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The Chairperson
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

21 December 2011

Dear Sir

MINERALS RESOURCE RENT TAX BILL 2011 AND RELATED BILLS

We refer to the invitation dated 24 November 2011 to provide a submission to the Senate Standing Committee on Economics in relation the *Minerals Resource Rent Tax Bill 2011 and Related Bills* ("the Bills") and we are pleased to provide the following for consideration by the Committee members.

Background

Our Firm

With over 150 partners and 1,300 employees, BDO is one of Australia's largest chartered accounting practices with offices in each capital city and providing services across audit and assurance, corporate finance, corporate and international tax and private entrepreneurial sectors.

The National Firm has taken clear positions in relation to tax reform, highlighted by our 2011 Tax Reform Survey in which we interviewed more than 150 business leaders across Australia and released our findings in a report.[1] We believe tax reform in Australia should be driven from the standpoints of:

- Simplicity;
- Equity;
- Consistency; and
- Incentivising growth.

[1] http://www.bdo.com.au/__data/assets/pdf_file/0009/131202/Tax-Reform-Survey-2011_WEB.pdf

Similar concerns were articulated in *Australia's Future Tax System – Report to the Treasurer* (the Report of the "Henry Review")[2]. Specifically, the Report noted the following on equity,

> *"The tax and transfer system should treat individuals with similar economic capacity in the same way, while those with greater capacity should bear a greater net burden, or benefit less in the case of net transfers. This burden should change more than in proportion to the change in capacity. That is, the overall system should be progressive. Considerations about the equity of the system also need to take into account exposure to complexity and the distribution of compliance costs and risk."*[3]

In Perth BDO has 20 Directors and over 200 staff. One of the focal areas of the Perth practice is the mining, oil and gas sectors. We have significant expertise in this area and our clients range from junior explorers through to large, ASX-listed producers. These clients operate in both domestic and international markets.

BDO has made numerous submissions to Treasury in relation to the *Minerals Resource Rent Tax Bill 2011* and the writer has appeared before the House of Representatives Standing Committee on Economics in relation to the Bills.

We note that on 23 November 2011 the Bills were passed by the House of Representatives and that the Government believes, should the Bills be passed by the Senate, the measures contained in the Bills will raise approximately $11.1 billion in the first three years of application.[4]

Submission

This Submission comprises two sections; namely:

1. Concerns we have in relation to the spreadsheets released by Treasury with respect to MRRT and iron ore[5] and the need for Treasury to release more details of its modelling and the data and assumptions contained in the modelling; and
2. The need for safeguard measures to be considered and introduced into the legislation.

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[2] http://taxreview.treasury.gov.au/content/downloads/final_report_part_1/00_AFTS_final_report_consolidated.pdf at page 17.
[3] Ibid.
[4] Confirmed in the following document dated 20 October 2011: http://www.treasury.gov.au/documents/2247/PDF/FOI_2247.pdf
[5] http://www.treasury.gov.au/documents/1962/PDF/MRRT_Model.pdf

Treasury Modelling

We have reviewed the spreadsheets released by Treasury in relation to MRRT and iron ore[6]. We remain concerned that core data has been blacked out on the model so that it substantially minimises any benefit third parties outside Treasury may derive from reviewing the model. Important data in relation to the projected iron ore price used for modelling purposes, the exchange rate and the starting base have all been hidden.

We note that Treasury has received information from BHP Billiton which appears to have been included in the formulation of Treasury's modelling of MRRT. [7] We note that the following information was included in an email dated 28 June 2010 from Mr Gerard Bond, BHP Billiton to Mr Chris Barrett, Treasurer's Office, Ms Tracey Winters, Department of Resources, Energy and Tourism, and Mr Tom Bentley, Office of the Deputy Prime Minister[8].

Iron Ore Price Forecast USc/dmtu (nominal)	Financial Year 2011	2012	2013	2014	2015	
Platts June	220	202				Platts forward curve (CIF China); market freight rates applied to estimate FOB Port Hedland
Consensus June	185	178	159	135	117	
June ABARE	173	149	140	127	113	June ABARE updated only FY11. Interpolated from FY12 to the same FY15 price as the March forec
March ABARE	128	119	119	117	113	

We note that BHP Billiton provided the following comments to the recipients in that email[9],

In addition, as discussed on 16 June, the move to index pricing of iron ore represents a major step-up in the terms of trade even beyond that likely to be forecast by ABARE. This too would represent a considerable increase in company tax revenue pre any new tax (and post). Attached is a comparison of the June ABARE numbers for iron ore with the early June forward curve from Platts, showing the market is projecting significantly higher prices than ABARE. Yes, Platts only goes out two years, but if the pattern of ABARE was to hold then clearly the realisable prices in this new index world are also higher. Will leave Treasury to extrapolate the possible numbers from this Platts data to get a good sense of possible future tax outcomes. This is public data.

We believe these comments appropriately reflect considered and measured thinking to support the modelling of starting base calculations amongst other things, as at 1 May 2010.

We further note that the Explanatory Memorandum to the *Minerals Resource Rent Tax Bill 2011* states,

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[6] http://www.treasury.gov.au/documents/1962/PDF/MRRT_Model.pdf
[7] http://www.treasury.gov.au/documents/1936/PDF/93_email_market_value_estimates.pdf
[8] Ibid
[9] Ibid

1.24 *Such valuations are generally conducted after the time to which they relate. This is unavoidable and in itself poses no great difficulty provided that the valuation takes into account only those facts, estimates, and predictions which prevailed at the time to which the valuation relates. A valuation of something at a point in time is not valid to the extent it draws on observations made since that time*. (emphasis added)

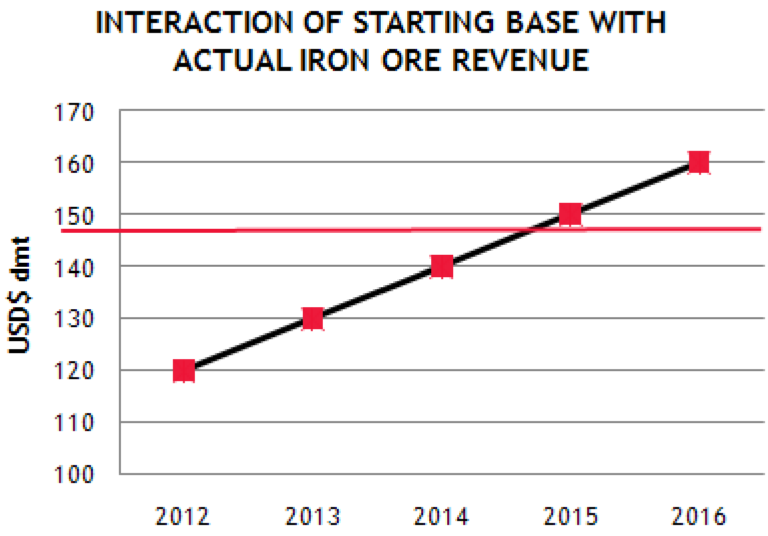
Lastly we note recently reported comments from Rio Tinto as follows,

Albanese said "assumptions that the floor price would not go much below $120 a tonne might be valid next year but not long beyond that." The less than optimistic outlook from the world's number two miner comes at the end of a week which saw iron ore prices drop more than 10%, almost wiping out the gains witnessed since October, when iron ore gave up $60/tonne signalling a sea change in the market. [10]

From the above data, it does not appear unreasonable to have a starting base calculation using an average iron ore price of say, USD$148 dmt whereas mining revenue may be calculated by reference to a price say USD$120 dmt to USD$125 dmt. If starting base deductions are calculated by reference to an iron ore price of USD148 dmt and revenue is brought to account at say USD$120 dmt to USD$125 dmt, it is difficult to envisage how mature companies will have MRRT liabilities. Of course we recognise the calculations in reality are more detailed than this, but the general point is still compelling.

In essence the following graph highlights our concerns where the starting base is calculated by reference to USD$148 dmt and hypothetically, the prices at which the iron ore is *actually* realised, starts at USD$120 dmt and increases in a linear amount until 2016 where the price is USD$160 dmt.

[10] From mining.com.au , 4 December 2011, Article by Frik Els; http://www.mining.com/2011/12/04/rio-tinto-chief-one-more-year-of-120-plus-iron-ore-then-its-over/



It is not until the actual price realised exceeds USD$148 dmt that a profit is made (all other things being equal and ignoring the impact of royalty credits and the uplift factor). We are not suggesting that iron ore prices will perform in the manner outlined and the model assumes no new resources come on stream; it is merely to emphasise that it is unlikely there will be MRRT revenue generated in relation to the resource which has been included in the determination of the starting base amount.

We respectfully request Treasury advise what MRRT tax will be collected if iron ore prices remain at USD$120 dmt for an extended period of time.

Further, we refer to the spreadsheet prepared by the Bureau of Resources and Energy Economics dated October 2011[11] headed *Project Listings*. It is unclear whether all of the "mining expenditure" (for the purposes of the *Minerals Resource Rent Tax Bill 2011)* for projects listed under *Iron Ore – Mining* Projects have been correctly included in the model.

Although not entirely clear, it appears that the model has calculated all depreciation by reference to a 25 year period, whereas, for example, the decline in value for a starting base asset is governed by either proposed section 90-10 or section 90-15 of the *Minerals Resource Rent Tax Bill 2011*. The effective life could be substantially shorter than 25 years.

We again respectfully request that the full model with all assumptions is made available to assist in transparency and enabling the community to understand in greater detail from whom the Government

[11] http://www.bree.gov.au/publications/resources/index.html

anticipates it will raise the MRRT tax revenue and to assist in informed debate concerning the operation of the law and its appropriateness against the tax benchmarks of efficiency and equity.

We also respectfully suggest that the Senators should receive the following information to better consider their vote regarding the legislation:

1. What iron ore pricing has been used in each year modelled and the basis of that pricing;
2. What production levels have been used in each year modelled and the basis of the production levels;
3. What exchange rate has been used in each year modelled and the basis of the exchange rates;
4. What starting base amounts have been used in each year modelled and the basis of the starting base amounts;
5. Which approach for valuing and writing off starting base assets does the model adopt, and the basis for choosing the approach;
6. What remaining effective life of the starting base asset has Treasury adopted for the model and on what basis has the effective life been chosen;
7. What excluded expenditure has been excised in each year modelled and the basis of the calculation of excluded expenditure;
8. What royalty credits have been used in each year modelled and the basis of the calculation of the royalty credits;
9. How many small miners has Treasury modelled will be eligible for the new low profit offset, for relevant taxpayers with mining profits equal to or less than $75 million on the one hand, and between $75 million and $125 million on the other, and how has the number of small miners so eligible been derived; and
10. What levels of rehabilitation tax offset have been included in the Treasury model, in which years, and how has the rehabilitation tax offset been calculated in each year.

Need for Safeguard Measures to be Introduced For Emerging Miners

As we have reviewed the proposed legislation from the standpoints of equity and efficiency, we believe that there are three general outcomes that may arise on the introduction of the law;

(1) Firstly, the iron ore price is so strong and production levels are maintained or increase so that all iron ore producers will be paying MRRT;

(2) Secondly iron ore prices fall away but the smaller miners which have a smaller starting base allowance for example, will pay MRRT in the early years of the law, whereas the larger companies with a more robust starting base allowance, will not pay MRRT;

(3) Lastly, iron ore prices experience a double dip drop (predicted by some analysts) to such levels that no one will pay MRRT.

We are concerned that, particularly in the light of more bearish pressure on the iron ore prices, the scenario where emerging miners with a smaller starting base will pay MRRT where mature miners with larger starting bases may not. We understand that the Treasurer does not hold this view.[12]

The reason for the difference is well explained by Mr Julian Tapp, in the recent House of Representatives Economics Committee hearing in relation to MRRT. The following extract explains the difference,

> *"CHAIR: You are suggesting that small miners do not have the same benefit because small miners do not have the same assets in the ground.*
>
> *Mr Tapp: It is a little more complicated than that. Remember that this will be the value of the assets in the ground as of 1 May 2010. To most of those mining companies in the early stage of development, the market effectively says, 'I'm going to discount that resource in the ground by the probability of your project ever getting up.' Because they are in an early stage of development, the value of the resource in the ground is massively discounted by the risk around their project. Once you are in operation, that 'will this project get up or not' discount effectively disappears. Anybody who is in an early stage of development has the value of their resource in the ground so discounted that they are unlikely to get much shield from it."*[13]

In the event that our analysis is closer to reality than that of Treasury, we reiterate our concern for the need of a safeguard measure that enables emerging miners to begin to pay MRRT at a ***time*** no earlier than when the mature miners pay MRRT and the effective ***rate*** at which the emerging miners pay MRRT is no greater than that of the mature miners.

In this regard, we respectfully draw the Committee's attention to one of the amendments moved by Mr Crook in the House of Representatives[14] [15].

We respectfully request that this amendment is modelled by Treasury and if the financial impact is negligible, we strongly recommend that such a safeguard is introduced to protect the emerging miners in the event that Treasury modelling does not accord with reality.

We believe that such an amendment is fully supported by reference to the tax policy criterion of equity, as outlined above in the quote from the Henry Review, together with that of economic

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[12] http://www.treasury.gov.au/documents/2223/PDF/MRRT_Response_Letter.pdf
[13] http://www.aph.gov.au/hansard/reps/commttee/r435.pdf at page 3.
[14] House of Representatives Hansard, 22 November 2011 at page 137, Mr Anthony Crook.
[15] http://parlinfo.aph.gov.au/parlInfo/download/legislation/amend/r4712_amend_8366fc52-6d35-4d4a-9654-e9928379f1b4/upload_pdf/11239Crook.pdf;fileType%3Dapplication%2Fpdf

efficiency, also acknowledged in the Henry Review as being one of the core design principles of a tax and transfer system[16].

BDO Perth accepts that the amendments moved by the House of Representatives in relation to the low profit offset rules, will potentially reduce the number of mining companies that will pay MRRT tax. Mr Wilkie stated in Parliament that,

> *"I understand that this would reduce the number of resource companies paying the full rate of the tax to 20 or 30 and would cost about $100 million over the forward estimates."*[17]

We are not sure how the number of companies affected has been calculated but notwithstanding the number may be as low as 20-30, we believe that the safeguard measures are required to ensure equity in the application of the proposed legislation.

BDO appreciates the Committee's time in reviewing both the legislation and BDO's submission.

Yours faithfully

BDO Corporate Tax (WA) Pty Ltd

John Murray
Director

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16 http://taxreview.treasury.gov.au/content/downloads/final_report_part_1/00_AFTS_final_report_consolidated.pdf at page 17.

17 House of Representatives Hansard, 22 November 2011 at page 140, Mr Andrew Wilkie.