Executive Summary

Introduction

For a substantial part of Australia's history the mining industry has been a source of national prosperity and national political importance. The Eureka Rebellion of 1854 was a revolt by Victorian miners against the heavy hand of taxation and regulation by colonial authorities. It also contributed to a growing sense of nationalism. To this day, the Eureka flag remains a potent political symbol.

In 2010, the mining industry was again forced to resist the heavy hand of government. This time a central government would ignite resistance to a poorly developed and poorly designed tax which would have dire consequences for the mining industry. Unlike the Eureka rebellion, the events of 2010 would also be about the rights of states and would highlight a growing schism between resource rich states and a distant central government in Canberra.

This report by the Senate Select Committee on the Scrutiny of New Taxes is about the various mining taxes – the Resource Super Profits Tax, the Minerals Resource Rent Tax and the expanded Petroleum Resource Rent Tax – developed by the Labor Government since 2010.

Poor process

After coming to office in 2007, the former Prime Minister, Kevin Rudd, and the Treasurer, Wayne Swan, commissioned a 'root and branch' inquiry into the nation's taxation arrangements – Australia's Future Tax System Review also known as the Henry Tax Review. The Government's response to the Review was to announce a Resources Super Profits Tax (RSPT). Without any meaningful consultation on the proposed RSPT the mining industry, the states and territories and all other stakeholders were taken by surprise.

Following the announcement of the RSPT, the mining industry mobilised a concerted campaign to have the RSPT abolished. The anti-RSPT campaign contributed to the removal of Prime Minister Rudd and the installation of his successor Julia Gillard. The new Prime Minister undertook to negotiate with the mining industry over the RSPT.

However, instead of negotiating with the mining industry, the new Prime Minister and her Treasurer, and now new Deputy Prime Minister, negotiated a new mining tax deal in secret and exclusively with the three biggest mining companies – BHP Billiton, Rio Tinto and Xstrata – in the shadow of what they knew would be a difficult 2010 general election. The secret and exclusive negotiations with the multi-national, multi-commodity and multi-project majors excluded around 320 of their competitors and every state and territory government from that process. The result was the Mineral Resources Rent Tax (MRRT) and expanded Petroleum Resources Rent Tax (PRRT).

The proposed MRRT and expanded PRRT are supposed to start on 1 July 2012. Revenue from the proposed national mining tax has been in the Commonwealth Budget since 2010-11. The revenue from those taxes – now the MRRT and expanded PRRT- which has been assessed by Treasury as reducing over time has been earmarked for a number of related measures, the cost of which will increase over time.

The key assumptions underpinning these taxes remain secret. In contrast to the secret approach of the Commonwealth, the state budgets of Western Australia and Queensland provide details of assumptions underpinning their mining royalties and therefore enabling proper scrutiny of their revenue estimates.

The Government has also refused to publicly release its cost projections for the various measures associated with the national mining tax proposal for the period for which MRRT revenue projections have ultimately been made available (ie to 2020-21). Information about the cost of those various measures to 2020-21 is necessary to properly scrutinise the fiscal impact of the whole national mining tax package. In the absence of relevant information from the government, the committee has made its assessments included in this report based on the best available information and with the assistance of economic experts in the Parliamentary Library.

Substantial secrecy has surrounded the development of the RSPT, the MRRT and the expanded PRRT. The Senate has been denied information only to find it released much later under Freedom of Information. The lack of openness and transparency has impeded the development of these proposed new taxes, and left many wondering what assumptions underpinned these important policy proposals.

The government's failed taxation reform efforts are the direct result of the government's flawed response to the Henry Tax Review. The government failed to consult appropriately with a wide range of stakeholders (including state and territory governments), the government underestimated the complexities of running a resource rent tax and royalty system in parallel, the government sidelined Treasury officials during the negotiations with BHP Billiton, Rio Tinto and Xstrata, the government refused to release key assumptions, the government demonstrated a lack of good faith by presenting much of the details of the tax as a 'fait accompli' and the government's modifications to create the MRRT and expanded PRRT was "policy by deal" rather than policy developed through extensive consultation and detailed consideration. In doing so, the government completely defied its own best practice regulation guidelines with predictable results.

A dagger at the heart of Australia's prosperity

The poorly designed tax has many short comings which are elaborated upon in this report, including that it:

- introduces another new tax on an important industry on top of the existing royalty and income tax arrangements making our tax system more complex and less fair;

- reduces Australia's international competitiveness as an attractive investment destination;
- gives an unfair competitive advantage to the three big multi-national, multi-commodity and multi-project companies who were given the exclusive opportunity by the government to negotiate the design of this new tax with all their competitors and other stakeholders locked out of the process;
- makes federal budget outcomes hostage to decisions by State and Territory governments about their royalty arrangements;
- raises serious and unresolved constitutional issues; and
- links a highly volatile and downward trending revenue stream to a projected increasing cost of related budget measures, which will worsen the Commonwealth Budget's structural deficit over time.

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

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

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

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

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

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

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

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

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

Way forward

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

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

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

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

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

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

This report

Chapter 2 sets out the process of the proposed tax's development. Chapter 2 identifies the main themes that will be examined in the remaining chapters of the report.

Chapter 3 examines the design process of the proposed tax in more detail. It illustrates the deeply flawed policy development processes behind the RSPT, the MRRT and expanded PRRT. It also considers the lack of transparency surrounding the development of these new taxes.

Chapter 4 examines the design of the proposed MRRT and expanded PRRT. Chapter 4 will explore the impact of the proposed taxes and inquire into the concerns that have been raised by stakeholders.

Chapter 5 investigates the broader economic and fiscal policy issues raised by the mining tax, specifically the structural deficit associated with the fiscally irresponsible combination of declining revenue streams and increasing costs of associated budget measures over the medium to long term.

Chapter 6 examines the role of the mining sector in the Australian economy, how the mining tax will impact on relevant states and territories and the implications for federal-state financial relations.

Chapter 7 focuses on the need for genuine tax reform instead of lazy tax grabs and proposes a more appropriate framework for tax policy development.

Recommendations

The recommendations of this report are set out on the following page.