The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA
ACT 2600
By email: economics.sen@aph.gov.au

23 December 2011

Dear Dr Grant

Submission to the Inquiry into the Minerals Resource Rent Tax Bill 2011

Thank you for the opportunity to lodge a submission to the Committee's Inquiry into the Minerals Resource Rent Tax Bill 2011 and related bills.

Since the announcement of the Resources Super Profit Tax (RSPT) in May 2010, the Magnetite Network (MagNet) has sought to work constructively with the Government and policy-makers to address the magnetite industry's concerns about the impact of the policy on an emerging, jobs-intensive industry. MagNet has welcomed past opportunities to detail the membership's position in written submissions and in making presentations and giving evidence to the Policy Transition Group, the Senate Select Committee on the Scrutiny of New Taxes, the Standing Committee on Economics and the Treasury, in addition to ongoing and extensive dialogue during the formulation and drafting of the Bill.

Since its formation in 2009, MagNet's membership has tripled to representation of emerging producers across four states; Tasmania, Western Australia, South Australia and New South Wales.

Current members	Current supporting members
Asia Iron Australia Pty Ltd/ Extension Hill Pty Ltd Atlas Iron Ltd CITIC Pacific Mining Ltd Crosslands Resources Gindalbie Metals Ltd Grange Resources	Iron Ore Holdings Braemar Iron Alliance comprising: *Bonython Metals Group* *Carpentaria Exploration Ltd* *Havilah Resources* *Minotaur Exploration* *Sinosteel PepinNini Curnamona Management*

Our members are focused on adding value in Australia to low iron-content ore bodies to produce high iron-content magnetite concentrate and pellets - commodities valued for their purity and chemical properties in steel production. Magnetite concentrate requires less energy and releases less carbon emissions in the production of premium-quality steel when compared to Direct Shipping Ore (DSO) or hematite iron ore.

Selected MagNet member projects in Western Australia, alone, represent an initial capital investment of some $21 billion, an estimated $11-12 billion in annual export revenue, more than 12 000 direct construction jobs and 4 000 direct permanent jobs. Please refer to the attached table illustrating the estimated economic benefits of selected MagNet member projects. Some of these are already under construction – the CITIC Pacific Mining Sino Iron project in the Pilbara and the Gindalbie/AnSteel joint venture Karara Iron Ore project in the MidWest.

MagNet's continuing submissions highlight the emerging industry's key concerns arising from the proposed Minerals Resource Rent Tax, as follows:

- Magnetite has more in common with minerals ***excluded*** than those included in the MRRT ; and

- Magnetite ore is not a saleable product of itself and has very little value. The MRRT liability, therefore, should be negligible.

- There is considerable complexity in the methodology to be applied to calculate back or netback the value of ore as extracted given that it is only saleable when made in to concentrate. For example sea-borne trade in magnetite ore has not occurred and it is difficult to work out what value is likely to be attributed by the Australian Taxation Office.

- Treasury has not disclosed its calculations as to what liability is forecast from magnetite projects and while Government Ministers have stated that "little or no tax" is likely to be paid by the magnetite sector this has not been put in writing from Treasury or Government.

The negative unintended consequences of an MRRT applied to magnetite include but are not restricted to:

- Companies will incur significant set-up and ongoing compliance costs;
- Lack of commercial certainty about liability – valuation methodology;
- Investment uncertainty in an emerging, jobs-intensive industry; and
- Investment has already been affected by announcement of the MRRT with a decline in the level of investment in new projects having occurred since May 2010. (Some activity is still occurring.)

Concerns regarding valuation methodology were set out at length in the PwC submission to the Standing Committee on Economics dated 5 October, 2011 lodged on behalf of CITIC Pacific

Mining (CPM), and representing the position of MagNet member companies in broad terms. In summary, these concerns are:

- Uncertainty surrounds the degree of flexibility in applying the appropriate transfer pricing method to calculate the value of the resource at the taxing point. Further, an implied mandated fixed return method for downstream operations, as opposed to a variable return mechanism (e.g., profit split method), is unsuitable for highly integrated magnetite projects. Limits the ability to give a true arm's length value of the resource at the taxing point.
- Explanatory Memorandum contains limited examples of possible downstream activity valuations. This adds to the uncertainty surrounding the application of transfer pricing methods which give the best estimate of the value of the resource at the taxing point in given circumstances. Further examples should be cited, acknowledging the potential application of all OECD transfer pricing methods.
- The stipulation that outsourced downstream functions should be valued at the actual amount paid appears inconsistent with the intent of the MRRT Policy transition Group, namely that revenue taxed by the MRRT does not capture value associated with downstream operations.

Recommendations

- Legislation should be consistent with the Policy Transition Group recommendations, including in particular that taxpayers should have the flexibility to apply the most appropriate and reliable method for their circumstances rather than the legislation prescribing a particular approach or methodology.
- Legislation should remove uncertainty regarding the degree of flexibility taxpayers will have to select and apply the transfer pricing method which gives the best estimate of the value of the resource at the taxing point in their circumstances.
- Additional examples of transfer pricing methods should be added to the explanatory memorandum. These examples should illustrate how the proposed legislative framework can be applied to properly estimate an arm's length value of the resource at the taxing point for projects with integrated and transformative downstream operations (such as magnetite projects).

MagNet notes there has been some real improvement in references to valuation methodology since the release of the second exposure draft version of these complex proposed laws. There was a shift in proposed legislation between the first and second exposure drafts and this saw a significant potential increase in the liability of magnetite projects.

However, reference to the profit split valuation methodology previously contained in the first exposure draft of the legislation has not been fully re-instated in the bill.

As there has not traditionally been sea borne trade in magnetite ore (i.e. before it is subjected to value-adding processing), it is difficult to know with certainty how the Australian Taxation Office is likely to value it. On all indications from Treasury and various Ministers' statements to exclude magnetite from the MRRT would have been revenue neutral: the Government has itself stated that magnetite producers are likely to pay "little or no tax" because the unprocessed ore is of little value.

From a public policy perspective, it is not in the national interest to discourage investment in an emerging industry that value adds and is very capital and jobs intensive at a time when there are significant imperatives to create new jobs in Australia. The patchwork economy is often cited but it is important to note that there are potential new mines in regional areas that have significant unemployment such as NW Tasmania.

The industry offers global carbon benefits as well.

The sorts of investment that can occur – in excess of $3 billion per average project - should be viewed as a very speedy form of economic stimulus given ongoing global uncertainties. The "window" for this investment will close when global iron ore supply catches up with demand.

Clearly some investment is continuing – my submission is that this could be much greater.

MagNet urges the Economics Legislation Committee to recommend to the Federal Government that there be adoption of a definition of "iron ore" that acknowledges and distinguishes between hematite DSO and magnetite. This would acknowledge the vastly different level of capital expenditure required to be spent on the purely processing infrastructure – as opposed to the investment that is common to both magnetite and DSO such as mine establishment, transport, energy, port and other infrastructure.

Such terms already exist in Western Australian legislation in the Mining Act State Royalty Regime and adoption of such a definition of iron ore provides a simple and effective means to amend the bill and given it is unlikely this Committee will recommend excluding magnetite concentrate from the MRRT regime provision can be made to recognise its unique issues.

Much of the detail is yet to be determined and it may well be that by the time of hearing evidence in February much greater clarity is available on the specific issues raised here.

A lot of work is still required in order to calculate actual liability of the individual projects.

Background

When the RSPT was amended to the current MRRT, as announced on 2 July 2010, the

Government noted:

"The new resource tax arrangement will apply to the value of the resource, rather than the value added by the miner. It will do this by setting the taxing point at the mine gate where possible, and using appropriate pricing arrangements to ensure only the value of the resource is taxed."
Source: Joint media statement PM Gillard, Deputy PM Swan and Resources Minister Ferguson - 2 July 2010

Under the Bill, the taxing point is at the run of mine or ROM stockpile. The magnetite industry has consistently argued that magnetite should be excluded from the MRRT:

- The substantial processing required means magnetite iron ore has more in common with minerals excluded, for example alumina and nickel, than those included in the tax;

- The low value of the magnetite resource at the taxing point (ROM stockpile) means that a properly designed rent tax should mean no liability for magnetite projects.

Treasury officials have consistently told MagNet that the Government was not forecasting MRRT revenue from magnetite. This was recently confirmed publicly by Minister Ferguson:

"When you actually go through the detail of this tax you'll see that in terms of the small miners we've gone out of our way, for example, in magnetite to effectively provide them the opportunity to pay little or no tax because, at the taxing point, magnetite the dirt is actually of very little value. The value is the downstream processing that occurs."
Source: ABC Radio National – 1 November 2011

MagNet's analysis of the MRRT design has identified six key issues that support the case for exclusion of magnetite, namely:

1. Magnetite concentrate can be readily distinguished from other iron ore products and this provides a simple method by which magnetite concentrate may be excluded from the MRRT; product derived from the extensive processing of magnetite ore *(Fe_3O_4)* that is only saleable as magnetite concentrate and hematite or direct shipping iron ore "(DSO)" *(Fe_2O_3)*.

2. Excluding magnetite concentrate from the MRRT regime is consistent with the Government's stated policy intent to tax the value of the resource, rather than the value added by the miner and to attribute a value to ore at the mine gate or point of extraction where possible;

3. To include magnetite concentrate in the MRRT regime, while excluding all other mineral concentrate from the MRRT regime, is inequitable and inconsistent as it is discriminatory against one mineral processing sector as against others;

4. The emerging magnetite concentrate industry is unlikely to generate significant, if any, new taxation revenue under reasonable assumptions surrounding the design features of the proposed MRRT regime;

5. Including magnetite concentrate in the MRRT regime will impose a significant compliance burden on magnetite concentrate producers and the public sector for a minimal if any net gain;

6. Including magnetite concentrate in the MRRT regime will have an adverse impact on this emerging industry by deterring investment and jeopardising the significant regional development, economic and social benefits that might otherwise occur.

I urge the Committee to recommend that the Minerals Resource Rent Tax legislation be amended to exclude magnetite, in recognition of the greater investment to be generated for an emerging industry set to diversify Australia's iron ore production and deliver significant economic benefits.

Failing that it is necessary for the Government to implement a legislative framework that will give effect to the objectives of its policy goal i.e. to tax the value of the ore as it comes out of the ground.

Currently the legislation does not ensure that this will occur with significant uncertainty remaining.

Thank you for your attention and consideration.

Yours faithfully,

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Estimated Economic Benefits of Selected MagNet Members' Projects

Company	Mine Life (years)	Capex (A$)	Employment (construction)	Employment (direct ongoing)	Annual Royalties (A$)	Export Revenue (A$)
Asia Iron Australia Ltd Extension Hill Project	+50	2.9b Phase 1	2000	500	50-150m	1.3b
Atlas Iron Ltd Balla Balla Project* (*under acquisition)	+26	1.9b Phase 1 & 2	1650	530	95m	1.1b
Atlas Iron Ltd Ridley Project	+30	2.8b	1100	750	75m	1.25b
CITIC Pacific Mining Sino Iron Project	+25	5.2b (USD)	4000	800	125m	3.0b
Gindalbie Metals Ltd Karara Mining JV	+30	2.6b Phase 1	2000	500	75-100m	1-1.4b
Grange Resources Savage River Operation (Tasmania)	Operating since 1966	NA	NA	600	15m	400m
Grange Resources Southdown Project	+19	2.5b	2000	600	80m	1.6b
Crosslands Resources Jack Hills Expansion Project (Real A$)	+39	3.9b	2000	1250	30-168m	2.0b
TOTAL	-	**$21.8 billion**	**14 750 jobs**	**5 530 jobs**	**$545-808 million**	**$11.65-12.05 billion**