO Accountants, *Submission 3*, pp 4–5, make this point. Fortescue Metals Group, *Submission 26*, make a similar argument.

81 Mr Tapp, Fortescue Metals Group, *Proof Committee Hansard*, 21 February 2012, p. 45. A similar point was made by Mr John Murray, Director, BDO Accountants, *Proof Committee Hansard*, 21 February 2012, p. 47.

82 The comment comes from two professors of accounting, Professor Peter Carey and Professor Neil Fargher, *The Age*, 16 February 2012.

83 Mr Hughes, Fortescue Metals Group, *Proof Committee Hansard*, 21 February 2012, p. 42.

1.120 While Fortescue said they would be depreciating over 'well under 25 years', Treasury is only assuming the industry as a whole is depreciating over 'slightly less than 25 years'.[84]

1.121 Treasury's defence of the starting base was to point out it was in the heads of agreement between the Government and the largest mining companies rather than to defend it in economic theory.[85]

1.122 There also may be anti-competitive aspect to the manner in which the starting base allowance operates. A number of witnesses believe the arrangements will favour large miners at the expense of small:

> …well established mines will not produce the MRRT profits on which MRRT will be paid initially, whereas emerging miners will have MRRT profits on which MRRT tax will be paid.[86]

> …independent financial modelling by the University of WA…shows that small emerging miners will pay a higher effective tax rate than large mature miners.[87]

> [the MRRT] is prejudicial to the junior companies…a mining company who just by nature had an asset before an arbitrary date which means they pay a lower rate of tax because of the shelter they get from those assets. They happen to be the biggest and because they happened to be the ones who were in the room on that day negotiating, they got that provision built in.[88]

1.123 The arguments are 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; allowing them to claim starting base losses based on that capital gain is extraordinarily and unnecessarily generous.*[89]

Recommendation G6

1.124 That the starting base for existing projects be restricted to the depreciated book value of what the companies have actually spent on mining

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84 Mr Rob Heferen, Executive Director (Revenue Group), Department of the Treasury, *Proof Committee Hansard*, 21 February 2012, p. 71.

85 Mr Rob Heferen, Treasury, *Proof Committee Hansard*, 21 February 2012, p. 64.

86 Mr John Murray, Director, BDO Accountants, *Proof Committee Hansard*, 21 February 2012, p. 47.

87 Mr Simon Bennison, Chief Executive Officer, AMEC, *Proof Committee Hansard,* 21 February 2012, p. 55.

88 Mr David Flanagan, Managing Director, Atlas Iron Ltd, *Proof Committee Hansard*, 22 February 2012, pp 8 and 11.

89 Construction, Forestry, Mining & Energy Union, *Submission 16*, p. 12.

infrastructure, rather than including the inflated market value, as this is a more prudent option to avoid the risk of eroding the revenue.

The taxing point

1.125 The MRRT is applied at the 'run of mine stockpile' (colloquially the 'mine gate') rather than the point of sale. 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. This poses a particular challenge for Victorian brown coal, which is predominantly used by vertically integrated electricity generators.

1.126 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.

1.127 One of the mining companies affected said there is a:

> …lot of subjectivity as to how you calculate those…[90]

1.128 The CFMEU submit that:

> 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…[91]

1.129 A similar concern is expressed by the Uniting Church who comment:

> …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.[92]

1.130 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

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90 Mr David Richardson, Chief Financial Officer, Gindalbie Metals, *Proof Committee Hansard*, 21 February 2012, p. 56.

91 Construction, Forestry, Mining & Energy Union, *Submission 16*, p. 9.

92 Uniting Justice Australia, *Submission 28*, p. 5.

> 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.[93]

Refundability of losses

1.131 Under the RSPT losses would be refunded when a project is closed and the loss unable to be transferred to another project. This was a feature of value to smaller miners with single projects that could not transfer losses from one project to another. It never attracted much support from the industry. As most small miners are likely to be excluded from the MRRT due to the threshold anyway, it is hard to see this change – the only change since the RSPT with the potential to increase revenue – having any significant effect.

1.132 To the extent that an uplift rate above the bond rate is justified as being to compensate for the risk that the company never benefits from credits for losses because it never makes a profit, it would be double counting to also refund losses.

Other concerns raised by the mining industry

1.133 Fortescue described the MRRT as 'a tax that is biased against debt financing because it doesn't allow financing costs as a deduction'.[94] But the MRRT also does not allow deductions for the cost of raising equity finance. So it is not biased against debt financing, it is neutral towards it. (By contrast, it can be argued that the company tax regime is biased *towards* debt by allowing interest as a deduction.)

1.134 The producers of magnetite argued that this kind of iron ore should be treated differently to the hematite variety of iron ore. On current forecasts magnetite will make only a modest contribution to MRRT revenue collections. But the aim is to have a regime in place that will be appropriate for the future and if some magnetite projects become more profitable they should be covered. For the Greens, the argument about whether magnetite mining more resembles hematite iron ore mining or nickel mining is moot as the Greens want both iron ore and nickel treated the same way. Exempting magnetite would also be an unhelpful precedent as it would likely lead to claims for similar exemptions for categories of other minerals when they are temporarily less profitable.

Review of the MRRT

1.135 The majority report suggests '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'.[95] Given the doubts that have been raised by the smaller miners and others about

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93 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, p. 10.

94 Fortescue Metals Group Ltd, *Submission 26*, p. 9. See also comments from Mr Tapp, Fortescue Metals Group, *Proof Committee Hansard*, 21 February 2012, pp 40–42 and 44–45.

95 It notes that the Policy Transition Group recommended a review 'within five years'.

whether the MRRT will raise the budgeted revenue, this is too late to start such a review.

Recommendation G7

1.136 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. By this time the first two quarterly instalments will have been paid. The review should involve independent experts as well as Treasury officers. It should also cover the additional revenue that would be raised were more minerals added to the coverage of the MRRT.

Sovereign wealth fund

1.137 The Greens believe that a proportion of the proceeds from the MRRT should be quarantined in a sovereign wealth fund which could invest overseas while the economy is booming and be drawn down after the boom.

1.138 There are two reasons. The first is inter-generational equity. There should be a fund that can be drawn on after the resources are exhausted as a means of sharing the benefits with future generations. The second reason is to address the challenge of the 'two speed' economy. A sovereign wealth fund investing offshore, by providing a partial offset to the purchases of Australian dollars to buy our mineral exports, will partly counteract the appreciation of the Australian dollar which has eroded the international competitiveness of important export industries such as sophisticated manufacturing, tourism and international education.

1.139 The CFMEU submits in favour of at least some of the revenue raised from the MRRT being saved in a sovereign wealth fund:

> …a resource taxation regime that provides for very long term, publicly-owned funds that provide for investment capital and income streams after the mining boom ends…resources rent taxes will inevitably be subject to major fluctuations, so it is important that year-to-year government budgets not be heavily reliant on it.[96]

1.140 Professor Quiggin said:

> …in prosperous economic times we should run substantial surpluses and identify those as a rainy day fund is one I endorse. Sovereign wealth funds, including the Future Fund, have been one approach to that.[97]

1.141 Norway is often cited as a good example:

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96 Construction, Forestry, Mining & Energy Union, *Submission 16*, pp 2, 8.

97 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, p. 5.

> The Norwegians have been particularly successful…They would be really the ideal example of a country that has done a very good job in maximising the returns from its natural resources. Norway is routinely ranked at the top of international living standard comparisons. he result has been the capacity to finance a very wide range of social services while maintaining, certainly by Scandinavian standards, a pretty competitive tax regime for the rest of the economy.[98]

Recommendation G8

1.142 That a sovereign wealth fund to established and a proportion of the revenue raised from the expanded mining tax, envisaged in the above recommendations, be placed in the fund.

Small business tax simplification

1.143 Part of the proceeds from the MRRT is being directed to assist small business. Many small businesses are suffering from the impact of the mining boom on the exchange rate, interest rates and wages while only a relatively small number, concentrated in certain regions, are benefiting from the boom.

1.144 Apart from the company tax cuts (discussed below); there are three measures which will make the tax system simpler for small business:

- the small business instant asset write-off threshold will be increased from $1,000 to $6,500;
- the general and long-life small business pool will be consolidated so that assets can be written off at one rate (15 per cent in the year of allocation and 30 per cent in other years); and
- small businesses purchasing a motor vehicle will be able to write-off up to $5,000 of its value immediately.

1.145 Business groups are unsurprisingly supportive:

> …the proposed accelerated depreciation or instant write-off up to $5,000 and $6,500. We certainly would welcome that, albeit that it is of limited value relative to the size of some of the investment that most of our members make.[99]

> Our small business members are supportive of a proposal in respect of the accelerated depreciation arrangements. They will provide some cash flow

98 Professor John Quiggin, *Proof Committee Hansard*, 22 February 2012, p. 6.

99 Mr John McKillop, Chair of Economics Committee, National Farmers' Federation, *Proof Committee Hansard*, 22 February 2012, p. 48.

> benefit to the small business community at a time when the small business community is very constrained…[100]

1.146 An increase in the instant asset write-off was recommended by the Henry Tax Review, but the recommendation there was for an increase to $10,000. The Review also suggested that the definition of small business be expanded from a turnover of less than $2 million to less than $5 million.[101] There seems less justification for specific concessions favouring motor vehicles over other asset purchases.

Recommendation G9

1.147 That the Government examine whether it would be preferable to extend the small business instant asset write-off threshold from $6 500 to $10 000 instead of the accelerated initial deductions for motor vehicles.

The cut in the company tax rate

1.148 While not part of the package of bills before this inquiry, the Government has said that the MRRT will fund a cut in the company tax rate from 30 to 29 per cent.

1.149 Professor Ergas initially expressed sympathy for a cut in the company tax cut but then warned:

> My first concern is where we are dealing with foreign investment and that taxation on that investment is subject to dual taxation arrangements. In those cases it may be that all that really happens is we lower our company tax rate and taxes payable overseas rise, so there is merely a shift in taxable income, not a net reduction in taxable income.[102]

1.150 Another problem he identified with cutting the company tax rate was:

> …when you have too large a difference between the top marginal, personal income tax rates and company tax rates, that you create undue incentives for income shifting and then add to compliance costs as you try to offset the effect of those incentives.[103]

1.151 Australia's company tax rate is compared with those in some peers in Table G6. The standard rate is not out of line, although some countries apply much lower rates to small business.

100 Mr Peter Anderson, Chief Executive, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 22 February 2012, pp 42–43.

101 *Australia's Future Tax System*, December 2009, recommendations 29 and 30, pp 173–174.

102 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, p. 12.

103 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, p. 12.

Table G6: Company tax rates, %

	Standard rate	Small company rate
Australia	30.0	30.0
Canada	27.6	15.3
France	34.4	15.0
Germany	30.2	30.2
Japan	39.5	24.8
Netherlands	25.0	20.0
New Zealand	28.0	28.0
United Kingdom	26.0	20.0
United States	39.2	20.1

Source: OECD tax database.

1.152 Company tax is budgeted to contribute around $80 billion a year in the coming years so a cut in the rate from 30 to 29 per cent will lower company tax collections by around $2½ billion a year.[104] Large and highly profitable mining companies and banks will be major beneficiaries of the company tax cut. The mining industry accounts for the largest share—around a fifth—of gross operating surplus and is dominated by large companies while the finance industry has the second largest share and is dominated by the big four banks. A study estimated that BHP-Billiton and Rio Tinto may save around $0.6 billion and the big four banks around $0.3 billion in 2013-14.[105]

1.153 By contrast with mining and banking, the industries which are suffering in the two-speed economy, such as tourism, are more characterised by small businesses. Sharing the wealth of the mining boom around would argue for directing reductions in business taxation towards smaller businesses.

Recommendation G10

1.154 That the general company tax cut not be proceeded with, but that consideration be given to providing more benefits for small business.

104 The net cost to revenue will be less as under dividend imputation there will be more personal income tax paid on dividends.

105 Naomi Edwards, 'An analysis of the proposed reduction in company tax rates in Australia', March 2011.

Superannuation

1.155 The MRRT and superannuation bills are related because, due to the concessionary tax treatment of superannuation, there is a cost to the budget of replacing some wage increases by superannuation contributions. This cost is (supposed to be) funded from some of the proceeds of the MRRT.

1.156 The SG increase is budgeted to cost $250 million in 2013-14[106], but as the SG increases over time the cumulative cost up to 2020-21 could reach $17 billion.[107]

Retirement income adequacy

1.157 There is considerable debate about whether a 9, 12 or 15 per cent SG is sufficient to give someone working full-time an 'adequate' retirement income without needing to call on the aged pension. This reflects differences in opinions on what level of income is 'adequate' and assumptions about how many years the typical worker will spend working and the rate of return earned by the superannuation fund.

1.158 The ACTU comment that 'adequate retirement income is widely agreed to comprise between 60 and 65 per cent of gross pre-retirement earnings'.[108] Consistent with this, the Financial Services Council assumes that an 'adequate' retirement income is 62.5 per cent of pre retirement income. On this basis they calculate that a 9 per cent contribution rate is insufficient to generate an adequate retirement income.[109] The situation is worse for women than for men as women are more likely to have time out of the workforce for child-rearing and have longer post retirement life expectancies.

1.159 Industry body ASFA provide the following example:

> For someone on an income of $60,000 a year (a typical wage earner), with SG at 9%, their income in retirement (including part Age Pension) after 35 years of contributions would be around $29,300 per annum (based on retirement savings in today’s dollars of $260,600). With the SG at 12%, their retirement lump sum would be around $350,000 and their retirement income would be $33,500. This can be compared to the ASFA Retirement Standard expenditure needs for a single person of $21,957 for “modest” and $40,412 for “comfortable” as at September 2011. The maximum single Age Pension (including supplements) is $19,470 per year.[110]

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106 Treasurer, 'Documents for Senate Order Relating to the Mineral Resources Rent Tax', 8 February 2012.

107 The Parliamentary Library estimated the cost as $17 billion; Senate Select Committee on the Scrutiny of New Taxes, *The Mining Tax: a Bad Tax out of a Flawed Process*, June 2011, p. 112.

108 Australian Council of Trade Unions, *Submission 9*, p. 13.

109 Financial Services Council, *Submission 1*, p. 1.

110 Association of Superannuation Funds of Australia, *Submission 21*, p. 2.

1.160 Australian Super give an example that increasing the SG from 9 per cent to 12 per cent would result in an additional $90,000 in superannuation accruing over a working life.[111]

Compulsory superannuation

1.161 While libertarians object in principle to the compulsory nature of superannuation,[112] there is broad support for the idea that individuals when young can be myopic and when they reach retirement age may regret not having saved more. There is also an 'externality': those who have adequate retirement savings in superannuation are not drawing on the public age pension and so reduce the load on other taxpayers.

1.162 This is recognised by some business groups:

> The main argument for compulsion is that it protects people from the regret of not having saved enough for their retirement when they were younger. It also protects societies from having to pay for safety-net benefits for those irresponsible individuals who did not provide for their old age.[113]

1.163 The Henry Tax Review did not recommend increasing the SG from 9 to 12 per cent. This was, however, as ASFA point out,[114] in the context of other recommendations that would increase incomes in retirement such as halving the tax on super funds earnings and raising the income tax threshold to $25 000.

1.164 The macroeconomic argument for compulsory superannuation is that (i) Australia as a whole should save more and (ii) that compulsory superannuation is an effective means of doing this. Saving more would allow Australia to invest more without drawing so much on foreign savings, potentially allowing higher economic growth, a smaller current account deficit and lower foreign debt. But it is not obvious that Australia's national saving rate is 'too low'. Australia currently saves more than its peers (although invests much more, hence the large current account deficit). If Australia wants to save more, compulsory super probably achieves this. While there is likely to be a partial offset from less voluntary saving, the best estimates suggest this only offsets less than a third of it. (As high income earners already save a lot regardless of tax concessions, making the superannuation tax concessions less skewed to high income earners would also raise overall saving.)

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111 Australian Super, *Submission 5*, p 2. The example assumes someone working from age 20 to 65, earning $40,000 a year with inflation of 4 per cent and investment return of 7 per cent.

112 For example, John Roskam of the Institute of Public Affairs, 'Slay the Super sacred cow', *Australian Financial Review*, 12 January 2012.

113 Chamber of Commerce and Industry Queensland, *Submission 4*, p. 10.

114 Association of Superannuation Funds of Australia, *Submission 21*, pp 6-7.

Who bears the cost of increasing the SG?

1.165 There has been some confusion about who will bear the cost of the increase in the SG. Some argue the impression has been created that the entire cost will be funded by the government from the proceeds of the mining tax (rather than just the cost to the government of the tax concessions).[115] But this is clearly not the case. Administratively the cost will be paid by the employer and the issue is whether the ultimate incidence of the SG stays with the employer or is passed on to the employee in the form of lower pay rises.

1.166 Most economists believe that the ultimate incidence of the increased guarantee will be on workers (in the form of slower growth in wages) rather than on employers, and this view was confirmed at the hearings:

> The expectation is that it [the SG increase] will be largely borne by wages.[116]
>
> The increase in the super guarantee will ultimately come out of wages.[117]
>
> The increase in SG is affordable. It is over seven years. It will be more than covered by wage negotiations…[118]

1.167 As the SG increases slowly though time, this should still allow real wages to increase. A minority view held by some business groups is that employers will bear the burden.[119] These business groups do not explain why if workers have enough bargaining power to force employers to meet the cost of the increased superannuation over coming years, they cannot use the same bargaining power to get higher wages.

1.168 As the SG increase will be borne by workers rather than employers, there is therefore no reason to think that the SG increase would have an adverse impact on employment.

1.169 A trade union witness at the inquiry opined:

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115 See for example Australian Chamber of Commerce and Industry, *Submission 14*, p. 7 and Business SA, *Submission 8*, p. 1.

116 Mr Paul McBride, General Manager, Personal and Retirement Income Division, Department of the Treasury, *Proof Committee Hansard*, 22 February 2012, p. 74.

117 Mr Peter Davidson, Senior Policy Officer, Australian Council of Social Service, *Proof Committee Hansard*, 22 February 2012, p. 56.

118 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 February 2012, p. 66.

119 Among those expressing this view are Mr Peter Anderson, Chief Executive, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 22 February 2012, p. 44. The Institute of Public Affairs is uncharacteristically more cautious, saying only that the SG 'is likely to flow onto employees in the form of lower wages'; *Submission 12*, p. 27. The National Farmers' Federation said that any increase in labour costs caused by the SG increase would be 'insignificant compared to the skills shortage that we are currently facing'; Mr John McKillop, NFF, *Proof Committee Hansard*, 22 February 2012, p. 48.

> …a figure of 0.25 per cent of an increase in wages is not the sort of number which causes difficulty in terms of workplace wage negotiations. It is more likely to be something like a rounding error than any sort of substantive claim or a matter that there is a disagreement about. Government has given business really longer than it needed to transition this and it should be able to do it very comfortably…it is about half as slow as the last time that we substantially moved the SG component.[120]

1.170 Supporting this view is the experience over the period when the SG was increased from 6 per cent in 1997-98 to 9 per cent in 2002-03. Over this period, wages grew by 33 per cent and profits grew by 41 per cent while employment increased by 10 per cent.

1.171 Further suggesting that the transition to a 12 per cent SG will not be disruptive is the observation that:

> …around 40 per cent of Australian workers already receive more than nine per cent through a function of either workplace bargaining or additional voluntary employer contributions. So there is already a substantial number of people in the economy receiving up to about 12 per cent, or more in some cases. This is about catch-up for the remaining 60 per cent of the workforce.[121]

Impact of expanding superannuation assets

1.172 The SG has helped Australian superannuation funds to accrue almost $1½ trillion in assets, the fourth largest in the world, and bigger than Australia's annual GDP. According to the Financial Services Council, increasing the SG to 12 per cent will add around another $½ trillion to superannuation assets by 2035.[122]

1.173 The Government claims that among advantages from this large pool of funds are that 'when the global financial crisis hit in 2008, our national savings were sandbags against the leakage of capital we saw elsewhere in the world' and implies that the large pool of superannuation assets lowers the cost of capital for Australian companies.[123]

Tax concessions for superannuation

1.174 The Greens regard the increase in the SG as a good time to address inequities in the taxation concessions for superannuation which are actually exacerbating inequalities in society. Tax concessions on superannuation cost around $30 billion

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120 Mr Tim Lyons, Assistant Secretary, Australian Council of Trade Unions, *Proof Committee Hansard*, 22 February 2012, p. 35.

121 Mr Tim Lyons, ACTU, *Proof Committee Hansard*, 22 February 2012, p. 35.

122 In addition to the natural increase that will occur if the SG remains at 9 per cent. Financial Services Council, *Submission 1*, p. 4.

123 Speech by Prime Minister Gillard to Financial Services Council breakfast, 31 August 2011.

each year.[124] In 2008 about half of the tax concessions on superannuation contributions were going to the wealthiest 12 per cent of income earners.[125] The caps on concessional contributions introduced since would have meant the wealthiest receive a smaller proportion of the benefits now. ASFA estimates that the wealthiest 12 per cent now receive 35 per cent of the benefits.[126]

1.175 There are three stages at which superannuation can be taxed; contributions, earnings and payments:[127]

- Currently, superannuation contributions up to $25 000 (or $50 000 for people over 50 years of age) are taxed at a flat rate of 15 per cent, which is a very concessional rate for a high income earner in the 45 per cent tax bracket but no concession for a low income earner in the 15 per cent tax bracket and a penal rate for someone below the income tax threshold.[128]
- Earnings by superannuation funds are taxed at a concessional rate of 15 per cent compared to the company tax rate of 30 per cent.
- Superannuation payments are tax-exempt when paid after the age of sixty, regardless of the income of the recipients.

1.176 A proposal for reform suggested by the ACTU[129] and others[130] is to tax superannuation contributions at the individual's marginal rate minus a fixed margin. The most commonly suggested margin is 15 percentage points. So for a person whose marginal tax rate is 45 per cent, their superannuation will be taxed at 30 pre cent. A person whose marginal tax rate is 15 per cent will not pay tax on their superannuation contributions. This would be consistent with the view of the Henry Tax Review that

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124 Treasury, *Tax Expenditures 2011*, p. 4. The main components are the concessional taxation of employer contributions and superannuation entity earnings. As ACOSS points out, this is about the same as the cost of the age pension; *Submission 18*, p. 7. The concessions are projected to increase to $42 billion by 2014-15.

125 ACOSS, 'A fairer, more efficient tax and social security system', September 2011, and *Submission 18*, p. 9. The latter also remarks that 'the top 20 per cent of income earners receive more in tax concessions over their lifetimes than they would have received if paid the maximum rate of age pension'.

126 Association of Superannuation Funds of Australia, Answers to questions on notice, p. 2.

127 By comparison, someone saving in a bank deposit makes the deposit out of income taxed at their full marginal income tax rate, the bank pays company tax and the interest paid is taxable at their full marginal income tax rate.

128 That is, the concessions are regressive. Mercer argues that including both the aged pension and tax concessions for superannuation, 'the total Government support for retirement incomes…is remarkably consistent across a range of lifetime income levels'; *Submission 13*, p. 2.

129 Australian Council of Trade Unions, *Submission 9*, p. 14.

130 For example, Anglicare in their submission to the Tax Forum.

'superannuation contributions should be taxed at a progressive but concessional rate'.[131]

1.177 The concession should only apply to contributions up to a cap, with contributions beyond this taxed at the marginal rate.

1.178 Taxing superannuation contributions at the individual's marginal rate minus 15 percentage points would increase the concession for low income earners, leave it about the same for average income earners and reduce it for high income earners. As well as being fairer, as high income earners already save a lot regardless of tax concessions, making the superannuation tax concessions less skewed to high income earners would also be more effective in raising overall saving.

1.179 ACOSS propose a different, but in essence similar, means of reaching the goal of a more equitable tax incentive. They suggest that contributions be taxed at the employee's marginal income tax rate but that the government makes a rebate. For low levels (say contributions up to 0.5 per cent of average earnings or around $350 a year) this could be dollar-for-dollar but beyond that it could be at a rate such as 20 per cent and then cut out at a ceiling (say at a contribution of 12 per cent of average earnings or around $8,000 a year).

1.180 ACOSS claim:

> The existing tax breaks are so skewed in favour of high income earners that it would be possible to design the rebate so as to ensure that at least the bottom 80% of superannuation fund members with current contributions were financially better off in retirement, at no cost to public revenue.[132]

Recommendation G11

1.181 That the increase in the superannuation guarantee be accompanied by changes to the taxation concessions for superannuation to remove the regressive elements, such as by replacing the flat 15 per cent tax on superannuation contributions by a tax at the employee's marginal rate less a fixed amount of around 15 percentage points. The best technical approach for doing this should be recommended by the Superannuation Roundtable.

Low Income Superannuation Contribution

1.182 The Government has announced a measure that will reduce but not remove the regressivity of the existing superannuation tax concessions. Under the proposed Low Income Superannuation Contribution, from 2013-14 there will be tax rebates of up to $500 a year for those on incomes up to $37,000 with superannuation

131 *Australia's Future Tax System*, December 2009, p. 100.

132 ACOSS, *Submission 18*, p. 18.

contributions.[133] This will effectively offset the tax they pay on superannuation contributions. The $37,000 threshold and the maximum $500 contribution are not indexed.[134] Furthermore, there is no phase out, so earning increasing income from $36,999 to $37,001 could mean the loss of $500 in rebate.[135] It will have a more immediate impact than the SG increase which is being phased in over time.[136]

1.183 The Government's proposal still means that superannuation contributions from high income earners are treated more generously than those by middle income earners (even if the treatment of middle and low income earners becomes more comparable).

Recommendation G12

1.184 That if the tax concessions for superannuation are reformed as suggested above, the low income superannuation contribution be dropped, but if the current superannuation tax concessions are retained, the low income superannuation contribution proceed.

Concessional contribution cap

1.185 The Government proposes to increase the concessional contributions cap from $25,000 to $50,000 for people under 50 (with less than $500,000 in superannuation assets). ACOSS regards this as:

> …a step in the wrong direction that would mainly benefit high income earners…Treasury estimates that less than 5% of people with incomes below $100,000 a year made over $25,000 in concessional contributions, compared with over half of those on incomes above $300,000 per year. This poorly targeted increase in tax breaks to individuals who are already relatively well-off would cost more than $500 million per year.[137]

1.186 As ACOSS argues:

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133 As well as earning less than $37,000 eligible individuals need to have received more than 10 per cent of income from business or employment. As Mercer, *Submission 13*, p. 6, point out, different definitions of income are used for the two tests, an unnecessary complexity.

134 This is criticised by Mercer, *Submission 13*, p. 5. They give the example that 'once the SG reaches 12%, a Government contribution of $666 would be required to offset the contribution tax on SG contributions for a person earning $37,000 (15% x 12% x $37,000 = $666)'. CPA Australia suggest linking the maximum LISC payment to the upper threshold of the 15 per cent marginal tax bracket; *Submission 17*, p 3. A similar proposal is made by the Australian Institute of Superannuation Trustees, *Submission 22*, p. 14.

135 This is criticised by Mercer, *Submission 13*, p. 6.

136 CPA Australia argue it is therefore a more significant reform in the short term; *Submission 17*, p. 2.

137 Australian Council of Social Service, *Submission 18*, p. 5.

> It is likely that many of those on middle incomes who contribute (or receive in employer contributions) more than $25,000 in a single year are not increasing their savings by doing so. Since this is almost half of an average full-time wage, it is clear that few middle income earners could afford to make such a high level of contributions unless they are transferring existing financial assets into superannuation, 'churning' their wages through superannuation accounts through 'transition to retirement' arrangements, or the contribution is gifted by a family member. In these cases, it is very doubtful that the proposed extension of tax concessions would boost private saving levels.[138]

1.187 By moving away from a uniform contributions cap, the proposal also increases complexity and compliance and administrative costs.[139]

1.188 ACOSS warns that to achieve a fairer system of superannuation tax concessions:

> …the annual cap on concessional contributions would need to be significantly lower than $25,000. In order to increase tax concessions at the bottom end something has to give in a revenue-neutral reform, and in our view it would be the caps…The cap should, however, be high enough to encourage people on around average earnings and below to make modest voluntary contributions to super in order to attain an adequate retirement income.

Recommendation G13

1.189 That the Government reconsider plans to increase the concessional contribution cap and seek the advice of the Superannuation Roundtable on an appropriate level for it.

Senator Bob Brown
Senator for Tasmania

Senator Scott Ludlam
Senator for Western Australia

138 Australian Council of Social Service, *Submission 18*, p. 12.

139 Mr Ian Silk, Chief Executive, Australian Super, and Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, raise this concern; *Proof Committee Hansard*, 22 February 2012, pp 65 and 70.