

19 December 2011

Committee Secretary  
Senate Standing Committees on Economics  
PO Box 6100  
Parliament House  
Canberra ACT 2600

Dear Sir/Madam

### **MINERALS RESOURCE RENT TAX – Legislation and Explanatory Memorandum**

This submission is made by the Chamber of Minerals and Energy of Western Australia (CME) in response to the call for public comment from the Senate Standing Committee on Economics on the Minerals Resource Rent Tax (MRRT) legislation referred for inquiry on 10 November 2011.

CME is opposed to the MRRT as it fails to meet a number of tax reform principles and its implementation will impact Australia's international competitiveness as a destination for resources investment. To that end, CME maintains a strong preference for retention of the current State based royalty regime.

Whilst CME appreciates the opportunity to provide comment on the MRRT legislation, it is concerned that a very limited time has been allowed. This period of consultation is inadequate given the complexity of the proposed policy and its potential ramifications on the Australian resources industry and wider economy.

#### **1. CME AND THE WA RESOURCES SECTOR**

CME is the peak resources sector representative body in Western Australia funded by its member companies who generate 95 per cent of all mineral and energy production and employ 80 per cent of the resources sector workforce in the State.

The Western Australian resources sector is diverse and complex covering exploration, processing, downstream value adding and refining of over 40 different types of mineral and energy resources. The sector is also a significant generator of power, predominantly for its own use. Besides being the largest private employer in regional and remote Western Australia, the sector is also the largest private sector employer of Indigenous Australians.

Western Australia's economy has rebounded strongly from the Global Financial Crisis (GFC). Despite economic growth slowing to 0.7 per cent in 2008-09, it grew by 4.3 per cent in 2009-10, 3.5% in 2010-11<sup>1</sup> and is forecast to grow by at least 4 per cent over the forward estimates<sup>2</sup>.

The strong performance of the resources sector underpins these results. In 2010-11, the value of Western Australia's minerals and petroleum production reached \$101 billion, representing a 39 per cent increase over the prior year. Exports of these products, in 2010-11, accounted for 95 per cent of Western Australia's total merchandise exports, and 41 per cent of Australian merchandise exports.

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<sup>1</sup> Australian Bureau of Statistics (ABS) annual State Account estimates

<sup>2</sup> Government of Western Australia, 2010-11 Government Mid-year Financial Projections Statement, December 2010

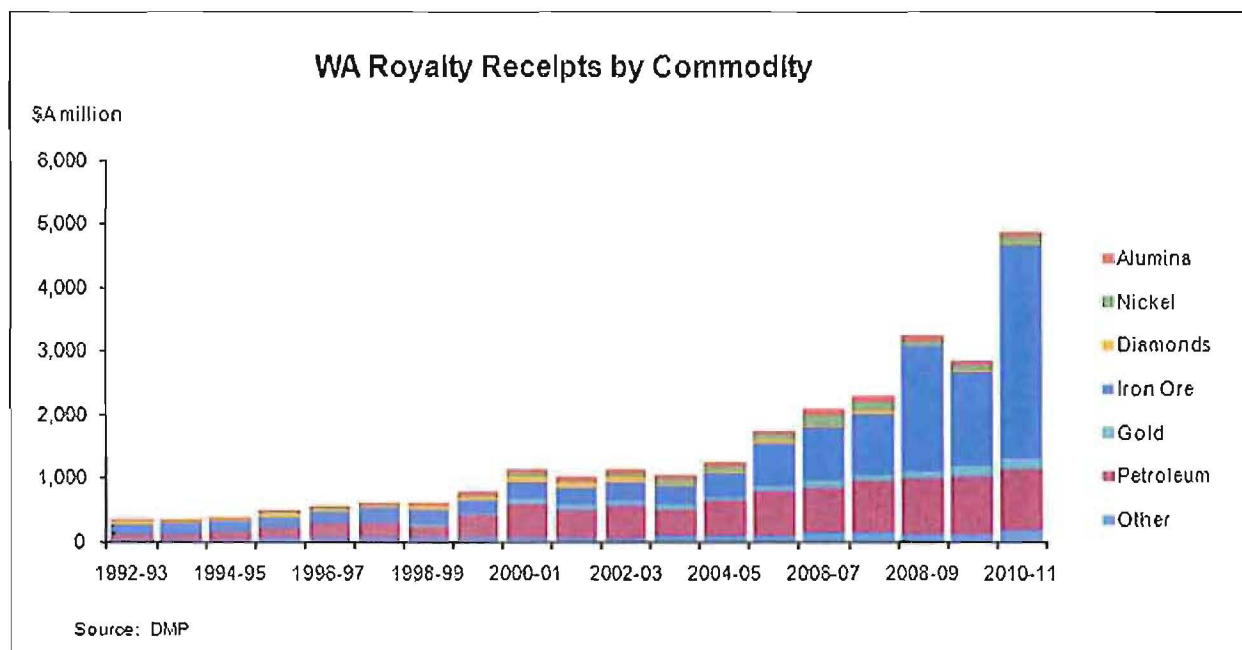
The prospects for future growth are strong, with \$1.59 billion<sup>3</sup> invested in minerals exploration in Western Australia in 2010-11, accounting for 54 per cent of total national investment. In addition, \$2.4 billion was invested in petroleum exploration, accounting for 73 per cent of the total national investment. This exploration is translating into significant further development, with the value of resource projects either committed or under construction more than \$200 billion.<sup>4</sup>

Besides being a significant direct and indirect employer and the major contributor to Australia's record terms of trade, the resources industry is a significant and growing source of revenue for both State and Federal Governments.

With respect to State royalties, the resources industry's contribution in this area has been rising significantly since 2004-05, in line with increasing production and commodity prices. Royalty payments to the WA State Government reached a record \$4.8 billion<sup>5</sup> for the 2010-11 year and are expected to rise to \$5.8 billion for the 2011-12 financial year.

The State also receives additional revenue from the resources industry via other state-based taxes and levies such as payroll tax and stamp duty. The resources sector also invests heavily in regional and community programs which are aided by the Royalty for Regions initiative.

**Graph 1: WA State Royalty Receipts (1992-3 to 2010-11)**



The minerals sector is already among the highest taxed industries in Australia. A recent tax survey report prepared for the Minerals Council of Australia (MCA) by Deloitte Access Economics found that the total tax take (royalties and company tax) from larger miners has been relatively stable in recent years, averaging 41.5% between 2007-08 and 2009-10<sup>6</sup>. The minerals industry revenue contribution from these two sources has exceeded \$80 billion over the last decade and is expected to reach a record \$23.4 billion alone in 2010-11.

Hence, it can be strongly argued that the resources sector is already a significant contributor to the Australian economy and will continue to be so for the foreseeable future.

## 2. RESOURCE RENT TAX REFORM

As you would be aware, CME has always maintained a strong preference for retention of the current State royalty regime, administered by the State Government and with revenues flowing to the State.

<sup>3</sup> Department of Mines and Petroleum, Quick Resource Facts, as at 29 September 2011.

<sup>4</sup> Department of Mines and Petroleum, Investment in major projects (as at 1 March 2011).

<sup>5</sup> Department of Mines and Petroleum, Quick Resource Facts, as at 29 September 2011.

<sup>6</sup> Minerals Industry tax data collection - survey results, Minerals Council of Australia, 29 August 2011.

The State has prime responsibility for resource project approvals and the provision of non-privately owned infrastructure. As such, it is imperative the State Government maintains and receives a dividend for WA resources.

However, the WA resources industry, through the CME, has consistently supported genuine reform of the Australian taxation system and continues to do so to provide for an efficient and effective tax regime. Tax reform is an essential function of Government and CME support the current government initiative in commissioning the Australia's Future Tax System (AFTS) report to develop equitable and efficient tax measures, protect Australia's international competitiveness and promote economic stability.

In relation to any consideration of a federal tax on resources, CME strongly believes that it should:

- be prospective, that is apply only to new investment;
- protect Australia's international competitiveness;
- be differentiated by resource commodities;
- be levied on primary resource value; and
- be equitable and efficient.

While the MRRT represents progress compared to the original Resources Super Profits Tax and has, to a limited extent, addressed some of the aforementioned principles, CME still has serious concerns with regards to a number of issues and firmly believes the proposed measures do not represent genuine tax reform. These issues have been comprehensively outlined in CME's prior submissions to Government and as yet have not been adequately addressed.

Central to its concerns, CME maintains its belief that the implementation of the MRRT must not adversely impact the Australian minerals and energy sector's international competitiveness. Hence, CME continues to oppose the introduction the MRRT until the full impact of the proposed changes is fully understood.

### **3. MRRT ISSUES**

Notwithstanding its opposition to the proposed tax, CME has actively engaged in the MRRT consultation process. CME has made a number of submissions to both Government and the specific reference groups set up to directly consult with industry, being the Policy Transition Group (PTG) and the Resource Tax Implementation Group (RTIG).

Prior CME submissions include the following:

- MRRT policy submission to the PTG (lodged 28 October 2010)
- Submission to the RTIG on the PTG report (lodged 21 April 2011)
- Submission on the preliminary exposure draft legislation (lodged 13 July 2011)
- Submission on the second tranche of exposure draft legislation (lodged 5 October 2011)
- Submission to the House of Representatives Standing Committee on Economics (House Committee) (lodged 8 November 2011)

In addition, CME was co-signatory on a number of MCA joint industry body submissions. The CME specific and MCA joint industry submissions are available upon request.

Listed below are key policy and legislative issues with respect to the MRRT. They are not intended to be exhaustive but highlight those critical concerns CME has with the design and implementation of the MRRT. For a more details on CME issues with respect to the MRRT, please refer to the aforementioned submissions.



(i) Impact on international competitiveness

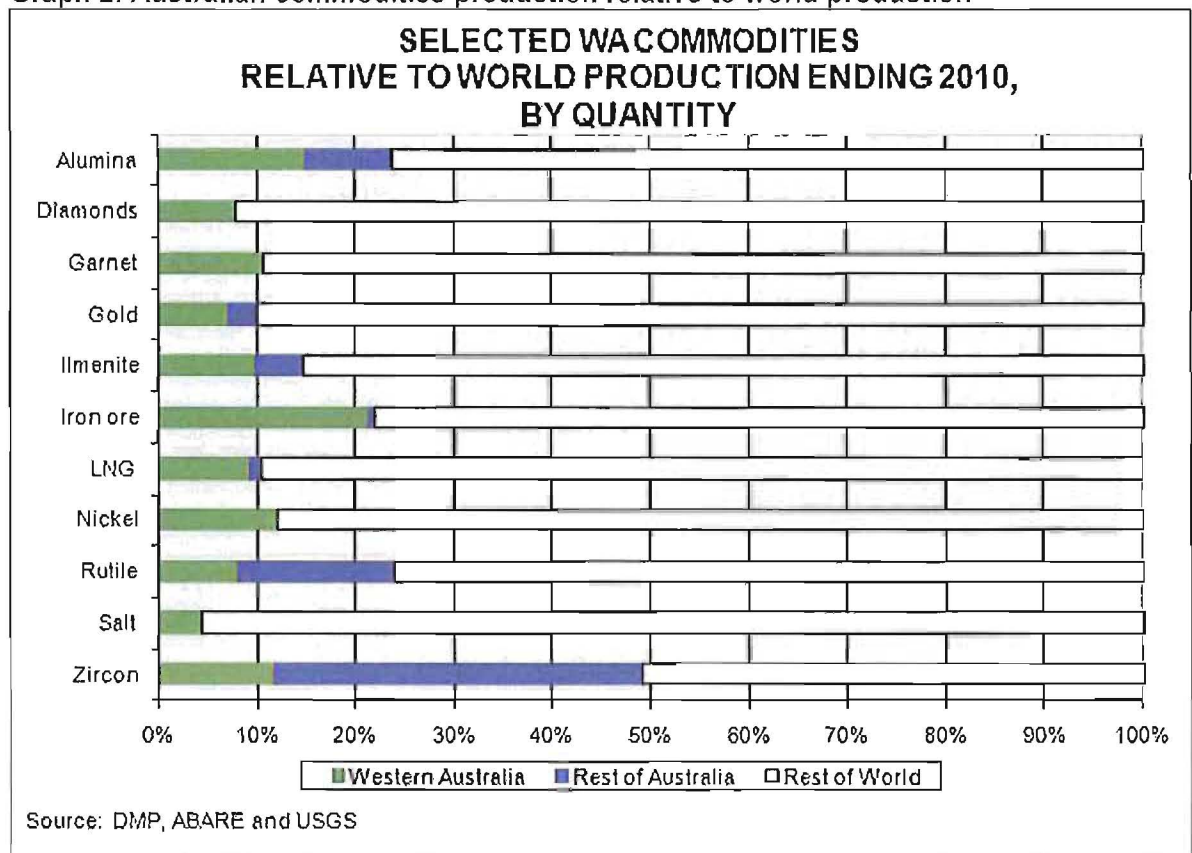
The vast scale of projects in the resources sector requires extensive infrastructure and long term investment capital. In a global economy, the capital essential to fund these projects is highly mobile. Even in the resources sector where Australia is well placed to drive economic growth, there are many competing jurisdictions for investment.

Australia's existing and recently-announced investments in mining and oil and gas are the culmination of significant project development processes. These investments cannot be taken as an indicator of future investments. The global resources sector is assessing other locations in other continents, which have significant potential, and Australia's tax system must remain internationally competitive in order to attract investment, economic development and employment growth into the future.

In this global context, Australia needs tax policies that do not provide a disincentive to investment in an industry and so restrict the ability of Australian operations from competing internationally.

While the Australian resources sector has an important foothold in the global industry, it does not dominate any one market (refer Graph 2). Therefore it remains susceptible to changes in policy that alter its attractiveness against resource sectors in other jurisdictions that compete for market share. In addition, Australia is a high risk, remote and infrastructure challenged environment that has a small population which exacerbates skills shortages.

Graph 2: Australian commodities production relative to world production



It appears little consideration has been paid to the impact of the MRRT on the international competitiveness of the Australian resources sector which relies so heavily on foreign investment.

Under the MRRT, iron ore and coal projects face an increase in their maximum effective headline rate to 45.75%<sup>7</sup>. This may alter investment decisions into Australia compared to other lower taxed jurisdictions. Ultimately, the additional impost of the MRRT will mean less revenue will be available to fund projects, repay debt and provide a return and refund to investors and this may be a real point of difference between funding a project in Australia versus one outside Australia that is not subject to an MRRT equivalent.

**(ii) Not genuine tax reform**

The MRRT does not constitute genuine tax reform but rather adds another layer of complexity and an additional layer of administrative and compliance burden on Australia's resource industry, specifically coal and iron ore. It diverges significantly from the Henry Tax Review recommendations, which, although flawed, did attempt to design an efficient and neutral tax that was not meant to distort investment decisions.

However, under the MRRT, no such efficiency is attempted in its design. Under the MRRT, state royalties are still payable and no refundable credit is provided in periods where no MRRT is payable. Hence, there is no benefit to marginal projects under an MRRT while more profitable projects are subject to a higher effective tax rate. Therefore, as with the RSPT, the MRRT will influence investment decisions.

**(iii) MRRT Threshold**

While CME welcomes an exemption threshold and the Prime Minister's 21 November 2011 endorsement of increasing the threshold from \$50 million to \$75 million, CME has concerns whether it provides the necessary shelter for junior and emerging miners and those producers mining low value resources. Until the impact of the MRRT on Australia's resource industries' international competitiveness and project costing is fully understood, CME recommends particular consideration needs to be given to a significant increase to the currently proposed phased threshold.

Furthermore, CME strongly advocates that the threshold should be subject to indexation to ensure the policy intent of excluding small miners is met in ensuing years.

**(iv) Administrative Burden**

Given the introduction of new major taxes, namely the proposed MRRT and the Clean Energy Future package, Australian companies now face significant tax and compliance costs that our trading competitors overseas do not. Uncertainty around implementation and administration of the new measures increases the risk premium international investors' demand from Australian investment.

CME has significant concerns that projects mining low value resources, which usually required significant processing to add value, will be required to undertake significant and costly compliance measures even though they will be paying minimal or no tax under the MRRT. These concerns also apply to junior developers trying to get their projects up and running.

Furthermore, the Henry Tax Review recommended that resources expected to deliver little or no rent should be exempted where the administration and compliance costs are likely to outweigh any gains from a rent-based tax.

The simplified MRRT obligations are the Governments proposed measures to shield small miners and those with low value resources from administrative burdens. Specifically, Division 200 of the *Minerals Resource Rent Tax Bill 2011* provides for methods a miner can elect to use where the miner's group profits is below certain limits.

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<sup>7</sup> Calculated as follows: MRRT rate of 30% less the extraction allowance of 25% = MRRT effective tax rate of 22.5%. Plus corporate tax of 30% less deduction for MRRT paid = total effect tax rate of 45.75%. Applying to pre-mine gate activities and assuming no starting base deductions or uplift at LTBR + 7%

However, outcomes arising under these provisions act as a disincentive for smaller coal and iron ore miners to elect to apply the simplified MRRT arrangements. For example, where the relevant tests are not satisfied in a subsequent income year or where a miner opts to withdraw from the simplified MRRT obligations, the taxpayer will be required to comply with the full MRRT obligations for that year. Such taxpayers would be treated as new MRRT taxpayers and only receive a deduction for expenditure incurred in the year they fail the test or move to the full MRRT.

This approach will have the effect of denying access to an MRRT starting base, unused royalties or prior year expenditure for smaller producers that exceed the MRRT threshold. This will limit any incentive for smaller producers or those with low value resources to adopt the proposed simplified MRRT arrangements and distort decision-making associated with the MRRT threshold.

Denial of access to an MRRT starting base and prior year expenditure will also impair the market value of these businesses in the event of a possible acquisition by existing MRRT taxpayers because an acquirer would want to be able to utilise starting base, historical losses and unutilised royalty credits.

CME maintains that Division 200 does not take account of these issues. The simplified MRRT obligations as they currently stand will not be taken up by smaller producers as the consequences for exceeding the threshold are likely to be greater than the administrative concessions of the simplified approach.

**(v) Default instalment rate for iron ore too high**

The *Mineral Resource Rent Tax (Consequential Amendments and Transitional Provisions) Bill 2011* includes provisions to collect MRRT under a quarterly instalment regime. The first quarter under which MRRT will arise is the quarter ending 30 September 2012 and the first quarterly instalment payment will be due on 21 October 2012.

The quarterly instalment payable by a miner is calculated as:

$$\text{MRRT instalment income for the quarter} \times \text{MRRT instalment rate}$$

For these purposes the MRRT instalment income equals the gross mining revenue arising from a mining revenue event under section 30-10 of the *Mineral Resource Rent Tax Bill 2011*. In most cases, pursuant to section 30-25(2) this will be equal to the gross revenue from the sale of ore in the quarter.

The MRRT instalment rate may be determined in several ways. Firstly it can be a rate set by the Commissioner based on the miner's previous year's MRRT liability. This will not be relevant for the first year in which the MRRT applies. Secondly, it can be a rate chosen by the miner. Thirdly, if neither the Commissioner nor the miner has chosen a rate, a default rate of 8% for iron ore and 3% for coal will apply.

This means that absent the miner choosing their own instalment rate, in the first year in which the MRRT applies a miner will have to make MRRT instalments equal to 8% of gross revenue arising from mining revenue events (usually the sale of the ore). Working backwards, this assumes approximately 70% of the gross sales revenue of iron ore represents upstream profit for the purposes of MRRT. CME consider this to be an unrealistic assumption and that therefore the default rate of 8% is too high.

Whilst a miner can select their own instalment rate, the miner will be subject to the general interest charge if the chosen rate is too low when compared to its actual MRRT liability.

Therefore, in the first year of the MRRT a miner will have the unenviable choice of either paying quarterly instalments at the rate of 8% of gross revenue or selecting a lower rate and bearing the risk of paying the general interest charge if the rate chosen is too low. This outcome is unfair given that in the first year of MRRT (and the first quarter in particular) a large number of miners may not be in a position to accurately predict their MRRT liability.

It must be remembered that the law is highly complex and is still being developed. There is a very large amount of implementation work to calculate the tax including undertaking starting base valuations (if elected), gathering information and ring fencing operations in a way that most company's information systems do not currently contemplate.

CME submits that the 8% default rate for iron ore is too high and no justification has been given for applying a different rate for iron ore than that which applies to coal. A default rate of 3% should apply to both iron ore and coal. In addition, a miner should not be subject to the general interest charge if it underestimates its instalment rate in the first MRRT year. Rather any interest on underpayment should be limited to the shortfall interest charge.

**(vi) The calculation of Mining Revenue in section 30-25 should be redrafted**

Under section 30-25 of the *Mineral Resource Rent Tax Bill 2011*, specifying a methodology by which to determine the value of the ore at the taxing point, and specifying a number of assumptions that have to be made in applying this methodology is not consistent with the recommendations of the PTG. The PTG simply stated that where there was not an arm's length sale at the taxing point, the value of the resource should be determined "using the most appropriate and reliable arm's length method".

The legislation in its current draft with specified legislative assumptions is potentially limiting.

#### **4. ADDITIONAL CONCERNS**

In addition to the above technical and policy issues with the MRRT, CME is also concerned with additional commitments made by the Prime Minister on 21 November 2011 in order to get passage of the bill through the lower house:

- (i) The establishment of a federal Independent Expert Scientific Committee (IESC) to provide scientific advice to governments about relevant extractive industry activities where they have a significant impact on water. Either through a COAG agreement or amendment to the Environment Protection and Biodiversity Conservation (EPBC) Act 1999, states will be obligated to act on the findings of the IESC.

CME submits that the excellent track record of mine related environmental management in Western Australia demonstrates that the Western Australian government agencies responsible for approving and regulating mining activities, in particular the Department of Mines and Petroleum, the Environmental Protection Authority, and the Department of Environment and Conservation have comprehensive and robust practices and processes in place to ensure extractive activities are managed in an environmentally sustainable manner.

CME does not support initiatives that dilute the stewardship of the State responsibility in managing the approvals process, divert resources and expertise to the Commonwealth, and add administrative burden to an already robust process.

- (ii) CME is disappointed that the Federal Government attempts to limit the State's ability to manage their royalties system as they see fit, including the Treasurer's formal advice to States that their Federal infrastructure funding will be reduced if they have raised royalties since 1 July 2011.

Furthermore, CME is concerned that the Terms of Reference of the current GST Review have been altered to examine the interaction between royalties, the MRRT and GST distribution, with the intention to "penalise and discourage those states which undertake any further royalty increases".

As stated earlier in this submission, the State has prime responsibility for resource project approvals and the provision of non-privately owned infrastructure. As such, it is imperative the State Government maintains and receives a dividend for WA resources via the royalties system.

## 5. CONCLUSION

While CME's preference is the retention of the current State based royalty regime, it will support genuine taxation reform. However, CME still strongly believes the proposed MRRT falls significantly short of delivering this reform and in its current form will significantly impact the international competitiveness of our resources industry, in particular our junior and developing mining sector.

Yours sincerely

**Reg Howard-Smith**  
Chief Executive