MINING & ENERGY
Division of the
Construction, Forestry, Mining and Energy Union

PO Box Q1641
SYDNEY NSW 1230 AUSTRALIA
Tel: (02) 9267 1035 **Fax:** (02) 9267 3198
International - Tel: (+612) 9267 1035 **Fax:** (+612) 9267 3198

Web: www.cfmeu.com.au Email: info@cfmeu.com.au

The Minerals Resource Rent Tax:

Response to Policy Transition Group Issues Paper

and submission to Senate Select Committee on Scrutiny of New Taxes

October 2010

1. Overview

1.1. The introduction of resource rent taxation is long overdue and is one of the more obvious and pressing economic reforms that should be pursued by government.

1.2. The RSPT was a more consistent and fairer proposal than the MRRT. The MRRT is at best a useful starting point for fairer taxation of the resources sector and for greater returns to the Australian community for the exploitation of their finite resource.

1.3. This submission goes beyond the Terms of Reference of he Policy Transition Group, addressing issues such as the use of funds raised under the MRRT (and expanded PRRT).

1.4. A number of comments are made on specific issues in the PTG's Issues Paper, notably the inclusion of brown coal and waste coal mine methane, the inclusion of market value of assets in the starting base, the deductibility of finance costs, and the transferability of MRRT losses and royalty credits.

2. The Union

2.1. The Construction, Forestry, Mining & Energy Union (CFMEU) welcomes this opportunity for input to the process of introducing the Minerals Resource Rent Tax (MRRT).

2.2. The CFMEU is a major union in the industries of its title, with around 120,000 members. It is the principal union in the black and brown coal mining industries, with around 20,000 members. It also has membership in metal ore mining, power stations, oil refining and chemical manufacturing.

3. Approach taken in this submission

3.1. The Policy Transition Group's mandate is restricted by its Terms of Reference to dealing with transitional and implementation issues related to the MRRT. The Issues Paper reflects this restriction.

3.2. While this submission will offer comment on these matters, it will not restrict itself to those. The CFMEU will also comment on the scope of the MMRT relative to its aborted predecessor, the Resources Super Profits Tax, and on aspects related to the use of the MRRT funds.

4. Principles and context

4.1. The following principles and context underlie the CFMEU approach to the MRRT.

4.2. The CFMEU broadly supports an efficient and effective taxation regime that is progressive, redistributive, enables sustainable growth and the achievement of social justice and equal opportunity.

4.3. Australia's mineral wealth belongs to its people and they should receive a good return for its exploitation.

4.4. While extensive, our mineral resources are not unlimited. They are non-renewable and, particularly with current rapid growth in demand, it is possible to see the time when mineral reserves will become substantially depleted.

4.5. Using our mineral resources sustainably requires that there be permanent wealth created from mining that lasts far beyond the resource extraction period. This is so that meeting the needs of the current generation does not limit the opportunities of future generations to meet their own needs.

4.6. The CFMEU therefore supports a resource taxation regime that provides for very long term, publicly-owned funds that provide for investment capital and income streams after the mining boom and after mineral reserves become depleted. Sovereign Wealth Funds are the generic title often given to this type of fund.

4.7. Resource Rent Taxes have been long debated in public policy circles. The CFMEU recalls them being supported by the then NSW Coal Association back in 1990 – principally as a means of removing the burden of royalties and reducing overall taxation at a time when the industry had poor profitability.

4.8. The CFMEU is a strongly supportive of the principle of resource rent taxation. However, the union also holds the view that the community is entitled to a return for the exploitation of its resources whether or not a mining company is making good (or any) profits.

4.9. The union therefore supports a mixture of royalties and profits-based taxation.

4.10. The Australian mining industry has always had components that are very profitable, though some sections were not. Much of Australia's mineral output was subject to monopsonistic[1] pricing and investment practices by buyers' cartels for many decades, adversely affecting its profitability.[2]

4.11. Since the late 1990s these monopsonistic buying practices have broken down, the major resources companies have grown rapidly in size, and market power has shifted decisively to mineral producers. Together with this shift in the structure of the market there has been rapid growth in demand for minerals driven by rapidly industrialising nations – notably China and more recently India.

4.12. This has resulted in a step change/increase in mineral pricing. This has enabled profit rates to be considerably and consistently higher than in previous decades.

4.13. This has brought to the fore the issue of resource rent taxation, especially in a context where there is a backlog of unfunded infrastructure and where other sources of public funds may stagnate or shrink due to weakness in other parts of the economy.

4.14. The move by the Australian Government to extend resource rent tax from the offshore oil and gas sector to more of the Australian resources sector is therefore timely and

---

[1] Monopoly practices by buyers rather than sellers.

[2] See, for example, Colley, P (1997), "Investment practices in Australian coal: the practice and profit of quasi-integration in the Australia-Japan coal trade" in *Energy Policy*, Vol. 25, No. 12, pp 1013-1025, and
Colley, P (1998), "Trading practices in the coal market: Application of the theory of bilateral monopoly to the Australia-Japan coal trade" in *Resources Policy*, Vol. 24, No. 1, pp 59-75

welcome. The broader introduction of resource rent taxation is an obvious and pressing economic reform.

5. Broad comments

5.1. RSPT vs. MRRT

5.1.1. The Resource Super Profits Tax was a broader and better proposal than the MRRT. The MRRT represents a compromise with the mining industry that is undesirable with respect to its impact on fiscal policy, community benefit and overall economy-wide impacts.

5.1.2. The MRRT is restricted to coal and iron ore. While these are hugely profitable industries and prime candidates for resource rent taxation, they are not alone in that respect and a more consistent tax would be applied more broadly.

5.1.3. The restriction of the uplift rate in the RSPT to the Long Term Bond Rate was possibly overly restrictive relative to the cost of funds to mining companies. However, the major increase in the uplift rate in the MRRT to the LTBR + 7% is overly generous. So much so that at several points in the Issues Paper there is discussion of measures to minimise potential company practice of holding on to MRRT deductions/losses in order to simply derive profits from the uplift rate.

5.1.4. The proposed RSPT tax rate of 40% was very reasonable, enabling companies to retain the majority of super or excess profits. Dropping that rate to 30% was an extremely generous compromise.

5.1.5. The further inclusion of an “extraction allowance” of 25% of the 30% effectively reduces the tax rate to 22.5%. Describing the extraction allowance as being in recognition of the actions and expertise of the mining company in extracting the resource is a spurious argument in that normal profit rates are meant to be the satisfactory level of return to investors and entrepreneurs for their contribution. It undermines the principle of resource rent taxation that above-average profits derive from privileged

access to the resource and can be substantially taxed without affecting investment and operating decisions. There should be no extraction allowance.

5.2. The State Royalties Problem

5.2.1. The solution proposed in the RSPT and MRRT of royalties being credited against the new tax liability was a means of avoiding a lengthy debate with State Governments over their constitutional right to levy such royalties.

5.2.2. However, it is clear that the Australian Government should set a cap on the crediting of such royalties, or else there would be a moral hazard problem of the State Governments being free to raise State royalties secure in the knowledge that these would be deducted from taxes payable to the national government.

5.2.3. It now appears that the major mining companies believe they agreed to an open-ended deal with the Australian Government – that all current and future royalty increases would be credited against MRRT liabilities. While it is difficult to believe that the major mining companies would genuinely think that the Australian Government would give such an open-ended commitment over a matter in which it has no control, a plain English reading of the MRRT deal does create grounds for concern.

5.3. MRRT Funds for Regions, and a Sovereign Wealth Fund

5.3.1. The proposed RSPT provided for spending on infrastructure of $700m per year along with other measures around company tax rates, depreciation and superannuation.

5.3.2. With the MRRT deal it is unclear what funds will be available from it for infrastructure investment.

5.3.3. The CFMEU has strongly advocated that a significant component of resource rent tax revenue should be allocated to improving social and economic infrastructure in mining regions.

5.3.4. This does not mean funding simply for mining-related infrastructure – eg railway lines and ports for minerals. The industry is capable of funding its own infrastructure. What the union means is funding for the infrastructure that services people in mining communities – regional roads, health services, schools, affordable housing, civic centres and public green space.

5.3.5. Funding of social infrastructure in mining regions is critical to improving quality of life and sustainability in mining regions. It will reduce labour turnover and the skills shortage problem. It will mitigate the heavy reliance on Fly-In, Fly-Out (FIFO) rosters and their associated high fatigue and turnover problems.

5.3.6. MRRT Funds for Regions spending should be done in consultation with Local Advisory Councils of local stakeholders. These advisory bodies should include local government, residents associations, unions and local chambers of commerce.

5.4.<u>Slowing down the resources boom</u>

5.4.1. During the mining industry attack on the RSPT, and the continuing attack on the MRRT by sections of the mining industry, it has been hysterically claimed that resource rent taxation would bring the boom to an end. Some companies threatened to withdraw from certain projects, or claimed to do so. (Though actual evidence of any disinvestment is very hard to find.)

5.4.2. The list of major projects from the Australian Bureau of Agricultural and Resource Economics for April 2010 shows 75 projects worth $110 billion firmly committed, and another 286 projects worth over $250 billion in planning stages.

5.4.3. The sheer size of the project pipeline is imposing major problems on Australia. There are shortages of labour (not just skilled labour) that is hurting other industries as well as mining. There are housing and other services shortages

in mining regions. Long working hours and extreme rosters are producing high labour turnover, fatigue, family breakdown and alcohol and drug problems.

5.4.4. The resources boom is partly caused by the very high profit rates that are available in the industry. This is leading to a large amount of speculative activity, with some entrepreneurs becoming extremely rich simply through the buying and selling of mining leases or even just "mining stories".

5.4.5. The MRRT will act to reduce the huge rate of profit available from many mining investments, while still leaving them very profitable. This will act to take some speculative hot air out of the sector and put it on a more sustainable growth path.

5.4.6. If the resources sector slowed down somewhat it would alleviate the significant "growing pains" it is imposing on the Australian economy and people.

5.5. Sovereign Wealth Fund

5.5.1. It is critically important that the benefits of a resources boom, and of a resource rent tax in particular, be properly husbanded to create long term benefits for the nation.

5.5.2. The revenue should not be entirely spent on short term measures, especially consumption measures.

5.5.3. Resource Rent Taxes will inevitably be subject to major fluctuations, so it is important that year-to-year government budgets not be heavily reliant on it.

5.5.4. Further, the key principle should be that, as mineral resources are finite, a tax that extracts super profits from the industry should provide for long term benefits after the resources are depleted. This fulfils the requirements of sustainable development that meeting the needs of the current generations should not limit the ability of future generations to meet their own needs. Expending the

wealth from resource on short term measures violates this principle.

5.5.5. The CFMEU notes the very large Norwegian sovereign wealth fund that now has over US$500 billion in assets. This fund is based on taxes on North Sea oil and gas, which are now already in a depleted state. The Norwegian fund will provide ongoing benefits for the Norwegian people long after the oil and gas have gone.

5.5.6. The CFMEU urges that, as soon as recovery of public finances from the Global Financial Crisis turmoil permits, a substantial proportion of MRRT revenues should be directed into an SWF for long term wealth accumulation for the people of Australia.

6. Specific issues

6.1. <u>The taxing point</u>

6.1.1. A significant part of the issues paper is concerned with this matter, and it will undoubtedly prove highly complex.

6.1.2. Because the MRRT is project based, there is a preference for basing the taxing point close to the minerals extraction point. However, the market price for most minerals is not readily determined at the “mine gate” and is far more commonly determined or ascertainable at the point of loading onto ship at port.

6.1.3. There will be ongoing tension, and no doubt litigation, over a system where the taxing point is some distance (geographically, and in the value chain) from the point at which a market price is more readily determined.

6.1.4. Given the carve-outs that have already occurred in the MRRT relative to the RSPT, the CFMEU is of the view that the design of the taxing point should seek to maximise tax raised under the MRRT. The other key consideration should be to minimise the opportunities for tax minimisation, tax avoidance and litigation.

6.2. Inclusion of brown coal

6.2.1. Brown coal is proposed for inclusion in the MRRT (page 12), notwithstanding that its extraction and use in Australia is almost entirely as part of vertically integrated brown coal-fired power stations.

6.2.2. It is questionable whether any of the methods discussed for determining an arms length price for brown coal will work. Further, the brown coal power industry is subject to intense debate as to its future under carbon pricing. The Australian Government is facing huge demands for compensation from those power station owners. In that context, it seems both counter-intuitive and a complicating factor to be considering the imposition of further taxes.

6.2.3. It is possible, but not yet probable, that the brown coal resources of Victoria might provide the feedstock for coal-to-liquids and various manufacturing processes provided that Carbon Capture and Storage can be commercially proven. In such circumstances the MRRT would be more appropriate.

6.2.4. The CFMEU is also aware of a proposal to export brown coal that has been dried.[3] It is conceivable in theory that this might create an arms-length price for determining the profitability of brown coal mining separate from power generation, but it will be a relatively small project relative to the volumes of brown coal currently mined.

6.2.5. The exclusion of vertically-integrated brown coal power stations from the MRRT should not create a rationale for the exclusion of vertically integrated black coal power stations. In the latter case, the vast majority of black coal production is for export, and indeed has an alternative market if not used for power station. So an arms-length price determination will be relatively simple.

---

[3] See www.exergen.com.au

6.3.Inclusion of waste coal mine gas

6.3.1. Inclusion of Waste Coal Mine Gas or Coal Mine Methane (CMM) (page 13) may also be more trouble than it is worth. The inclusion of alternative coal technologies in general is supported.

6.3.2. Because CMM is present only in diluted amounts in coal mine ventilation air, and has various contaminants, it is far less usable and therefore far less valuable than coal seam methane (CSM).

6.3.3. CMM is a significant contributor to Australian greenhouse gas emissions and therefore the industry is under considerable pressure to reduce the venting of CMM to the atmosphere. The use of CMM in power generation is a way of both reducing emissions and replacing other power generation. But simply flaring the gas to the atmosphere also reduces emissions (because methane is replaced by carbon dioxide, which is a much less potent greenhouse gas than methane).

6.3.4. The use of CMM for power generation is of marginal or doubtful economic viability without incentives, and the CMM industry obtained certificates under the NSW Greenhouse Gas Abatement Scheme, and has sought assistance under the Renewable Energy Target.

6.3.5. It therefore seems surprising to be seeking to tax it under the MRRT. It is suspected that no MRRT would be payable, and it would mostly constitute a compliance burden. It would be counter-productive to greenhouse gas reduction efforts if the application of the MRRT to CMM encouraged the flaring of CMM to the atmosphere rather than its use in power generation.

6.4.Non-deductibility of financing costs

6.4.1. The non-deductibility of financing costs under the MRRT is strongly supported. The arguments against non-deductibility on page 45 of the Issues Paper are correct.

6.4.2. In particular, allowing the deductibility of financing costs would cause a bias towards debt financing and away from equity financing. It would therefore encourage more speculative and risky investments.

6.4.3. It is the highly-geared speculative investments that inflate asset bubbles and contribute to catastrophic downturns, causing great social and economic dislocation, especially to ordinary working Australians.

6.4.4. With the current huge pipeline of projects (see for example, the list of major projects maintained by the Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences) there is already a case of a surfeit of speculative investments. The MRRT should discourage rather than encourage such speculative activity.

6.5. Transferability of MRRT losses

6.5.1. While the terms of Reference state that MRRT losses will be transferable, the PTG questions whether transfer should actually be required (page 55).

6.5.2. This is because the high uplift rate creates the situation where, if MRRT losses are not immediately offset against MRRT profits elsewhere, they grow at a substantial rate. There may be an incentive for some entities to bank MMRT losses that will grow at a faster rate than their cost of funds.

6.5.3. This problem would be resolved by lowering the uplift rate. In the absence of that, requiring that MRRT losses the transferred and offset against MRRT profits elsewhere in the business makes sense.

6.6. Transferability of Royalty credits

6.6.1. The Terms of Reference state that royalty credits are not able to be transferred or refunded, so the PTG does not examine the issue (page 56).

6.6.2. However, royalty credits are uplifted at the full uplift rate. This means their value will increase rapidly if they are not used. The longer they are held, the greater will be their ultimate cost to the MRRT.

6.6.3. It is arguable that, if MRRT losses can be transferred (and should be transferred, as stated above) then so should royalty credits in order to minimise their longer term adverse impact on revenue raised by the MRRT.

6.6.4. Alternatively, royalties might be uplifted at a reduced rate, or not uplifted at all.

6.7. Market value vs book value of assets for the starting base (page 57)

6.7.1. It is preferable that only book value be used to determine the starting base, as this reflects the actual investment by the company in the project.

6.7.2. Where the bulk of the investment was considerably in the past, it is both fair and appropriate that the written down book value be used as the starting base.

6.7.3. Using current market value (albeit with the trade off of no uplift factor, and long time frames or claiming them as MRRT losses) enables companies to claim a deduction for costs they have never incurred. This is clearly a rort.

6.8. The $50m threshold (page 69)

6.8.1. The CFMEU accepts that the application of the $50m threshold is likely to require a phase-in approach as applies in some parts of the income tax system.