

Hearing for the Senate Select Committee on the Scrutiny of New Taxes
Legislative Council Committee Offices,
55 St Andrews Place, Melbourne

BHP Billiton testimony company representatives – Mr. Gerard Bond and Mr. Bernie Delaney

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Opening Statement

[1. INTRODUCTION]

Thank you Committee members for inviting us to appear today.

First let me make some introductions. My name is Gerard Bond, and I have been an employee of BHP Billiton for over thirteen years. For the period 1 April to 1 September of this year, I was responsible for managing BHP Billiton's response to the recommendations of the Henry Review, and subsequently the matters arising in relation to the announcement of the RSPT on 2 May 2010.

On my right is Mr. Bernie Delaney, BHP Billiton's Vice President Government Relations. Bernie has been with BHP Billiton for over twenty years. Bernie has been involved with the proposed new taxes on the resources industry from the Government Relations perspective.

BHP Billiton acknowledges and respects the role of the Australian Government to set tax policy, and that Parliament creates the nation's tax laws.

As the nation's biggest payer of corporate taxes, we understand this reality very well.

This does not mean that BHP Billiton always considers that proposals for new taxes are sound or in the best interests of the mining industry or Australia. In our industry in particular, tax stability and a rational tax regime is of paramount importance.

The resources industry is characterised by large, multi-billion dollar capital investments, long lead times, volatile prices and exchange rates, and hence risky and variable economic returns that are derived over an extended period of time.

Investments in the resources industry are typically significant – in our case, ranging from two billion to ten billion dollars - and may not begin to generate a payback for five to fifteen years. These investments are high risk, and require operation over a number of decades or more to provide an appropriate return.

A well designed and stable tax regime is critical to a country attracting investment in the resources industry. There is strong competition between countries for investment in resources. Australia has historically had a stable and rational tax regime for the mining industry, which has contributed to the development of a globally competitive resources industry.

The RSPT, and now the MRRT, must be understood in this context. Changing the rules of the game, after investments have been made – and to a flawed new tax – jeopardises Australia's leading position in the global resources industry.

We believe there are four principles that should govern consideration of minerals resources tax design.

The four principles are **prospectivity, competitiveness, differentiation, and resource based**.

Specifically, we believe minerals resources tax reform must be:

1. **prospective** – any minerals resources tax must be prospective in its application, so as to preserve Australia's position as a stable place for investment.
2. **competitive** – any minerals resources tax must ensure that the overall tax burden is competitive with other mineral resources countries, or, Australia will lose investment to countries with more attractive tax regimes
3. **differentiated** – any minerals resources tax should vary by commodity, in recognition of the fact that the investment characteristics and margins of individual commodities are different.
4. **resource based** – any minerals resource tax must be levied on the value of minerals alone, and not unintentionally penalise investments in infrastructure, processing or other enabling and value adding activities.

I want to make four key points about recent proposals for a new minerals resources tax in Australia.

They are:

- That the rationale for a new resources tax was based on a fundamentally false foundation,
- That the RSPT was fundamentally flawed in design,
- The Government recognized that the design of the RSPT was flawed and replaced it with an MRRT, and fourthly,
- That we are concerned about some public statements made regarding the implementation of the MRRT.

[2. MAIN BODY]

The first point is that the rationale for a new resources tax was based on a fundamentally false foundation.

The fundamental and widely publicised foundation for the RSPT was that the mining industry was not paying its fair share of tax. The government repeated again and again that the industry was only paying seventeen and a half per cent tax, and pointed to the change in royalties as a percentage of profits over the period 2002 to 2009 to evidence this.

I would like to deal with each of these in turn.

The seventeen and a half per cent number was not representative of the facts. Rather than referring to actual tax payments, the Treasury relied on statistics from a draft report from a US university study that even its own authors have said was not appropriate for the purpose used by Treasury.

Inexplicably, the analysis produced by Treasury showing royalties as a percentage of profits over the years 2002 to 2009, and excluded the significant increase in company tax payments made over the same corresponding period.

The key reference years in this analysis were also selective: the first year coincided with a point of low industry profitability (making the more constant royalties appear as a high percentage of profits); while the last years were projections only and not actual results.

We know now that Treasury's calculation of projected industry earnings for FY2008 and FY2009, were inflated through use of unrealistic assumptions, which had the effect of depicting an underpayment of total tax.

In BHP Billiton's case, the reality is that:

- Over the last seven years to June 2010, BHP Billiton paid over twenty-nine billion dollars in taxes and royalties to Australian Government
- This equates to approximately forty two per cent of profit from our Australian operations
- In 2010, for every one dollar of profit from our Australian operations, one dollar thirty went back into Australia, by:
 1. paying over five and a half billion dollars in taxes and royalties, representing forty six per cent of Australian operating profits.
 2. investing over eight billion dollars on capital projects in Australia, and
 3. returning one point nine billion dollars in dividends to Australian based shareholders
- In addition to the above we spent many billions of dollars of on goods, services and employment necessary to derive those profits.

It should be noted that over the last decade the industry returned ninety eight per cent of its cash flows to the Australian community through taxes and investment — this is before dividends to Australian shareholders.

The second point is that the RSPT was fundamentally flawed in design.

If we look at how the Petroleum Resource Rent Tax was introduced in the late nineteen eighties, and compare it to the RSPT announcement, it is clear that there was no industry consultation on, or testing of the theory of the RSPT before it was announced by the Government on 2 May 2010. This was despite our repeated efforts to engage with Government and Treasury prior to this time.

BHP Billiton assessed this RSPT and concluded that it was poorly designed, did not meet any of the four principles of sound minerals taxation reform, and would be very damaging to the future of the industry in Australia, and therefore damaging to the future prosperity of all Australians, if it were implemented.

The real world impact – as opposed to the theoretical impact of the tax – was not well understood by its designers, as there were fatal flaws in design assumptions; such as the value of loss refundability; the neutrality of the tax; what constituted a “super profit”; and most importantly, how it would impact resource development in Australia.

The RSPT as proposed would have had a significant negative impact on the mining industry and the service industries that support it, and diminish one of the areas of the economy that is now, and forecast to be in the future, a competitive strength for the nation.

The RSPT would have reduced near-term investment in the industry, and allowed other mineral-rich countries to become substitutes for Australian products in meeting the forecast demand growth over that same period. It is a pragmatic, commercial reality that tax policy, fiscal stability and broader regulatory practices matter in the global contest for investment finance where resource development occurs.

Australia faces fierce competition from other mineral-rich countries. Australia has only 15 percent of the world’s iron ore resources, 13 percent of gold and copper resources and 6 percent of black coal resources – the RSPT would have had serious adverse consequences for the Australian minerals industry and its competitiveness on the world stage.

The third matter I would like to address were events after the announcement of the RSPT on 2 May 2010.

Following the announcement we publicly acknowledged the Government's right to review its taxation policies. Again, BHP Billiton does not object at all to sound, principle based, tax reform – however, it was simply quite clear to us that this RSPT did not meet these principles.

With the public debate ongoing, we remained committed to constructively engaging with the RSPT consultation panel led by Treasury, and we made a presentation to them on 21 May 2010.

However, as reported by many other participants at that time, the panel informed us that their scope was constrained and limited to transition – they were focussing on the mechanics of moving to the RSPT – not its design.

Thereafter, BHP Billiton supported the Minerals Council of Australia in its efforts to raise the public's awareness of the industry's concerns about the RSPT. BHP Billiton also communicated its concerns to its stakeholders – including shareholders and employees – and urged the Government to engage in genuine consultation.

BHP Billiton, along with Rio Tinto and Xstrata, were invited to meet with representatives of the Federal Government and Treasury in Canberra on 16 June 2010.

In this meeting, for the first time, the Government indicated it was willing to consider some changes to the RSPT.

We made the point that prospectivity was a threshold issue that had not been adequately considered in the Government's revised thinking. On the matter of competitiveness we reiterated that forty per cent was too high for any mineral and asked how this rate had been arrived at.

The response from the Treasury representative was that the forty per cent, quote “was arbitrary” end quote, and it was apparent to us that international competitiveness was not a criteria for the choice of the tax’s headline rate.

The Government also indicated to us that its focus was primarily on iron ore and coal, and also stated that any revisions to the tax proposal needed to preserve the three and nine billion dollars of tax revenue attributed to the RSPT in its first two years.

Prior to and during this meeting we asked that the Government canvas views from as many affected companies as possible to get a broader view of the impact of the tax.

BHP Billiton, Xstrata and Rio Tinto were invited to Canberra to attend a meeting on 29 June 2010 with representatives of Government. At this meeting the Government outlined the key elements of a different new resources tax, to be called the Minerals Resource Rent Tax, or MRRT.

Significantly this MRRT allowed the starting base to be market value, thereby approximating the essential requirement of prospectivity.

Other elements with which you are familiar in the announced MRRT were also present – such as immediate deductibility of expenditure, transferability of losses, and the crediting of all royalties.

After further consideration of the rates applicable in other competing jurisdictions for coal and iron ore, the Government’s representatives settled on a proposal whereby the MRRT would have an effective rate of twenty two and a half per cent.

On 30 June 2010 representatives from each of BHP Billiton, Xstrata and Rio Tinto were invited by the Government to go to Treasury’s offices to be shown and comment on certain input assumptions used by Treasury in its MRRT modelling.

To allow each Company to provide comments to Treasury on specific assumptions without divulging commercially sensitive, proprietary information to the other companies, we did this in separate sessions.

In our view, Treasury's assumptions, shown to us, did not reflect market conditions or likely industry activity.

BHP Billiton expressed its views on assumptions pertaining to prices, volume, capital expenditure and foreign exchange.

We do not know what use, if any, Treasury made of BHP Billiton's views – or indeed the views expressed by any other companies.

We were never given a copy of Treasury's model, nor did we ever review it.

At the conclusion of discussions on 1 July 2010, a carefully worded, substantive document was finalised that captured the essential elements of the MRRT. Prior to its finalisation, I was involved in a line by line, word by word review of the document with Treasury representatives. At the Government's suggestion, the document was titled a Heads of Agreement.

On 2 July 2010 the Government announced the MRRT. BHP Billiton, Xstrata and Rio Tinto released a joint public statement acknowledging the RSPT has been replaced by the MRRT and replicated in full the Heads of Agreement but for a paragraph on the Policy Transition Group's role, and its signatories.

The last matter we wish to address in this opening statement is a summary of where we see things now.

Notwithstanding that the minerals resources industry in Australia already pays amongst the highest rates of tax globally, this Government is pursuing the introduction of the MRRT.

The manner in which the RSPT was proposed and amended has not been great for Australia's reputation, focussing as it did on near term revenue rather than principle based reform, and changing Australia's reputation as a stable fiscal environment in which to invest.

Accordingly, close adherence to the MRRT design principles in the Heads of Agreement is essential. This MRRT may yield higher near term revenue, but the full impacts of having the highest taxing regime on iron ore and coal will be experienced for decades to come.

Since the commencement of the current consultation process we have been and remain committed to working constructively with the Government's Policy Transition Group to ensure the technical design of the MRRT is realised in line with the Heads of Agreement announced on 2 July 2010.

Several issues have been raised through this process, including the crediting of all state and territory royalties against the MRRT liability. We are concerned with the recent comments by some parties seeking to move away from all royalties being creditable.

It was clear from the context of the discussions we had with Government, and later Treasury, that "all" meant all. Current and future. The "all" is essential for the MRRT to set a maximum rate of tax on the earnings of the iron ore and coal operations, which combined with the proposed Company tax rate, is approximately forty five per cent. Any departure from this point would undermine a critical design feature of the MRRT.

Mr Chairman, we would also like to make an observation in regards to whether this tax favours one industry participant over another. We are of the strong view that this tax is neutral as to whether or not infrastructure is owned by the resource owner, or the capital structures employed by the resource owners – the liability for MRRT is indifferent.

This was achieved through the Heads of Agreement term that arms length principles would determine the value of all transactions pre and post the taxing point. This term was discussed in detail with representatives of Treasury as part of the review of the draft Heads of Agreement, prior to it being signed.

The concept is essential to be adhered to in order to preserve the principle of resource based taxation, and not penalise or favour ownership of infrastructure.

[CONCLUSION]

I would like to conclude our opening remarks and invite questions Mr. Chairman.