Fortescue's submission to the Standing Committee on Economics – 7 November 2011.

Key points

- The submission draws conclusions about the MRRT by comparing an existing miner with a new miner as opposed to comparing a big miner with a small miner.
- All mining projects that existed on 2 May 2010 have access to the two starting base valuation methodologies (market value and book value).
- The MRRT starting base provisions have been designed to shield existing investments made prior to the announcement of the new resource taxation arrangements. The MRRT will apply equally to all new projects.
- The MRRT applies in the same way to all miners regardless of their size, with the exception of the $50 million threshold and the phasing in of the MRRT liability on profits above $50 million. In addition, access to the alternative valuation method has a 10 Mtpa limit.
- Fortescue's submission raises a number of concerns about small miners' ability to access debt financing. The ability to access debt financing is a feature of the risks and rewards associated with specific projects and project proponents. These risks and rewards are not influenced by the MRRT.
  - Under the MRRT, debt financing costs are not deductible to preserve the competitive neutrality of financing projects with either debt or equity.
  - Financing costs are excluded because the purpose of the MRRT is to tax profits arising from the non-renewable resources that are extracted and those profits should not depend on the way in which a taxpayer chooses to finance its operations.
  - Under the MRRT all capital expenditure (whether equity or debt financed) is immediately deductible.
  - Allowing a specific deduction for financing costs would amount to a double deduction for the cost of capital and leakage of rents to financiers unless the financiers were also subject to MRRT.
- Fortescue's proposed amendments would introduce distortions and could be subject to constitutional challenge. They would also compromise the privacy of taxpayer information.

BDO revised modelling – 6 November 2011

- BDO's analysis compares an existing miner with an emerging miner.
- The same emerging miner example appeared in BDO's 1 November report.
- The BDO emerging miner project has a 358 per cent internal rate of return (pre tax and royalties). After the MRRT is applied, the project's rate of return in 219 per cent. This is a highly profitable project so you would expect the project to pay MRRT.
- BDO have revised their Rio Tinto model making it difficult to verify the figures, some of the changes include:

- MRRT revenue has increased from \$4.13 billion to \$7.46 billion;
- Their analysis now includes \$3.83 billion of upstream operating costs;
- Capital expenditure has increased by \$0.18 billion; and
- Royalty credits are calculated by reference to the MRRT revenue rather than the FOB value.

• On 1 November 2011, BDO released its initial analysis of the impact of the MRRT on the large miners. Based on these figures Treasury raised the following concerns:

  - contrary to the BDO analysis, the majority of capital expenditure would be on downstream activities and therefore not immediately deductible for MRRT purposes;
  - inconsistency in calculating the value of the resource for starting base purposes and for attributing value to the taxing point; and
  - the apparent inclusion of non Australian capital expenditure.

• Treasury concluded that, notwithstanding its flaws, if BDO's 1 November 2011 model were to be applied using more realistic (but still conservative and highly simplifying assumptions), then both BHP Billiton and Rio Tinto would be shown as paying MRRT.

Specific analysis of Fortescue's submission

Letter reference	Views expressed in submission	Treasury's view
Executive summary paragraph 1	"junior miners who will be unable to adopt the market valuation approach"	The market valuation approach is available to all miners.
Executive summary paragraph 1	"This will leave the junior miner competitively disadvantaged , and facing higher financing costs"	The core design features of the MRRT are applied to all iron ore and coal miners. Financing costs are not considered in the calculation of a profit based rent tax to ensure the competitive neutrality between debt and equity funding.
Executive summary paragraph 2	"amending the legislation to ensure that the rate of MRRT paid by junior iron ore miners cannot be more than the rate paid by either of BHPBIO or RTIO."	Constitutional issues may arise if the MRRT was applied in this manner, due to the possibility of the tax being arbitrary.
Detailed submission paragraph 1	Research work conducted by BDO	Treasury believes the analysis conducted by BDO contains a number of flaws.
Detailed submission paragraph 1 – 2nd dot point	"Economic rents only last as long as it takes for factors of production to be attracted to the high economic rents"	Non- renewable resources tend to be protected by mining rights which provides a barrier to entry.
Detailed submission paragraph 1 – 3rd dot point	"utilising the accelerated write-off of the market value of their resources"	Market value will be written off over the life of the mine and does not attract accelerated depreciation.
Detailed submission paragraph 2	"same generous concessions are not available to smaller miners"	All miners have access to the same starting base valuation options.
Detailed submission paragraph 3	"competitive disadvantage faced by the smaller miners"	The relative ability of large and small miners to access debt financing is not influenced by the MRRT.
Detailed submission paragraph 8	"simpler to exclude small miners on the basis of tonnage rather than MRRT profit"	A tonnage based exclusion would be very distortive and would lead to miners altering their production in order to remain under the tonnage limit. In addition, including a tonnage based concession within a profit based tax

		would erode some of the efficiency gains inherent in a profit based regime.
Detailed submission paragraph 9	“therefore would appear in contravention of s51(ii) of the Constitution”	The MRRT provides miners with a full credit for all State royalties paid in relation to the resources. We are of the view that the MRRT therefore does not discriminate between States or give a preference to one State over another.
Detailed submission paragraph 11	“proposed amendments”	The proposed amendments would introduce distortions and could be subject to constitutional challenge. The privacy of taxpayers’ commercial and taxation information would also be compromised.