

Chapter 6

The taxation of non-renewable resources and implications for the federation

Introduction

6.1 This chapter provides an overview of the importance of the mining industry to the Australian economy and individual State economies. It considers the implications of the proposed MRRT and expanded PRRT for federal-state financial relations, in particular royalty and GST sharing arrangements.

6.2 Importantly, this chapter highlights the practical ramifications of the Commonwealth's tax raid on the own-source revenue base of the states and territories and the implications of undermining the sovereignty of the states and territories in their capacity to raise revenue.

The mining industry in Australia

6.3 According to the Association of Mining and Exploration Companies (AMEC), the general structure of the resources industry is similar in Australia to that found around the world.¹ Australia has about 2,500 companies comprising an industry structure with a few conglomerates dominating the overall market, followed by a small number of mid-tier and emerging firms with the major portion of the industry comprising 'juniors' engaged in exploration.²

6.4 These 2500 companies employ around 160,000 persons with a further 500,000 engaged in indirect employment in the services industry associated with the resources sector.³ While the economic contribution of the mining sector is discussed below, it should be noted that it also contributes to rural and regional communities, through infrastructure partnerships with government as well as indigenous employment and Aboriginal cultural heritage protection.⁴

6.5 Australia's economic growth has been due, in part, to the strength and success of the mining industry. With today's high commodity prices, Australia's minerals

1 Association of Mining and Exploration Companies – Submission to the Policy Transition Group: *The proposed minerals resources rent tax and the exploration development options*, (Note, submission provided to the Senate Select Committee on new Taxes: Mining Tax Inquiry) p.8.

2 Association of Mining and Exploration Companies, *Submission*, p.8.

3 Association of Mining and Exploration Companies, *Submission*, p.9.

4 Association of Mining and Exploration Companies, *Submission*, p.9.

sector accounts for 8 per cent⁵ of gross domestic product (GDP) compared to a longer term average of around 5 per cent.⁶ Being very capital-intensive, the sector employs only 1.7 per cent of Australia's workforce.⁷ Australia is ranked in the top five producers of key mineral commodities including bauxite, alumina, uranium, lead, zinc, lithium, iron ore, manganese, nickel, black coal, aluminium, brown coal and copper.⁸

The mining industry and royalties

6.6 While the Report has focussed on the RSPT, MRRT and expanded PRRT, it is important to understand the royalty arrangements across Australia.

6.7 Royalties are levied to ensure that state and territory governments, representing the people of the states and as owners of the minerals, are compensated for the extraction of their natural resources. Within the Australian federation, royalties are levied at the state and territory level and the revenue generated is retained by those governments. The structure and type of royalties differs dramatically across state⁹ jurisdictions although they generally fall within one of three general royalty categories:

- unit based;
- value based (ad valorem); or
- profit/income-based.¹⁰

'Specific' or 'unit based' royalties

6.8 Specific/unit based royalties are levied on a fee per unit of volume (per cubic metre) or weight (per tonne) and are generally applied to minerals that are homogenous (for example, sand or gravel), or sold in bulk (for example, coal, iron ore, salt etc).¹¹ Unit based royalties are the oldest form of royalty assessment. They

5 Average calculated using statistics for 2006-07 to 2009-10 sourced from ABS:
[http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/\\$File/52040_2009-10.pdf](http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/$File/52040_2009-10.pdf), (accessed 1 November 2010).

6 Average calculated using statistics for 2001-02 to 2005-06 sourced from ABS:
[http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/\\$File/52040_2009-10.pdf](http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/$File/52040_2009-10.pdf), (accessed 1 November 2010).

7 Australian Bureau of Statistics, 6291.0.55.003 - *Labour Force, Australia, Detailed, Quarterly*, Aug 2010.

8 Minerals Council of Australia, *Fact Sheet: The Australian Minerals Industry and the Australian Economy*, November 2008, p. 1,
http://www.minerals.org.au/_data/assets/pdf_file/0017/32804/Aus_min_industry_fact_sheet_Nov_2008_v5.pdf, (accessed 1 November 2010).

9 Note: A reference to state includes a reference to territories.

10 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 55.

11 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 50.

are simple to administer as assessments of price, value and cost do not need to be made and they are payable regardless of the profitability of a mine.¹²

'Value-based' or 'ad valorem' royalties

6.9 Value-based or Ad-valorem royalties are payable regardless of a mine's profitability but, as they are based on the value of the commodity being mined, will fluctuate with international commodity prices.¹³ The method of calculating value can become complicated and may be defined differently in different jurisdictions.

Profit-based royalties

6.10 Profit-based royalties are based on the profitability of an operation. Unlike specific and ad-valorem regimes however, during the early years of a mining operation when establishment costs far exceed any income, minimal or no royalties will be collected. This has resulted in some public criticism on the basis that the minerals are being extracted yet no compensation is being paid.¹⁴

Australia's royalty regimes

6.11 In Australia, the ownership of minerals is determined by property law and the various State and Territory Acts. Royalties are levied differently in all states and on different bases on different minerals within the states. Generally, however, ad valorem or specific royalties apply. The exception is the Northern Territory which uses a profit-based regime.¹⁵ The role of the states and territories to apply and change royalties is a function of Australian federalism and the corresponding allocation of taxation powers between the Commonwealth government and the states and territories.

6.12 It is important to note however that royalty regimes differ for states and territories in this important respect: territories are delegated legislative power from the Commonwealth Parliament and do not enjoy the autonomy and protection granted to the states by the Constitution. Consequently, the Commonwealth enjoys legislative freedom to act with respect to the territories which it does not enjoy when dealing with the states.

6.13 Table 6.1 provides an overview of the existing royalty regimes throughout Australia. Table 6.1 highlights a selected number of key commodities and their associated royalty arrangements.

12 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, pp 50-51.

13 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 52.

14 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 64.

15 Parliamentary Library, *Briefing Note-Mining Royalty Regimes in Australia*, 2010, p. 1.

6.14 It is important to note that resource royalties are only one aspect of a country's tax regime. Therefore, in determining resource royalty regimes the cumulative effect of all taxes needs to be considered as investors will be concerned with the effective tax rate and whether or not royalties are tied to profitability.¹⁶

Table 6.1 - Royalty Regimes in Australia, 2009¹⁷

Mineral	State	Royalty Rate	Basis of Calculation	Last review/change
Coal	QLD	7% where the value of the coal produced does not exceed \$100/tonne	Ad valorem	2008 – <i>Mines and Energy Legislation Amendment Regulation (No 2) 2008</i>
		10% on the value of the coal exceeding \$100/tonne		
	NSW	Open cut mining 8.2%	Ad valorem	2008 – <i>State Revenue and Other Legislation Amendment (Budget Measures) Act 2008</i>
		Underground mining 7.2%		
		Deep underground mining 6.2%		
	VIC	Brown Coal	Ad valorem with quantum rate for brown coal	2006 – <i>Mineral Resources Development (Amendment) Regulations 2006</i>
		\$0.0588 per GJ, adjusted in accordance with the consumer price index		
		Other than Brown Coal 2.75%		
	WA	If exported 7.5%	Ad valorem and quantum rate	2000 – <i>Mining Amendment Regulations (No. 4) 2000</i>
		If not exported		
\$1/tonne (adjusted each year at 30 June in accordance with comparative price increases)				
SA	3.50%	Ad valorem	2005 – <i>Mining (Royalty No 2) Amendment Act 2005</i>	
Iron Ore	QLD			2.70%
		\$100,000 threshold	Ad valorem	2005 – <i>Mining (Royalty No 2) Amendment Act 2005</i>

16 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 32.

17 Source: Craig Bowie, Special Counsel, MinterEllison Lawyers, 8 April 2009, pp 1-5, <http://www.minterellison.com/public/connect/Internet/Home/Legal+Insights/Newsletters/Previous+Newsletters/A-ERU3+mining+royalties+overview>, viewed 27 October 2010 and Western Australian Budget 2011-12, Economic and Fiscal Outlook, Budget paper No.3, pp.90 – 91.

		Discount of 20% if processed in Qld and metal content is at least 95%	Ad valorem	2008 – <i>Mines and Energy Legislation Amendment Regulation (No 2) 2008</i>	
	NSW	4%			
	VIC	2.75%			
	WA	Beneficiated Ore 5%		Ad valorem	No change since the introduction of the <i>Mining Regulation 2003</i>
		Fine Ore 5.625%		Ad valorem	Recent announced change, royalty concession on iron ore 'fines' to be phased out with royalties to rise to 6.5% from 1 July 2012 and to 7.5% from 1 July 2013.
		Lump Ore 7.5%		Ad valorem	No recent change
SA	3.50%				

The importance of royalty revenue

6.15 Data published by the Commonwealth Grants Commission illustrates the comparative importance of mining revenue to Australia's state and territory governments. This is not surprising given many of Australia's mineral resources are concentrated in the north of Western Australia and Queensland.¹⁸ As set out in Table 6.2, in both absolute and per capita terms, mining is of most importance in the states of Western Australia and Queensland. While smaller in its national importance, mining is also important to the Northern Territory government.

Table 6.2: State governments' revenue from mining 2008-09¹⁹

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Mining revenue (\$m)	1278	46	3364	3184	152	32	0	227	8286
Mining revenue (\$ per capita)	181	8	773	1444	94	63	0	1026	382
Proportion of State revenue (%)	5.2	0.2	16.7	29.3	2.4	1.9	0	21.6	9.5

18 Department of the Treasury, *Budget Paper 1: Statement 4 – Benefitting from our mineral resources: opportunities, challenges and policy settings*, 2010, p. 4.17.

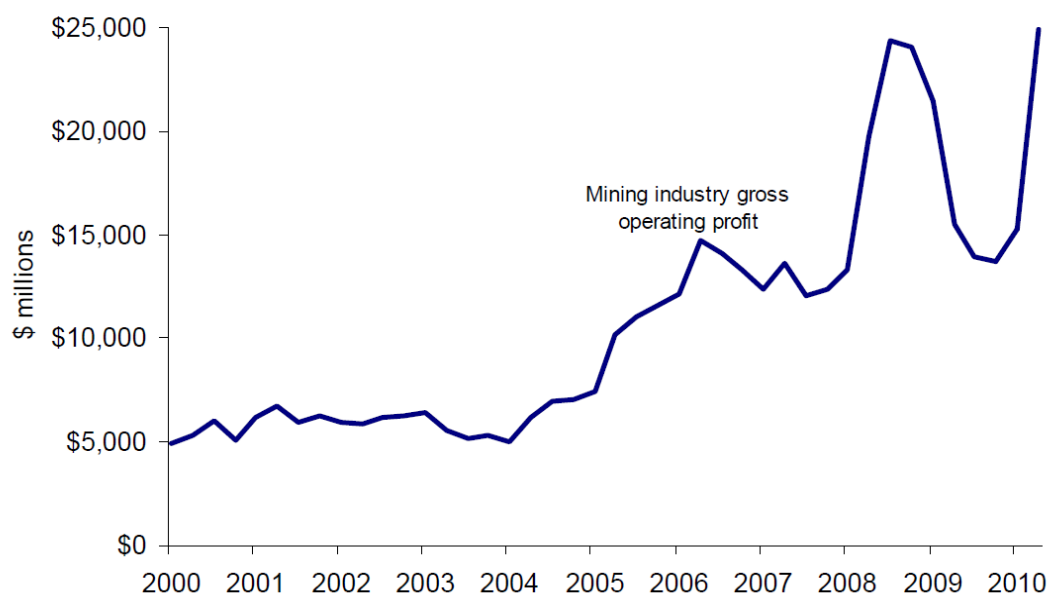
19 Source: Adapted from information published by the Commonwealth Grants Commission. Mining revenue includes mining royalties and exploration permit fees.

6.16 The Commonwealth Grants Commission recently noted that:

...mining revenue has grown substantially as a proportion of State revenue from 5.2 per cent in 2005-06 to 9.5 per cent in 2008-09. It grew in all States, but most particularly in Queensland and Western Australia due to increased coal and iron ore royalties.²⁰

6.17 The large growth in profits in the mining sector this decade (Chart 6.1) has been the result of strong demand from China and India. Forecasts suggest that these economies will experience sustained growth over the long term thereby ensuring demand for these commodities remains high.²¹ Demand for Australia's resources has generated the best terms of trade in 140 years.

Chart 6.1: Mining industry gross operating profit 2000-2010 (current prices)²²



6.18 Although rapid growth in profits has been experienced over the recent boom years, it has been argued by the government that receipts from the application of the existing taxation arrangements have not experienced the same rate of growth. In its report to the Treasurer, the Henry Tax Review contrasted recent strong growth in profits and the corresponding tax take. The Henry Tax Review report detailed that the existing taxation arrangements governing Australia's resource sector are inefficient as

20 Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities—2010 Review*, Chapter 8: Mining Revenue, 2010, p. 129.

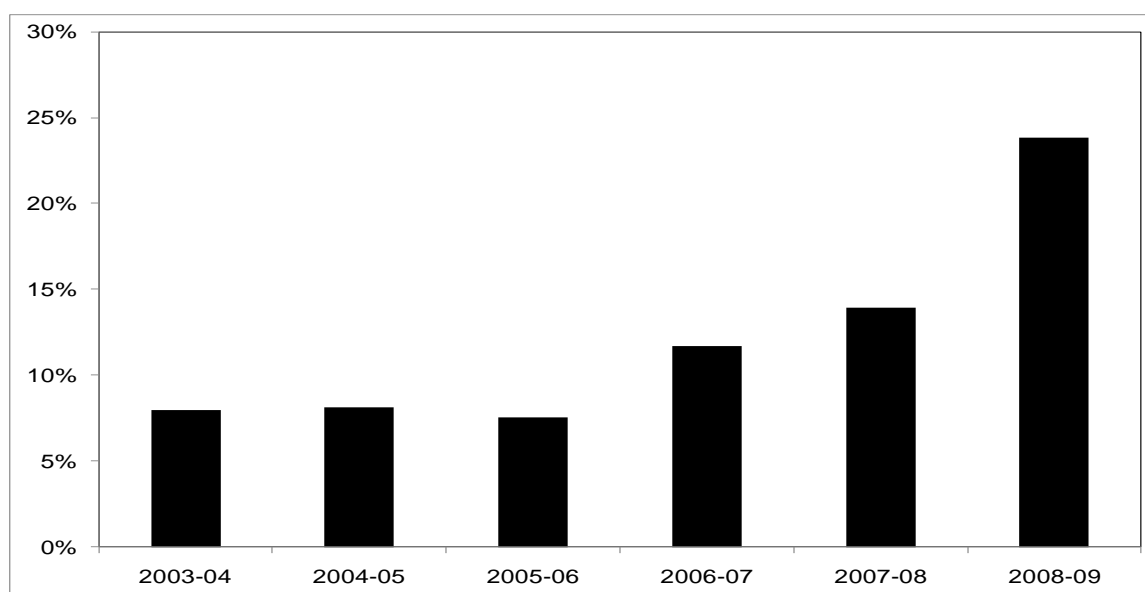
21 Department of the Treasury, *Budget Paper 1: Statement 4 – Benefitting from our mineral resources: opportunities, challenges and policy settings*, 2010, pp. 4-5.

22 Source: Australian Council of Trade Unions, *Submission 9*, p 6.

the returns they generate are not responsive to changes in profit and distort investment and production decisions.²³

6.19 However, Australian Taxation Office data suggests that the mining sector's share of total company tax revenues has risen rapidly since 2003-04:

Chart 6.2: Mining sector share of total company tax revenue, 2003-04 to 2008-09²⁴



6.20 A more complete snapshot of the various taxes raised from the mining sector is given in Table 6.3.

Table 6.3: Taxes and royalties paid by the mining industry, \$ billion, 2007-08²⁵

Taxes and royalties	Amount (\$ bn)
Company tax	8.1
Royalties	4.6
Petroleum Resources Rent Tax	1.9
GST (net refunds)	-3.8
Fringe Benefits Tax	0.2
Income tax (PAYG)	4.4

23 *Australia's Future Tax System Review, Report to the Treasurer*, December 2009, Part Two, p. 217.

24 Source: Australian Tax Office, *Taxation Statistics*, Table 8: Company Tax.

25 Source: Treasury, Answer to 2010 Budget estimates question on notice BET 1.

6.21 Australia's ability to share the long-term profits from its resources sector among the community relies on reforming the taxation arrangements that apply to the extraction of these finite mineral deposits. Table 6.4 identifies the expected life of mineral deposits in Australia.

Table 6.4: Mineral resource exports, indicative resource life and ranking²⁶

Mineral resources	Exports 2008-09(\$m)	Export shares(%)	Indicative life years at 2008(a)	World ranking at 2008(b)
Black coal	54,698	33.9	90	6
Iron and steel	35,602	22.0	70	3
Gold	16,146	10.0	30	2
Aluminium	10,932	6.8	85	2
LNG (Gas)	10,086	6.2	60	14
Crude oil and condensate	8,755	5.4	10	(c)
Copper	5,863	3.6	85	2
Nickel	2,656	1.6	130	1
Zinc	1,858	1.2	35	1
Manganese	1,406	0.9	20	4
Uranium	990	0.6	125	1
Others	12,538	7.8		
Total mineral resource exports	161,532	100.0		

- a. Indicative life for a commodity is calculated as the stock of the accessible economic demonstrated resource (EDR) relative to annual production for that commodity or the relevant raw commodity.
- b. The world ranking is based on the EDR in Australia compared to that in other countries.
- c. The ranking is not available. Australia's reserves of crude oil and condensate accounted for 0.6 per cent of the world total in 2008.

Note: The data for crude oil and condensate and for LNG (Gas) are based on economic demonstrated resources, which for these two commodities is equivalent to accessible economic demonstrated resources.

6.22 As previously discussed, the Henry Tax Review recommended that the current state based resource royalties should be replaced with a project-based uniform resource rent tax, imposed and administered by the federal government and set at 40 per cent.²⁷ The review also recommended that the Government negotiate an agreement with the states as to an appropriate inter-governmental allocation of the revenues and

26 Source: ABARE, Geoscience Australia and Treasury.

27 *Australia's Future Tax System Review, Report to the Treasurer*, December 2009, Part One, p. xxi.

risks from the tax.²⁸ As outlined in this report, the MRRT and expanded PRRT do not have much in common with the Henry Tax Review recommendation.

6.23 For most industry participants, the proposed MRRT is more complex and less fair than the status quo and it was of course negotiated exclusively and in secret and came out of a deeply flawed process.

6.24 At the time of writing this report, still no inter-governmental agreement has been signed with the states and territories to give effect to the MRRT Heads of Agreement. In fact the government has not even started engaging with the states and territories about the implications of the proposed MRRT and expanded PRRT for them. There has been a complete failure to consult and negotiate with the states and territories in relation to an important State and Territory revenue base. In addition, the Heads of Agreement between the Australian Government and the big three mining companies of BHP Billiton, Rio Tinto and Xstrata appears to be ambiguous with respect to the interaction between state royalties, the MRRT and the RSPT:

CHAIR—Dr Henry, I had a close look through your review document again. Chapter 6, ‘Land and resource taxes’, under 6.1, ‘Charging for non-renewable resources’, talks about how current charging arrangements distort investment and production decisions, thereby lowering the community’s return from its resource—hence your recommendation. It is fair to say that your recommendation was for the national resource rent tax to replace state royalties completely. That is right, isn’t it?

Dr Henry—Yes, that is correct.

CHAIR—And under the RSPT the distorting effects of royalties were effectively removed because they were completely refunded—is that right?

Dr Henry—That is correct.

CHAIR—But under the MRRT they are not, are they?

Dr Henry—No, clearly they are not.

CHAIR—So the distorting elements of state royalties, to the extent that they exist, have not been removed, have they?

Dr Henry—To the extent that there is not a full credit provided for those royalties under the MRRT, the royalties would be impacting on investment decisions.

CHAIR—Would be impacting on investment decisions?

Dr Henry—I would expect so, yes.

CHAIR—And, potentially, production decisions too, wouldn’t they?

Dr Henry—Indeed.

28 *Australia's Future Tax System Review, Report to the Treasurer, December 2009, Part Two, p. 217.*

CHAIR—Smaller projects that are not yet subject to the MRRT would continue to pay royalties?

Dr Henry—That is correct.²⁹

6.25 In these circumstances, a key objective of the Resource Rent Tax has not been realised through the MRRT and expanded PRRT putting smaller mining companies into the worse position of all.

6.26 The states and territories were not consulted before the announcement of the MRRT. The implications of the MRRT Heads of Agreement for states and territories in terms of their capacity to make decisions about their own source revenue arrangements continue to be unresolved.

Mining, royalties and the federation

6.27 No state or territory is likely to agree to abolish its royalty arrangements. When asked during the Senate Fuel and Energy Committee inquiry whether any Western Australian government was likely to ever agree to the abolition of royalties, The Western Australia Department of Treasury and Finance Acting Under-Treasurer Mr Barnes, said:

CHAIR—Thank you very much, Mr Barnes. Is there any prospect that Western Australia would give up imposing royalties on the extraction of its resources?

Mr Barnes—I am speaking on behalf of the Department of Treasury and Finance and my strong view is that, under this government or under any future WA government, that would be an extremely remote prospect.³⁰

6.28 Mr Barnes, continued:

Turning next to the issue of the state's autonomy over mining and petroleum royalties, we view the Commonwealth's proposed mining tax regime as an unwelcome intrusion into an area of state government responsibility, undermining the state's autonomy and budget flexibility. While the proposed MRRT and expanded PRRT are currently envisaged to operate along-side state royalties, with a tax credit available for state royalty payments, we are concerned that overtime there is a significant risk that states will effectively be crowded out of this revenue base, at least in respect of iron ore, coal and petroleum. The intentions of the Henry review committee were quite clear in this regard. Industry is also likely to bring pressure to bear on states to abolish their royalties so that companies need comply with only one regime, rather than two. Such an outcome would increase WA's reliance on Commonwealth grants and exacerbate the

29 Senator Mathias Cormann, Chair, Senate Select Committee on New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, Monday 22 November 2010, p. 8.

30 Senator Mathias Cormann, Chair, Senate Select Committee on Fuel and Energy and Mr Michael Barnes, Acting Under Treasurer, Department of Treasury and Finance, Western Australia, *Fuel and Energy Committee Hansard*, 13 July 2010, p.3

already high vertical fiscal imbalance between the Commonwealth and the states. A related issue is the extent to which the Commonwealth government will seek to cap the royalties that are creditable against liabilities under the MRRT and expanded PRRT. In our view, it is essential that states have full flexibility to alter their royalty regimes as appropriate to their specific circumstances.³¹

Gillard Government version of the mining tax: A tax on Western Australia

6.29 Since the announcement of the Gillard Government's mining tax deal, various Senate Committees and the Senate itself sought access, again and again, to information about where the mining tax revenue was expected to come from. How much from Western Australia, how much from Queensland and how much from other States? For more than nine months the government refused to release any information in response to those requests. The government completely ignored them and continued to keep the information secret. This is even though David Parker, then the Executive Director the Department of the Treasury's Revenue Group, had given evidence to the Senate Fuel and Energy Committee back in July 2010 that it would not be a difficult piece of analysis to perform. Eventually some information was released by the Treasury under Freedom of Information.³² Namely, Treasury released its MRRT model including revenue projections over a decade, which were broken down into revenue from coal and iron ore production.

6.30 That information which had been kept secret up until then finally revealed officially that the proposed MRRT is in fact a massive tax on Western Australia.

6.31 The table below provides the relevant breakdown of the mining tax revenue drawn from the Treasury's MRRT modelling conducted back at the time of the mining tax deal:

31 Mr Michael Barnes, Acting Under Treasurer, Department of Treasury and Finance, Western Australia, *Fuel and Energy Committee Hansard*, 13 July 2010, p. 3.

32 Department of the Treasury, Freedom of Information release: <http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962> (accessed 20 June 2011)

Table 6.5: Revenue breakdown from the MRRT³³

Year	Total MRRT	MRRT on Iron Ore/WA	Per cent
2012/13	\$4bn	\$3.5bn	87.50%
2013/14	\$6.5bn	\$5bn	76.90%
2014/15	\$6.5bn	\$4.5bn	69.20%
2015/16	\$5.5bn	\$3.5bn	63.60%
2016/17	\$4bn	\$2bn	50%
2017/18	\$3bn	\$1.5bn	50%
2018/19	\$3bn	\$1.5bn	50%
2019/20	\$3bn	\$1.5bn	50%
2020/21	\$3bn	\$2bn	66.60%
Total	\$38.5bn	\$25bn	64.93%

6.32 This table demonstrates that at the time the Gillard Government entered into the mining tax deal it expected that more than 80 per cent of its MRRT revenue would come from iron ore production in Western Australia over the then forward estimates.

6.33 Over the period 2012/12 to 2020/21 nearly 65 per cent or \$25 billion out of the total projected MRRT revenue of \$38.5 billion is expected to come from iron ore production in Western Australia. The expectation then was that the about 35 per cent or \$13.5 billion of the remaining MRRT revenue would come from coal production.

6.34 The reason we can legitimately reach these conclusions is because revenue from iron ore production is a reasonable proxy for revenue from Western Australia. That is because 98 per cent of iron ore production in Australia takes place in Western Australia. Ninety-nine per cent of iron ore royalties nationally are raised in Western Australia. Then Treasury Secretary Ken Henry agreed:

Senator CORMANN ... It is fair to say that the iron ore share of the MRRT revenue is a proxy for the Western Australian share of the MRRT revenue, is it not?

Dr Henry—That is probably a reasonable proxy, I would think.³⁴

33 Department of the Treasury, Freedom of Information release:
<http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962> (accessed 20 June 2011)

6.35 No wonder the Gillard government did not want the people in Western Australia to know before the last election.

6.36 The committee considers that it is surely completely unreasonable, inappropriate and discriminatory for a single new national tax to target one specific State economy like this.

Horizontal fiscal equalisation

6.37 The fact that royalties are raised by individual states does not, of course, mean that only the residents of those states benefit from the mining boom. Income gains from higher commodity prices accrue to households through their shareholdings in mining companies (directly, or indirectly through superannuation funds) and where revenues would otherwise:

...accrue disproportionately to particular State governments, fiscal equalisation arrangements allocate those gains among all States and Territory governments [and] [t]he tax-transfer system in Australia further acts to spread the gains, as does the reallocation of resources within the economy.³⁵

6.38 The tax-transfer system referred to above, relates to the way in which the Commonwealth and the states and territories share revenue. One mechanism through which this is done is via the Commonwealth Grants Commission (CGC) processes of horizontal fiscal equalisation (HFE).

6.39 The CGC recommends how the revenues raised from the (GST) should be distributed to the states and territories to achieve this goal. It is an independent statutory body which responds to requests sent to it by the Commonwealth Treasurer. It makes its recommendations in consultation with the States and Territories and based on data provided by them and independent statistical sources.³⁶

6.40 Horizontal fiscal equalisation is:

...a process whereby the Commonwealth distributes money amongst the states so that they all end up with the same fiscal capacity, so that if they all made the same effort to raise revenue from their own sources, they would be able to provide a comparable level of services to their residents.³⁷

34 Senator Mathias Cormann, Chair and Dr Ken Henry, Secretary, Department of the Treasury, Committee Hansard, *Economics Committee Estimates*, 24 February 2001, p. 25.

35 Department of the Treasury, *Budget Paper 1: Statement 4 – Benefitting from our mineral resources: opportunities, challenges and policy settings*, 2010, p. 17.

36 <http://www.cgc.gov.au/> (accessed on 28 April 2011)

37 Mr John Spasojevic, Secretary, Commonwealth Grants Commission, *Committee Hansard*, 21 October 2010, p. 117.

6.41 Over recent years the application of HFE has seen the GST revenue allocation for both Western Australia and Queensland reduce.³⁸ The Grants Commission explains that the boom in the mining sector in these states raised the states' own revenue raising capacity due to the consequential impact on housing and jobs and therefore growth in stamp duties and payroll taxes.³⁹

CHAIR—Let me go back to your 2010 methodology review, where on page 13 you say that Western Australia has the highest assessed fiscal capacity due to its very high revenue raising capacity. What are the main factors that cause this highest assessed fiscal capacity?

Mr Spasojevic—They have got a lot of iron ore.

CHAIR—So it is fair to say that state government tax revenues from mining states like Western Australia and Queensland through your processes are then shared with other states.

Mr Spasojevic—They are.

CHAIR—Through the processes of horizontal fiscal equalisation.

Mr Spasojevic—Correct; the revenue that they collect from royalties are redistributed, effectively, by the GST.... If I imagine I have one state which has a very high value of mining production and one which has a very low in per capita terms, they would have an unequal capacity to raise revenue from mining royalties. That unequal capacity to raise revenue from mining royalties then would feed through, other things being equal, into requiring less per capita in the GST in the state which has an above-average capacity to raise mining royalties. So there is a balancing process.⁴⁰

6.42 The HFE process is contentious. Its relationship with State and Territory royalty regimes will depend on a wide range of factors.

6.43 According to the Commonwealth Grants Commission, following negotiations between the Western Australian Government and BHP Billiton and Rio Tinto, there was agreement to apply a higher royalty rate of 5.625 per cent to part of iron ore fines production, affecting about half of the total iron ore fines production in Western Australia. This increase aligned the royalty rate to that applying to other miners of iron ore fines in the State. Western Australia estimated this change would raise an additional \$340 million in royalties in 2010-11.

38 Commonwealth Grants Commission, *Report on State Revenue Sharing Relativities 2009 Update*, 2009.

39 Commonwealth Grants Commission, *Report on State Revenue Sharing Relativities 2009 Update*, 2009.

40 Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of new Taxes, and Mr John Spasojevic, Secretary, Commonwealth Grants Commission, *Committee Hansard*, 9 December 2010, p. 1-2.

6.44 The majority of States said the 2010 Review assessment method grouped minerals according to whether their prevailing royalty rate was above or below 5 per cent. On that basis, iron ore fines should now be treated as a high royalty mineral. As the 2011 assessment grew closer Western Australia was concerned about the impact on it.

6.45 On 18 March 2010, the Western Australian Treasurer, the Hon Troy Buswell MLA, wrote to the Treasurer expressing the Western Australian government's concern about the operation of the Commonwealth Grants process and its application to decisions by the Western Australian government to increase its royalties:

Also underpinning this request for a relativity floor is the need to address the distortionary impact on government policy making of the Grants Commission's method of assessing mining royalties. In this regard, the Commission's recommendations included a last minute change away from an energy/non energy categorisation (similar to that reported by the ABS) to a high royalty / low royalty rate split, with lump iron ore being included with fuel minerals in the high rate group.⁴¹

6.46 On 11 May 2010, the matter was pursued further in a letter from Western Australia Under-Treasurer, Timothy Marney, to the his counterpart, Dr Ken Henry:

I also seek your assurance that the Commonwealth will guarantee that there will be no change to the Grants Commission's classification of "high" vs "low" royalty rate minerals as a consequences of the changes in royalty rates proposed by Western Australia (and other States), pending the next full review of the Grants Commission's methods.

In this regard you may recall that an unintended consequence of the Grants Commission's late decision in its 2010 Review to base its assessment of mining royalty capacity on a high/low rate classification is that an increase in Western Australia's royalty rates on fine iron ore could lead to fine ore being reclassified as a high royalty rate mineral, reducing our GST by more than the additional royalty revenue we would collect.⁴²

41 The Hon Troy Buswell MLA, Treasurer, Facsimile, 18 March 2010. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

42 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer, 11 May 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

6.47 Again, on 16 November 2010, in a letter from Western Australia Under-Treasurer, Timothy Marney, to the his counterpart, Dr Ken Henry:

A change to the classification of iron ore fines would lead to a reduction in our GST of around three times the additional royalty revenue we would collect from removing the royalty rate concession on these fines. As we expect around \$300 million per annum from this measure, our GST share could fall by nearly \$1 billion. This would be an untenable outcome both in terms of the policy neutrality and equity of the GST distribution process.⁴³

6.48 While Western Australia was making its case, the Queensland Treasurer wrote to the Chair of the Commonwealth Grants Commission and copied the letter to the Treasurer, with support for Western Australia's position. The Queensland Treasurer's letter of 9 February 2011, states that:

Individual policies of states directly impact on their GST shares and there are clear incentives for states to alter their mining royalty regimes to maximise their GST. For example, when Western Australia removes some concessions for iron ore fines, they will lose far more GST from this policy change than is gained in mining revenue under the current methodology.⁴⁴

6.49 On the 15 February 2001, the Treasurer wrote to the Grants Commission with terms of reference for its conduct of its distribution of GST revenue amongst the states in 2011-12. The Treasurer specifically instructed the Grants Commission to:

The Commission should ensure that, with regard to the removal of iron ore fines royalty rate concessions in 2010, the classification or iron ore fine should not move between mineral royalty rate groups in between methodology reviews.⁴⁵

43 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer, 16 November 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

44 Letter, Queensland Treasurer copied to the Treasurer, 9 February 2011, p.2. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

45 Letter, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP to the Commonwealth Grants Commission (Mr Alan Henderson – Chairperson), http://www.cgc.gov.au/publications2/publications/latest_reports/2011_update/2011Update/contents/preliminaries (accessed on 23 May 2011)

6.50 As a consequence of the pressure applied to the Treasurer, the decision of the Grants Commission was:

As noted above, the terms of reference direct the Commission not to change the treatment of iron ore fines because of the removal of royalty concessions in 2010 before the next methodology review.⁴⁶

6.51 Western Australia was not penalised under the Grants process through the distribution of GST revenues.

6.52 The nature and extent of vertical fiscal imbalance has been a characteristic of the Australian federation for decades, but primarily since uniform income taxation was applied during the 1940s. The monopolisation of income and company tax by the Commonwealth has been exacerbated by the best terms of trade for 140 years, as the Commonwealth has enjoyed substantial increases and windfall corporate tax collections.

6.53 As part of the 2011-12 distribution of the Goods and Services Tax revenue, the Treasurer wrote to the Commonwealth Grants Commission to provide them with their terms of reference for the allocation. On 15 February 2011, the Treasurer wrote and expressly asked that:

11. The Commission should ensure that, with regard to the removal of iron ore fine royalty concessions for 2010, the classification of iron ore fines should not move between mineral royalty rate groups in between methodology reviews.

12. The Commission should also ensure that those payments which it has previously been directed to treat so that they had no direct influence on the relativities continue to be treated in that way. Where those payments are replaced, the treatment of the new payment should be guided by paragraphs 7 and 8 above, unless otherwise directed.⁴⁷

6.54 As outlined above, the Commonwealth Government established that the states and territories would have some latitude in setting their royalties. It is important to note that the Treasurer's letter to the Commonwealth Grant's Commission occurred after the Heads of Agreement was signed.

6.55 While the Treasurer had instructed the Commonwealth Grants Commission to undertake the upcoming 2011 GST Review with a particular approach, the Government had further moves in mind, as outlined below.

46 Commonwealth Grants Commission, *Report on GST revenue sharing relativities - 2011 Update*, p. 43.

47 Letter, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP to the Commonwealth Grants Commission (Mr Alan Henderson – Chairperson), http://www.cgc.gov.au/publications2/publications/latest_reports/2011_update/2011Update/contents/preliminaries (accessed on 23 May 2011)

Reforming the Commonwealth Grants Commission framework

6.56 As outlined above the impact of a surge in mining activity has had an impact for the financial relationships in the federation. During a visit to Perth on 30 March 2011, the Prime Minister and Deputy Prime Minister announced a review of the distribution of revenue from the Goods and Services Tax to the states and territories.

6.57 The Review is to be conducted by former New South Wales Premier, Mr Nick Greiner, former Victoria Premier, Mr John Brumby and Mr Bruce Carter. The purpose of the review is to improve the existing horizontal fiscal equalisation process.

6.58 The Review has the difficult task of addressing the issue of where the:

...States [are] facing penalties for economic growth and rewards for economic underperformance, the GST distribution process should encourage economic reform and better delivery of services, and provide States with certainty.⁴⁸

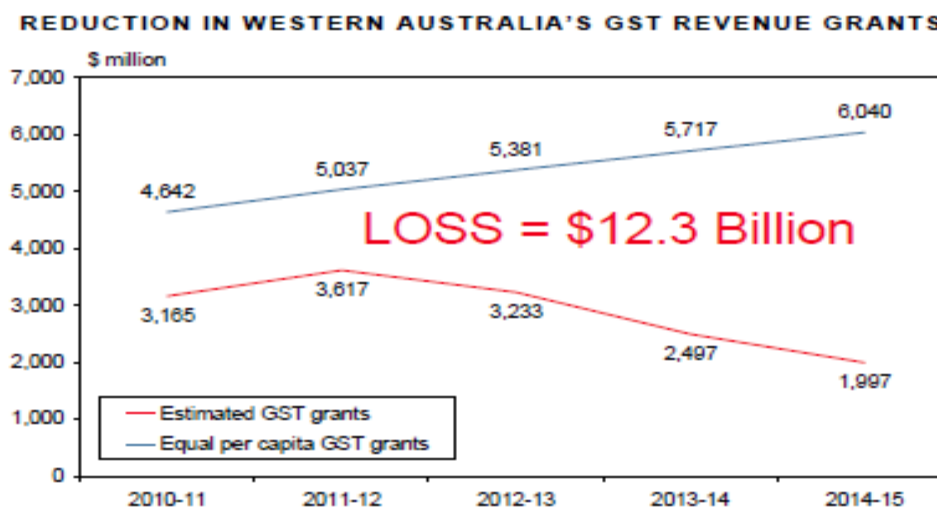
6.59 One of the reasons the review is being undertaken, which is supported by evidence to this inquiry and material contained in the Henry Tax Review report is that, according to the joint media release by the Prime Minister and the Deputy Prime Minister:

In particular, we recognise growth in the mining sector is increasing the discrepancy in the amounts of revenue raised by States and Territories, as well as making it more difficult to anticipate GST distribution from one year to the next.⁴⁹

6.60 The graph below, gives a practical view on the impact for Western Australia. As mentioned earlier, Western Australia derives a substantial portion of its revenue from mining royalties and in turn this has an impact on its treatment in the allocation of GST revenue. Chart 6.3 below from the Government of Western Australia (Budget factsheet 2011-12) provides an example:

48 Joint media release: the Prime Minister, the Hon Julia Gillard MP and the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP: *Review of GST Distribution*. (<http://treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/028.htm&pageID=003&min=wms&Year=&DocType=>) (accessed 21 April 2011)

49 Joint media release: the Prime Minister, the Hon Julia Gillard MP and the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP: *Review of GST Distribution*. (<http://treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/028.htm&pageID=003&min=wms&Year=&DocType=>) (accessed 21 April 2011)

Chart 6.3: Reduction in Western Australia's GST Revenue Grants⁵⁰

6.61 The Review will be advised by a Heads of Treasuries Advisory Committee comprising representatives from all States and Territories, and will seek submissions from the public. It will be supported by a secretariat within the Commonwealth Treasury, with representation from the States and Territories as well as other agencies as appropriate.

6.62 The Review will provide an interim report to the Treasurer by February 2012 and a final report by September 2012.

6.63 In the meantime, the Commonwealth Grants Commission will continue as the independent organisation making recommendations on the distribution of GST revenue. The Commonwealth Government will request the CGC to update its methodology to reflect any agreed recommendations from the Review. The Review will not affect the distribution of the GST revenue in 2011-12 or 2012-13.

The Commonwealth declares a tax war against the resource states

More pitfalls from the flawed MRRT and expanded PRRT process continue to emerge – the Western Australia Budget 2011-12

6.64 On Thursday, 19 May 2011, the Western Australia Treasurer, the Hon C. Christian Porter MLA, delivered his first budget. A key component of the Budget was the decision to raise the royalty rate on 'fine' iron ore gradually from 5.625 per cent to 7.5 per cent by 2014. This measure would raise around \$2 billion over four years. In the context of the Heads of Agreement and the impending GST

50 Government of Western Australia, *Budget 2011-12 Factsheet*.
http://www.dtf.wa.gov.au/cms/uploadedFiles/State_Budget/Budget_2011_12/2011-12_fact_sheets_western%20australias%20gst%20share.pdf (accessed 23 May 2011)

Review, the decision by the Western Australia Government was an important step and was undertaken in response to the 'rapid and massive' decline in GST receipts.⁵¹

6.65 As a direct result of the governments ill thought out mining tax deal, the government under these arrangements would have to find about \$2 billion out of its budget to fund credits for increased Western Australian royalties back to the those companies able to claim them against their resources tax liability.

6.66 The ongoing risk to the Commonwealth Budget could have been avoided. The government knew it needed to negotiate with the States, as then Treasury Secretary Ken Henry recommended this in his review. They never even tried. Yet when the Prime Minister and the Treasurer signed the mining tax deal, they went ahead and committed the Commonwealth to crediting all State and Territory royalties against any national mining tax liability.

6.67 Once the MRRT and the expanded PRRT is in place, however, '[t]he Commonwealth will also receive less revenue as a result of Mr Barnett's decision under the proposed Mineral Resource Rent Tax, which provides a full credit of state royalties paid by mining companies.'⁵² This once gain highlights the shortcomings, of the decision to tie a volatile revenue stream to upward trending outlays – it magnifies the risk of the ongoing structural deficit identified in Chapter 5 of this report.

6.68 The failure to negotiate and agree the MRRT and the expanded PRRT with the states and territories has led directly to a situation in which the Commonwealth has exposed its fiscal position to erosion caused by increases in state and territory royalties. While the MRRT revenue rolls and announced expenditures combine to create a structural deficit, further pressure is placed on the Budget due to the risk that the states and territories will increase their royalties.

6.69 The absence of a Commonwealth, state and territory agreement was always going to expose the federal budget bottom line to future royalty increases in any state or territory. And of course under the Constitution changes to royalty rates are the exclusive prerogative and responsibility of the states and territories. In these circumstances, how the federal government ever thought they could 'reform' resources taxation and royalty arrangements without actively engaging the States and ultimately reaching agreement with them remains a mystery.

6.70 The reality is that the government has only got itself to blame. The mining tax deal the government negotiated exclusively and in secret with the three biggest mining companies prior to the last Federal election is the real cause of the blow-out.

51 Andrew Burrell, 'Barnett blows \$2bn hole in Swan's budget target', *The Australian*, 20 May 2011, p. 1.

52 Media release, the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, *Barnett's 'own-goal' on iron ore royalties*, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/057.htm&pageID=003&min=wms&Year=&DocType=> (accessed 23 May 2011)

6.71 The appropriate level of royalties is of course a matter for the states as the appropriate level of income tax on mining company profits is a matter for the Commonwealth Government.

6.72 There is no need for a multi-billion dollar new tax on top of the existing taxation framework to ensure an appropriate return for the community. Royalties are the price paid by mining companies for the value of the non-renewable resource which is owned by the states.

6.73 The suggestion by the Treasurer that somehow state and territory governments must get his approval before making decisions about royalty rates was rightly condemned by state Leaders on both sides of politics. There is no constitutional basis for his assertion and no state Premier is a signatory to Labor's mining tax deal with the three big miners.

Who knew what, when

6.74 At the time of the announcement by the Western Australian Treasurer, the political process in Canberra went into overdrive. Much of the debate centred on what the Treasurer knew about Western Australia's plans to remove royalty concessions on iron ore fines. He had pleaded ignorance and surprise about the move to align royalty rates for iron ore fines and lumps.

6.75 The timeline below provides an overview of correspondence to the Treasurer on the matter of Western Australia increasing its iron ore fines rate.

Facsimile: Western Australia Treasurer, Troy Buswell MLA - 18 March 2010 – to the Treasurer, the Hon Wayne Swan MP:

'... if Western Australia successfully negotiates an increase in the royalty rates on fine iron ore that current apply under State Agreements (as it is currently endeavouring to do), and this leads to fine ore being reclassified as a high royalty rate mineral, our GST revenue would be reduce...'⁵³

53 The Hon Troy Buswell MLA, Treasurer, Facsimile, 18 March 2010. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

Facsimile: Western Australian under Treasurer, Mr Timothy Marney – 11 May 2010 – to the then Treasury Secretary, Dr Ken Henry:

'...I seek your urgent conformation that "scheduled increases" in Western Australia would include the removal of existing iron ore royalty rate concessions, which would see both fine and lump iron ore royalty rates being levied at 7.5%, and beneficiated iron ore at 5%, by 1 July 2012.'⁵⁴

Treasury Executive Minute 17 May 2011 – to the Treasurer:

'The proposed changes to royalties on some commodities in Western Australia at at Attachment C'.

Attachment C

'Western Australia indicated at a recent Commonwealth Grants Commission meeting (prior to the announcement of the Resources Super Profits Tax) it was considering increasing the royalty rate on iron ore fines from the current rate of 5.625% to the 7.5% for lump iron ore'.⁵⁵

Facsimile: Western Australian Under-Treasurer, Mr Timothy Marney – 16 November 2010 – to the then Treasury Secretary, Dr Ken Henry:

"I refer to the matter of the Commonwealth Grants Commission's treatment of iron ore fines as outlined in my previous correspondence of 11 May 2010. [this is referred to above] I am very keen to receive confirmation as soon as possible that iron ore fines will not be reclassified (from low rate to high rate), given the potential implications for Western Australia's budget revenues and associated policy settings'.⁵⁶

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- 54 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer, 11 May 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.
- 55 Freedom of Information release: Treasury Executive Minute: Mining projects and Royalties in Western Australia – 17 May 2010. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.
- 56 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer, 16 November 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

Letter: Queensland Treasurer, the Hon Andrew Fraser MP – copied to the Treasurer – 9 February 2011:

'For example, when Western Australia removes some concessions for iron ore fines, they will lose far more GST from this policy change than is gained in mining revenue under the current methodology.'⁵⁷

Letter: The Treasurer – to the Chair of the Commonwealth Grants Commission, Mr Alan Henderson - 15 February 2011

'Terms of Reference for the 2011 Update of the State Revenue Sharing Relativities

11. The Commission should ensure that, with regard to the removal of iron ore fines royalty rate concessions in 2010, the classification of iron ore fine should not move between mineral royalty rate groups in between methodology reviews'.⁵⁸

Facsimile: Western Australia, the Hon C. Christian Porter MLA – 19 May 2011 – to the Treasurer:

'I am writing to inform you of a decision in Western Australia's 2011-12 Budget, released today, to increase the royalty rate on iron ore 'fines' from the current 5.624% to 6.5% from 1 July 2012 and then to 7.5% from 1 July 2013'.⁵⁹

6.76 The Treasurer certainly knew about those plans when he recommended to the Prime Minister that she sign off on the promise to credit all State and territory royalties.

Turning nasty – the threats fly

6.77 As outlined earlier, the Treasurer wrote to the Commonwealth Grants Commission on 15 February 2011, outlining the way in which the 2011 allocation of

57 Letter, Queensland Treasurer copied to the Treasurer, 9 February 2011, p.2. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

58 Letter, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP to the Commonwealth Grants Commission (Mr Alan Henderson – Chairperson), http://www.cgc.gov.au/publications2/publications/latest_reports/2011_update/2011Update/contents/preliminaries (accessed on 23 May 2011)

59 Facsimile, Western Australia Treasurer, the Hon C. Christian Porter MLA, 19 May 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

GST Review was to be conducted. It required that no penalty be imposed on the decision of states to alter their royalty schemes.

6.78 The Treasurer's most recent statements appear to contradict his earlier direction:

[o]ur advice is that the CGC [Commonwealth Grants Commission] is highly likely to revise up their estimate of Western Australia's revenue raising capacity, which means they will allocate less GST to the State'.⁶⁰

6.79 As a result:

[t]he Federal Government does not intend to intervene in the CGC process to save Mr Barnett from the effects of his own decision to play politics with the mining boom.⁶¹

6.80 The Treasurer's comments were supported by the Minister for Resources, the Hon Martin Ferguson AM MP. In Parliament on Monday 23 May 2011, Minister Ferguson stated:

The outcome of the increase in royalties has sent a very strong message to the Commonwealth Grants Commission that the WA economy has a huge capacity to actually increase its revenue. In essence, we could end up with a situation by which the Western Australia Government could very likely lose more in GST revenue than it gains in additional royalty payments.⁶²

6.81 As outlined above, the Treasurer's response to that is to threaten a tax war against Western Australia by letting the Commonwealth Grants Commission take even more of the GST away from Western Australia and by cutting infrastructure spending to that state even further. Never mind that none of the GST money would help him fix up his \$2 billion budget hole. It would merely be redistributed among other States and territories.

6.82 Declaring a tax war against the people of Western Australia is not going to fix the mess the government has created by not thinking things through. The Treasurer cannot hide behind the Commonwealth Grants Commission either. What ultimately happens with Western Australia's share of GST as a result of their decision to remove royalty concessions on iron ore fines is entirely his decision.

60 Media release, the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, *Barnett's 'own-goal' on iron ore royalties*.
<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/057.htm&pageID=003&min=wms&Year=&DocType=> (accessed 23 May 2011)

61 Media release, the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, *Barnett's 'own-goal' on iron ore royalties*.
<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/057.htm&pageID=003&min=wms&Year=&DocType=> (accessed 23 May 2011)

62 House of Representatives, *Hansard*, Monday 23 May 2011, p. 58.

A risky business – the result of no deals with the states and territories

6.83 Holding the Heads of Agreement together could become increasingly difficult for the Commonwealth Government in the absence of an agreement made with the states and territories over royalties.

6.84 Another important consequence of the Western Australia Budget revolves around the willingness of the Commonwealth Government to hold to its agreement with the other parties to the Heads of Agreement. In particular:

[a] senior mining executive, who asked not to be named, said that big resources companies would not tolerate any back-down from the government and could walk away from the MRRT deal that was struck soon after Julia Gillard deposed Kevin Rudd as prime minister last year'.⁶³

6.85 While the recent debate on the decision by the Government of Western Australia to raise its iron ore fines has ignited a controversy with the Commonwealth Government, the issue is still smouldering away in three other states, Queensland, New South Wales and Tasmania.

6.86 In New South Wales, the Premier the Hon. Barry O'Farrell has said that;

[R]oyalties are a state taxing instrument. They have gone up, they have come down, and as far as I'm concerned that's how it should be. That's an issue for state governments to determine. It's not an issue for us to be limited by federal governments. The same applies in relation to the gaming tax. I'm prepared to defend state revenues in the face of increasing attacks by federal governments. I'm not going to flag whether royalties are going up or down.⁶⁴

6.87 Also, in New South Wales, the Treasurer the Hon Mike Baird has said in the context of royalties that, '[w]e reserve the right to consider all measures in the budget. Our desire is to have a constructive relationship with the federal government but, we will make no apologies for standing up for NSW.'⁶⁵

6.88 The New South Wales response to the encroachment of the Commonwealth on its taxation powers has been to see the matter in the context of Australia's federation, the Queensland Government has seen the matter through the prism of the right of governments not to bind their successors.

63 Andrew Burrell, 'Barnett blows \$2bn hole in Swan's budget target', *The Australian*, 20 May 2011, p. 1.

64 Cole Latimer, NSW may raise coal royalty rates, 6 June 2011, <http://www.miningaustralia.com.au/news/nsw-may-raise-coal-royalty-rates> (accessed 7 June 2011)

65 Andrew Clennell, 'Barr O'Farrell's budget threat on rail money by increasing mining royalties', *The Daily Telegraph*, online article 6 June 2010, <http://www.dailytelegraph.com.au/news/barry-ofarrells-budget-threat-on-rail-money-by-increasing-state-mining-royalties/story-e6freuy9-1226069739476> (accessed 7 June 2011)

6.89 The Premier of Queensland, the Hon. Anna Bligh has said that 'I will not sign up to agreement that binds a future Queensland Government that effectively ties their hands behind their back'.⁶⁶

6.90 According to the Queensland Premier:

'We reserve the right to determine the appropriate royalties as a return for the minerals taken out of our state. We will certainly be maintaining our right completely to set royalties not only now, but I would expect any Queensland government of any political persuasion forever. If that has consequences for federal arrangements that would be something that needs to be negotiated frankly between the mining companies and the federal government.'⁶⁷

6.91 The Tasmanian Government has taken the issue of a state's rights to raise a royalty further than just talking about such an option.

6.92 In its 2011-12 Budget, the Tasmanian Government foreshadowed an increase in its minerals royalty. According to the Tasmanian Budget, the minerals royalty will rise from \$36.2 million in 2010-11 to \$52.3 million in 2014-15.⁶⁸ According to the Budget:

'[t]he increase in Mineral Royalties reflects the increase anticipated by the Department of Infrastructure, Energy and Resources and the introduction of a revised Royalty regime'.⁶⁹

The further erosion of the credibility of the Commonwealth Grants process

6.93 The Commonwealth Grants Commission process and distribution of the GST revenue amongst the states and territories is a contentious process. The process is being made more contentious given the impact that the resources boom MkII is having on the financial relationships between the states, territories and the Commonwealth.

6.94 The extent of financial tension in the federation can be gauged from correspondence from the Hon Andrew Fraser MP, the Queensland Treasurer and the Commonwealth Grants Commission. In correspondence on 9 February 2011, the

66 Francene Norton, 'No mining tax if states lose revenues: Bligh', *Eraming.com.au*, 22 December 2010, <http://www.efarming.com.au/News/agricultural/22/12/2010/124679/no-mining-tax-if-states-lose-revenues-bligh.html> (accessed on 7 June 2011)

67 Lisa Martin, 'Bligh defiant on mining royalties', 21 December 2010, *NineMSN*, <http://news.ninemsn.com.au/national/8186928/bligh-defiant-on-mining-royalties> (accessed on 7 June 2011)

68 Parliament of Tasmania, *The Budget – Budget Paper No.1*, Presented by Lara Giddings MP, Treasurer, for the information of Honourable Members, on the occasion of the Budget, 2011-12, p5.25.

69 Parliament of Tasmania, *The Budget – Budget Paper No.1*, Presented by Lara Giddings MP, Treasurer, for the information of Honourable Members, on the occasion of the Budget, 2011-12, p5.25.

Queensland Treasurer expressed concern that the revenue from the MRRT that has been put aside for states would be taken into account as part of the GST revenue distribution process. Such a move would penalise the largest two single recipient of the MRRT funding, Queensland and Western Australia:

'As you would appreciate, a redistribution of these [MRRT] funds would likely result unless such payments are excluded from the relevant assessment, an option that is possible under the current arrangements.

This has potential to render the proposed allocations to the resource states illusory – with the benefits effectively clawed back by other states through a reduction in the GST grants to the resource states.

A key policy goal of the MRRT stands to be frustrated should the infrastructure financing proposal not be excluded from the Grants Commission's consideration of GST allocation.⁷⁰

6.95 The impact of mining industry revenues on the Commonwealth Grants Commission process is exemplified by the fact that:

'It is clear that the Commission's methodology places undue emphasis on mining royalties. As outlined in Queensland's 2010-11 Budget papers, mining revenues comprises only 7 per cent of all revenue of all states. It however, represents 70 per cent of the GST funds that redistributed on states' revenue raising capacity.'⁷¹

70 The Hon Andrew Fraser MP, Queensland Treasurer; Minister for Employment and Minister for Economic Development, Letter to Mr Allan Henderson AM, Chair of the Commonwealth Grants Commission, 9 February 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, executive Director, Fiscal Group, the Department of the Treasury.

71 The Hon Andrew Fraser MP, Queensland Treasurer; Minister for Employment and Minister for Economic Development, Letter to Mr Allan Henderson AM, Chair of the Commonwealth Grants Commission, 9 February 2011. 1 June 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

6.96 The redistributive nature of the Commonwealth Grants Commission process can be demonstrated by Table 6.6 below:

Table 6.6: Commonwealth Grants process in action⁷²

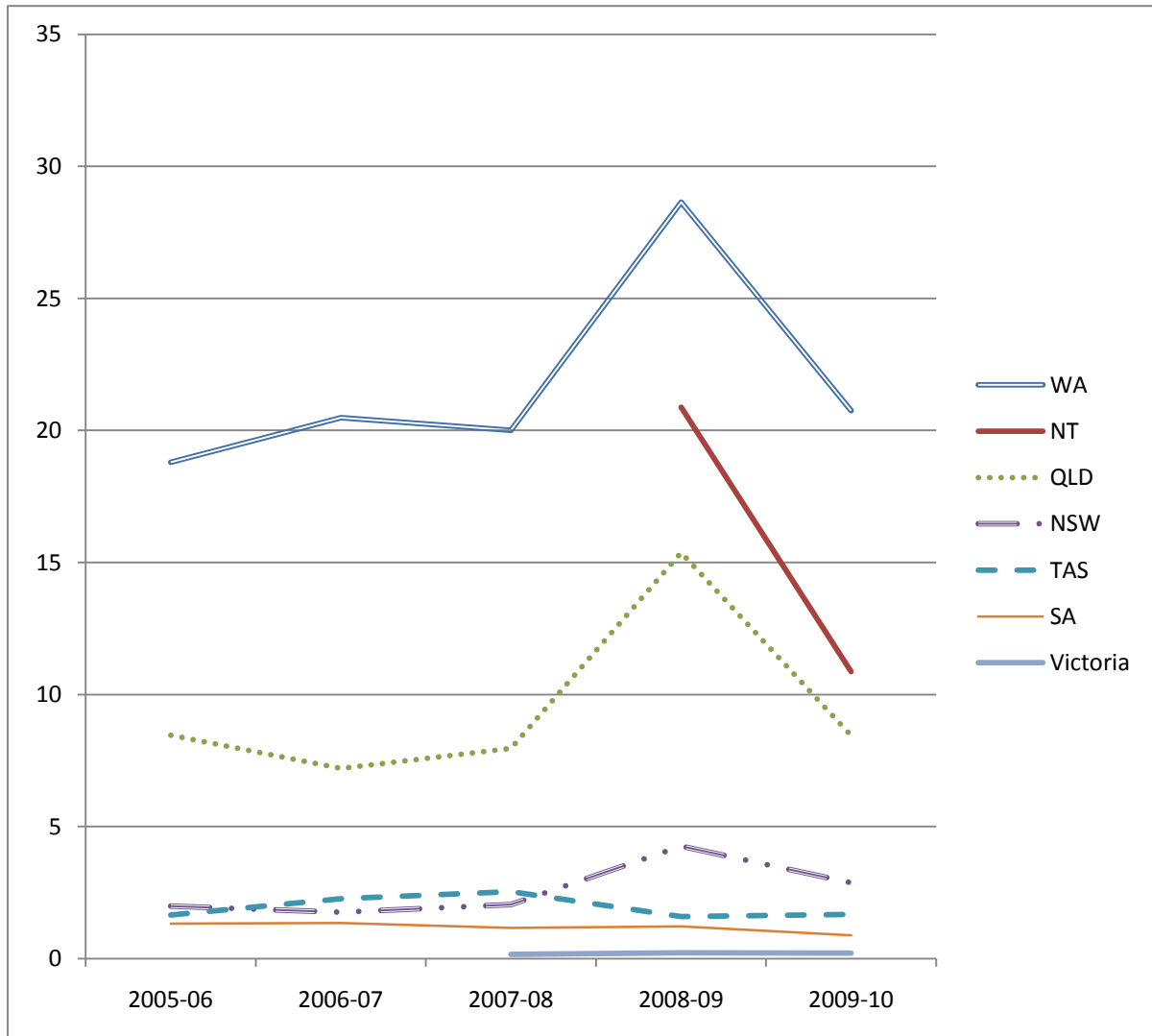
	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Mining Revenue (\$m)	781	43	2,032	2615	147	36	0	136
2010 Review GST redistribution (\$m)	1,123	1,501	-973	-2,097	292	107	103	-57
Net mining revenue (\$m)	1,903	1,544	1,059	518	439	143	103	79
Net mining revenue (\$ per capita)	274	294	250	242	276	289	302	363

6.97 As Table 6.5 highlights, Queensland and Western Australia in particular earn substantial revenue from mining revenue. Both earn more from mining revenue than the other states and territories, but end up on a per capita basis with least revenue from mining.

72 Source: The Hon Andrew Fraser MP, Queensland Treasurer; Minister for Employment and Minister for Economic Development, Letter to Mr Allan Henderson AM, Chair of the Commonwealth Grants Commission, 9 February 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, executive Director, Fiscal Group, the Department of the Treasury.

6.98 The importance of royalties to the states and territories is set out in the chart 6.4, below. The chart below highlights the percent of own source royalty revenue across the states and territories. As the table indicates, Western Australia and Queensland have source much more of their revenue from mining than do the other jurisdictions.

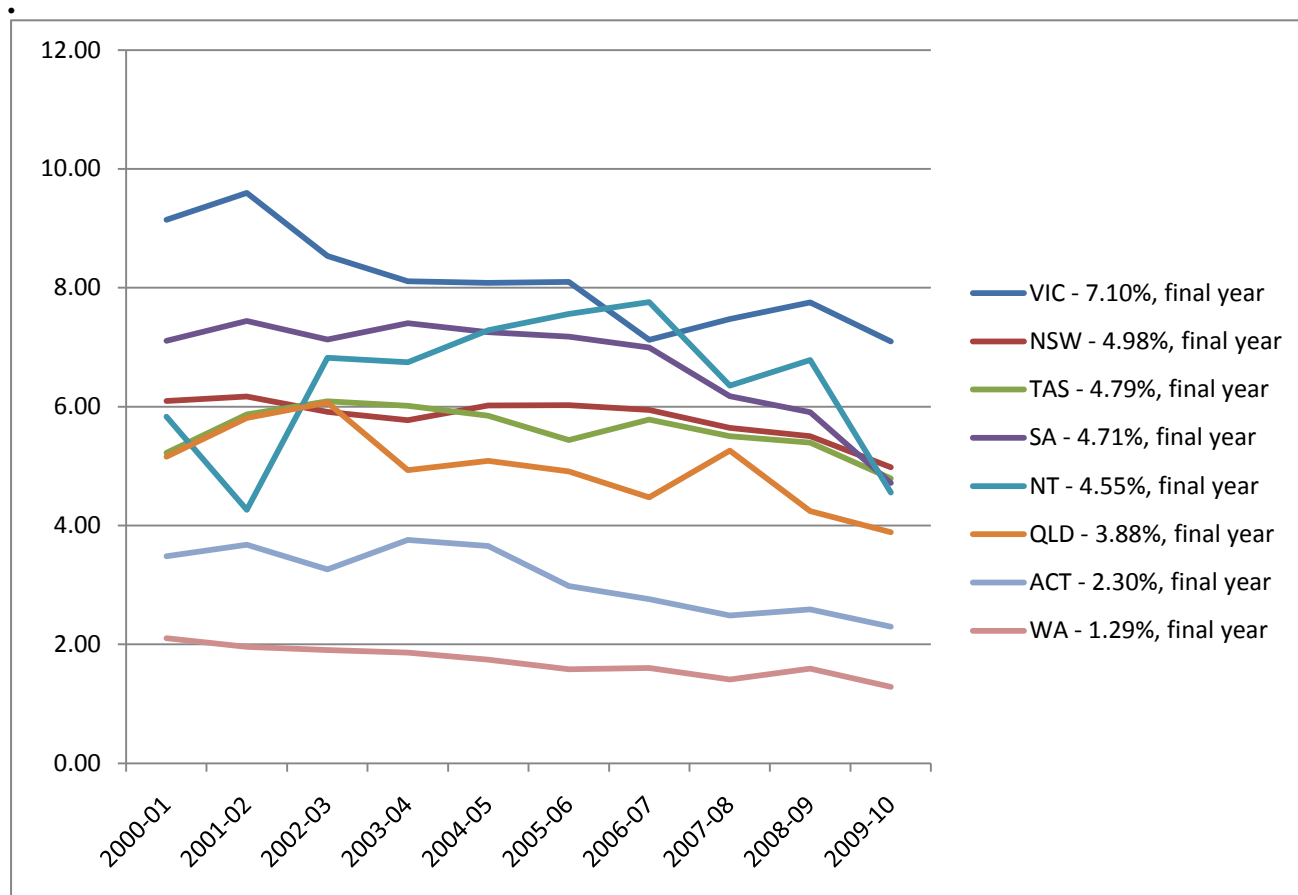
Chart 6.4: Mining royalty revenue as a percentage of own source state and territory revenue, 2001-2010⁷³



73 Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 1 June 2011. Note: data for South Australia and Victoria unavailable. Note – no data available for the Northern Territory for 2005 – 2008 and for Victoria 2005 and 2006.

6.99 The importance of gambling revenue to the states and territories is set out in chart 6.5 below. As the table indicates, Western and Queensland are in the bottom three of jurisdictions that rely on gambling revenue.

Chart 6.5: Gambling revenue as a percentage of State own source revenue, 2001-2010⁷⁴



6.100 There is a curious interplay between the state and territory own revenue from mining and gambling:

Senator CORMANN: But the factual question—confirm this one for me. If a state government increases either its tax base or its rate in relation to poker machines, it gets to keep 100 per cent of the revenue which it collects as a result of those decisions.

Mr Spasojevic: It is true that if a state changes any revenue in relation to gambling there is no impact on its GST distribution.⁷⁵

74 Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 1 June 2011.

75 Senator Mathias Cormann and Mr John Spasojevic, Secretary, Commonwealth Grants Commission, Proof Committee Hansard, *Estimates transcript of evidence*, 1 June 2011, p.67.

6.101 Under this arrangement of the GST distribution, the gaming states are never penalised for expanding their gaming revenue base but the mining states are penalised for expanding their mining revenue base.

6.102 The mining tax is bad policy which came out of a bad process. If the Government was fair dinkum about genuine tax reform it would start from scratch.

6.103 It would scrap the mining tax and engage in an open, transparent and inclusive process about tax reform not just targeted at one industry in isolation and involving all stakeholders including State and Territory governments.

6.104 The Commonwealth Government has only got itself to blame for the mess it is in over the mining tax. It should work on finding a way out without penalising Western Australia, Queensland or any other state or territory which decides to exercise its rights and responsibilities under the Constitution.

Constitutional issues

6.105 Proposed new taxation arrangements, particularly when they related to minerals and resources which are the property of the States, invariably raise questions about the constitutionality of such taxes. The Henry Tax Review version of a resource rent tax, the RSPT, MRRT and expanded PRRT have been no exception. The committee raised this issue with Treasury which provided inconclusive answers in relation to the constitutionality of the MRRT.

The Resources Rent Tax

6.106 In response to a Freedom of Information request, the Department of the Treasury released a range of documents that related to the policy development of the RSPT. These materials are available from the Department of the Treasury website.

6.107 On the Department of the Treasury website and released as part of the Freedom of Information request, there are two pieces of Australian Government Solicitor advice that discusses the constitutionality of the resource rent tax and the RSPT.

6.108 On 9 December 2009, the Australian Government Solicitor provided advice to the Department of the Treasury on:

... whether the proposed (resource rent tax) raises any constitutional issues.⁷⁶

6.109 The advice was requested in relation to the Henry Tax Review recommendation for a resource rent tax. It is important to note that elements of the

76 Freedom of Information disclosure. Department of the Treasury website: <http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936> (accessed 11 May 2011), Australian Government Solicitor legal advice, 9 December 2009, p.9.

Australian Government Solicitor's advice have been redacted under specific provisions of the *Freedom of Information Act 1982*.

6.110 Based upon those elements of the Australian Government Solicitor advice that have not been redacted, the advice states that:

In our view, there are no significant issues raised by the proposal to implement a (resource rent tax) which would make the proposal infeasible. In particular, we do not think the (resource rent tax) would be a law with respect to taxation which discriminates between States for the purposes of section 51(ii) of the Constitution.⁷⁷

The Resources Super Profits tax

6.111 As the government's tax plans evolved so did the nature of the advice sought from the Australian Government Solicitor. Under the Freedom of Information request outlined above, another piece of Australian Government Solicitor advice was released. It is dated 27 April 2010 and has had parts of it redacted under the various provisions of the *Freedom of Information Act 1982*.

The advice was sought because:

You asked us to consider whether there are any constitutional problems with the proposal to introduce a tax credit/refund based on royalties paid to states, which can offset the RSPT liability.⁷⁸

The advice covered two different mechanisms for dealing with the refund of state and territory royalties:

As part of the implementation of the RSPT, it is proposed that State and Territory royalty regimes would continue, at least for a transitional period liable for both the RSPT and State taxes, but it is proposed that entities would receive a Commonwealth tax credit or refund for the royalties they pay under state regimes during this transitional period. {REF!}

6.112 The Australian Government Solicitor noted that:

You seek an opinion on whether refunding or crediting state royalties in this way raises any constitutional issues.⁷⁹

77 Freedom of Information disclosure. Department of the Treasury website: <http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936> (accessed 11 May 2011), Australian Government Solicitor legal advice, 9 December 2009, p.9.

78 Freedom of Information disclosure. Department of the Treasury website: <http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936> (accessed 11 May 2011), Australian Government Solicitor legal advice, 27 April 2010, p.1.

79 Freedom of Information disclosure. Department of the Treasury website: <http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936> (accessed 11 May 2011), Australian Government Solicitor legal advice, 27 April 2010, p.5

6.113 The Australian Government Solicitor's advice, under the above text, was deleted as part of the Freedom of Information response from the Department of the Treasury.

6.114 The other mechanism considered as part of the advice, and also redacted in parts, was a cap on the credit/refund arrangement as part of the RSPT. The advice found that:

There is a risk that this proposal, specifically the proposal to cap the amount of refund available based on the State in which the expenditure was incurred, constitutes discrimination between States for the purposes of s51(ii) of the Constitution and a preference between the States for the purposes of s99 of the Constitution. To avoid this risk, one possibility would be to impose a cap on the total refund/credit which is consistent across all States.⁸⁰

The Mineral Resources Rent Tax and the Petroleum Resources Rent Tax

6.115 In recognition of the importance of the constitutionality of the MRRT, the then Secretary of the Treasury was asked whether legal advice had been sought specifically regarding the proposed new MRRT separate from the RSPT:

Dr Henry—Tell me if I am wrong fellas, but so far as I know we have not sought external legal advice on the constitutionality of the government's MRRT proposal.

CHAIR—But you did so for the RSPT?

Mr Parker—We did have it for the RSPT. Insofar as the taxing point is concerned—that is, the first saleable form under the MRRT—it is not, in my understanding, in any degree of substance different to the RSPT design.

CHAIR—But it is, isn't it? We have already had this discussion. The RSPT was a pure profits based tax, whereas the MRRT—even with the name—is a minerals resource rent tax which is applied at the point of extraction rather than as part of a pure assessment of the profits of the particular mining venture concerned. What I am trying to get at is where the line in the sand is that the Commonwealth will not cross. Is there one? Have you legal advice that has defined that line in the sand for you?

Dr Henry—Yes.

Mr Parker—Yes. I do not think that the purity of the tax, as you have framed it, goes in any degree of essence to the limits of the Commonwealth's constitutional taxation power.

CHAIR—The taxing point is what I am looking at.

Dr Henry—I wish it did. It would be rather nice if the Constitution obliged us to levy taxes only on pure profit.

80 Freedom of Information disclosure. Department of the Treasury website: <http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936> (accessed 11 May 2011), Australian Government Solicitor legal advice, 27 April 2010, p. 2.

CHAIR—But you have not sought any further legal advice as to whether the MRRT is in fact constitutional, based on your assumption that there is no difference between the RSPT and the MRRT on that front.

Mr Parker—That is right.⁸¹

6.116 During the course of the hearing into the MRRT and expanded PRRT, the issue of constitutionality of these taxes arose. The evidence before the Committee revolved around two key matters. The first matter can be described in the context of the MRRT and expanded PRRT as:

MR PAPE - The terms of reference for this inquiry seem to inextricably link the topics of resource taxation and fiscal federalism. My interest in this proposed minerals resource rent bill... is whether the parliament is overreaching its powers under section 114 of the Constitution. Relevantly, section 114 states that the Commonwealth shall not:

... impose any tax on property of any kind belonging to a State.⁸²

6.117 As there is no agreement about royalty arrangements in the context of the MRRT and expanded PRRT either between the Commonwealth and the states and territories or between states and territories themselves, the second key issue revolves around the interaction between the MRRT/expanded PRRT and state and territory royalties:

MR PAPE - As presently advised, I doubt if a rebate or credit for state royalties, if it were to be allowed against the proposed tax, would be seen as discriminatory so as to offend section 51(ii) or section 99 of the Constitution. But, of course, the difficulty we have in all of this is that the so called bill is nonexistent and we are speculating as to what in fact the Commonwealth might do.⁸³

6.118 However others have suggested that such discrimination may exist, for instance, Andrew Forrest has signalled that he believes the proposed taxation arrangements are discriminatory. It has been reported that:

Claiming that the mining tax being pushed by Prime Minister Julia Gillard is discriminatory, Fortescue Minerals Group (FMG) chief executive Andrew Forrest said on Tuesday that he is prepared to challenge the measure's legality in the Australian High Court.

... Forrest stressed that the minerals resource rent tax (MRRT) proposed by the Gillard government heavily favors the country's giant mining firms such

81 Senator Mathias Cormann, Chair Fuel and Energy Committee, Dr Ken Henry, Secretary, Department of the Treasurer, Mr David Parker, Executive Director, Department of the Treasury, *Fuel and Energy Committee Hansard*, 5 July 2010, pp. 41 – 42.

82 Mr Bryan Pape, Senior Lecturer, School of Law, University of New England, *Committee Hansard*, 13 December, p. 1.

83 Mr Bryan Pape, Senior Lecturer, School of Law, University of New England, *Committee Hansard*, 13 December, p. 1.

as BHP Billiton, Rio Tinto and Xstrata, which he insisted should not have been the case as the three companies can very well afford to cover the additional expenses entailed in the new tax initiative.⁸⁴

6.119 Given the legal matters that have been drawn to the Inquiry's attention and the absence of a draft Bill, the Commonwealth Parliament and the High Court may play an important role in settling the final form and legality of the legislation that deals with the MRRT, the PRRT and state and territory royalties:

CHAIR—What sanctions are there against the federal parliament passing legislation which is unconstitutional?

Mr Pape—Until the High Court declares it unconstitutional, it is valid.

CHAIR—Essentially, the parliament can pass whatever unconstitutional law it likes. If nobody objects to it, it will stand.

Mr Pape—That is right.

CHAIR—So there is nothing that can be done before a law is passed to test its constitutional validity?

Mr Pape—It may well be that a senator might say, ‘My view is that this law is unconstitutional. I believe it would have standing to go to the High Court to run the case that it is unconstitutional.’⁸⁵

6.120 Senator's are not able to seek the advisory opinion of the High Court of Australia on Bills. According to advice provided by the Acting Clerk of the Department of the Senate on 15 December 2010:

... [i]t is not possible for the High Court to give an advisory opinion on the constitutionality of a bill; the court does however have jurisdiction to consider the constitutionality of any Act where there is a dispute between parties on a matter arising under the Act.⁸⁶

6.121 Advice from the Acting Clerk of the Senate, Mr Elliott did note that while the High Court had no jurisdiction to offer an advisory opinion, it was open to Senators to privately seek their own legal opinions, question the government on the matter or pursue the issue through the Senate inquiry process.⁸⁷

84 Unknown author, 'FMG's Andrew Forrest hints of challenging MRRT in court', *International Business Times Australia*, 14 June 2011, <http://au.ibtimes.com/articles/162159/20110613/fmg-s-andrew-forrest-hints-of-likely-legal-challenge-against-mrrt.htm> (accessed 21 June 2011)

85 Senator Mathias Cormann, Chair, Senate Select Committee on New Taxes and Mr Bryan Pape, Senior Lecturer, School of Law, University of New England, *Committee Hansard*, 13 December, p. 3.

86 Mr Cleaver Elliott, Acting Clerk, Department of the Senate, Formal email: Seeking advisory opinions from the High Court on the Constitutionality of bills, 15 December 2010.

87 Mr Cleaver Elliott, Acting Clerk, Department of the Senate, Formal email: Seeking advisory opinions from the High Court on the Constitutionality of bills, 15 December 2010.

6.122 In these circumstances, the Committee members will continue to carefully scrutinise the relevant legislation when it comes before the Parliament.

6.123 The Senate will not be the only interested party following the developments of the MRRT, it has been reported in *The Australian* that:

... [the] likelihood of Fortescue supporting a High Court challenge to the proposed MRRT, Mr Forrest said it was not possible to say at this stage, given the legislation was in draft form and "totally unfinished".

But should the draft legislation remain unchanged, Mr Forrest said he was keen to test the constitutionality of the proposed tax.

"As it stands now, any Australian who has a tax which allows multinationals to pay less per dollar of profit than what they do, that should be challenged, that is totally against the constitution," Mr Forrest said.

"If that is what finally appears, you may be assured that Fortescue and others will challenge a precedent so dangerous that it gives multinationals a major advantage over Australia home grown companies."⁸⁸

6.124 The Western Australian Government is also assessing its legal options in relation to the draft MRRT legislation, it was reported in the *The Australian* that:

THE Barnett government and the West Australian resources industry were last night weighing up a High Court challenge to the Gillard government's planned \$11.1 billion mining tax after the release of draft laws failed to silence miners who claim the impost is unjust.

A spokesman for West Australian Attorney-General Christian Porter said the 176-page draft legislation had been sent immediately to the State Solicitor's Office, which would assess its constitutionality.

Mr Porter has argued that the High Court could strike down the tax because it would discriminate between the states by allowing a miner in one state to receive a different royalty credit to a company mining the same resource in another state. The tax could also be unconstitutional because WA's mineral resources remain the property of the state rather than the commonwealth.⁸⁹

88 AAP, 'Fortescue may challenge resources rent tax of constitutional grounds, says Forrest', *The Australian*, 13 June 2011, <http://www.theaustralian.com.au/business/mining-energy/fortescue-may-challenge-resources-rent-tax-on-constitutional-grounds-says-forrest/story-e6frg9df-1226074326165> (accessed 21 June 2011)

89 Andrew Burrell, 'Colin Barnett and miners eye high court challenge to Julia Gillard's tax', *The Australian*, 11 June, <http://www.theaustralian.com.au/business/mining-energy/colin-barnett-and-miners-eye-high-court-challenge-to-julia-gillards-new-carbon-tax/story-e6frg9df-1226073303486> (accessed 21 June 2011)

Committee comment

6.125 The committee considers that there are still way too many unresolved issues and uncertainties for the Parliament to allow this legislation to proceed.

6.126 Whether the proposed MRRT and expanded PRRT are constitutional remains unresolved. It is entirely unsatisfactory for the government to ask the Parliament to pass legislation which may well breach the prohibition against imposing a tax on state property.

6.127 The interaction between the proposed MRRT, expanded PRRT, state and territory royalties and GST sharing arrangements remain unresolved.

6.128 The Parliament should not pass legislation which is likely to have a significant impact on investment and activity in an important sector of the economy, when such constitutional and other uncertainties remain. In particular, given the Government has consciously chosen not to remove these uncertainties through genuine consultation and negotiation with the states and other stakeholders.

6.129 The clearest demonstration of the problems caused by the Commonwealth Government stubbornly refusing to engage the states was illustrated when the Western Australian government decided to remove royalty concessions on iron ore fines, increasing the rate over time to the standard rate for iron ore of 7.5 percent.

6.130 As a direct result of the government's mining tax deal negotiated exclusively and in secret with the three biggest mining companies that Western Australian Government decision blew a \$2 billion black hole into the federal budget. Why? because the Prime Minister and the Treasurer had committed the Commonwealth to crediting all state and territory royalties against any national mining tax liability. They did so without first checking what the state and territory intentions were in relation to mining royalties into the future.

6.131 Much of the debate recently centred on what Wayne Swan knew and when about Western Australian plans to remove royalty concessions on iron ore fines. He had pleaded ignorance and surprise about the move to align royalty rates for iron ore fines and lumps.

6.132 The evidence presented above is that Treasurer Swan had indeed been told about those plans on several occasions over a period of more than a year. Whatever developments may have happened later, there is no doubt that the Treasurer knew about those plans at the time he recommended to the Prime Minister that she sign off on the promise to credit all state and territory royalties.

6.133 Even leaving that aside, the committee considers that surely any competent Australian Government about to commit to credit all state and territory royalties against any new national tax liability would make it its business to find out. Surely a competent government would discuss and reach agreement about royalty rates into the future before pressing ahead. The committee considers that the government should

have been awake to the fact that the Commonwealth has no legal authority over royalty rates in the states and territories. The government should have realised that in the circumstances a promise to credit those royalties without having reached agreement with the states about what would happen to them in the future was reckless, irresponsible and incompetent.

6.134 Through its refusal to genuinely engage and consult with the states as the constitutional 'owners' of mineral royalties, the Commonwealth has exposed its own Budget to the decisions of the states to an extraordinary degree. This exposure of the Commonwealth budget to the activity of other levels of governments, in this case the states, has no precedent in recent Australian history.

6.135 The Gillard Government never sought any assurance from the states and territories in relation to its royalty arrangements. Instead it just asserted without legal authority that states and territories would not increase royalties into the future.

6.136 In the shadow of a difficult 2010 election, the government was too desperate to get a deal which would get the big miners off their back and let them put the mining tax revenue towards the budget bottom line and to create the illusion of an early surplus by 2012/13. A surplus, which under the Gillard Government version of the mining tax is exposed to decisions about royalty rates in six different states and the Northern Territory.

6.137 The committee agrees that the appropriate level of royalties is a matter for the states as the appropriate level of income tax on mining company profits is a matter for the federal government.

6.138 The committee also considers that there is no need for a multi-billion dollar new tax on top of the existing taxation framework to ensure an appropriate return for the community.

6.139 Royalties are the price paid by mining companies for the value of the non-renewable resource which is owned by the states.

6.140 The suggestion by the Treasurer a few weeks ago that somehow state and territory governments must get his approval before making decisions about royalty rates was rightly condemned by state leaders on both sides of politics.

6.141 There is no constitutional basis for his assertion and no state Premier is a signatory to Labor's mining tax deal with the three big miners.

6.142 The government has made a complete mess of the mining tax process. In the committee's view the Parliament should demonstrate its opposition to both the tax and the flawed process which led to the tax by voting against any legislation seeking to implement it.

Recommendation 8

6.143 The committee recommends that the Parliament insist on the government tabling an agreement with the states and territories about the interaction between the proposed MRRT/expanded PRRT, royalties, GST sharing arrangements and any other related federal-state financial relations issues before considering any mining tax related legislation.

