

Operation and impact of the MRRT

Impact of the Bills on small miners – overview

- 3.1 The committee has carefully examined the features of the MRRT to assess its impact on miners, whether large or small. In particular, the committee has analysed the operation of the starting base – a feature designed to fairly recognise investment decisions made prior to the announcement of a profits based tax in May 2010 – to determine whether it has the potential to unduly favour the interests of the larger or more established miners. The committee has also considered those features of the Bill that are designed to specifically benefit smaller miners.
- 3.2 The committee is mindful of the need not to impose unnecessary compliance costs. This is particularly important for smaller miners that do not have the same capacity as larger miners to deal with these administrative burdens. It is also an issue for those developing new techniques to exploit taxable resources, such as magnetite producers, that are not at this stage expected to face significant MRRT liabilities.
- 3.3 The committee does not consider that the Bill discriminates against small or emerging miners. In most respects the MRRT applies in the same way to all miners regardless of their size. The exceptions are those features of the MRRT that are tailored to benefit smaller miners. In particular, the Bill relieves a miner of any MRRT liability if its mining profit is less than \$50 million. The Bill also gives a small miner the choice to simplify their compliance and record keeping obligations. Both of these features exclusively serve the interests of smaller and emerging miners.

Small and emerging miners

Background

- 3.4 There were conflicting views put by mining representatives on the effect of the MRRT on small miners relative to large ones.
- 3.5 Fortescue Metals Group (FMG) and the Association of Mining and Exploration Companies (AMEC) expressed concerns that the bulk of the MRRT will be paid by the small and emerging miners, while the largest miners will pay little or no MRRT. This view was largely premised on the notion that BHP Billiton, Rio Tinto and Xstrata had secured a favourable agreement from the Government in mid-2010, at the expense of all other iron ore and coal miners. In particular, FMG and AMEC consider the design of the starting base to be unfair to small miners.¹
- 3.6 In contrast, the Minerals Council of Australia (MCA) claimed that the bulk of MRRT liabilities will fall on larger miners with more profitable projects. It submitted that:
- The MRRT is based on the principle of competitive neutrality (i.e. neutral across included resources and different project configurations) with general tax principles applied in a consistent fashion. It has been aligned deliberately with familiar concepts and definitions of Australian tax law. No provision of the tax discriminates against smaller, emerging Australian miners; indeed, certain features of the MRRT (the low profit threshold and simplified obligations) are designed to lower the overall burden of the tax on smaller miners.²
- 3.7 The MCA also submitted that the claims ‘that small miners will pay a disproportionate share of the MRRT contradict the experience with other profits-based mining taxes in Australia – notably company tax. Larger miners (with annual income above \$1.46 billion a year) make up 0.5% of all mining companies but on the basis of the most recent official statistics pay more than 82% of net company tax for mining in Australia’.³
- 3.8 In support of its view, FMG cited modelling it had commissioned by BDO Corporate Tax (WA) that claimed to show that BHP Billiton and Rio

1 Fortescue Metals Group, *Submission 1*, p. 1; Association of Mining and Exploration Companies, *Submission 9*, p. 1.

2 Minerals Council of Australia, *Submission 7*, p. 21.

3 Minerals Council of Australia, *Submission 7*, p. 21.

Tinto were unlikely to pay MRRT in the first five years of its implementation.⁴

- 3.9 On 8 November 2011, the Treasurer and Deputy Prime Minister, the Hon. Mr Wayne Swan MP wrote to BDO expressing concerns that the modelling contained mathematical errors and made inconsistent assumptions that overstated deductions (including, for example, investments made in Canada and Guinea) and understated revenue. The Treasurer attached to that letter advice from the Treasury. That Treasury advice stated that if BDO's model were to be applied using more realistic assumptions, then both BHP Billiton and Rio Tinto would be shown as paying MRRT. The Treasurer also pointed out that BDO's example of a commercially realistic small miner was one that generated returns to investors of over 200 per cent per year, even after allowing for the payment of the MRRT. The Treasurer questioned whether it was appropriate to extend further concessions to a miner in such circumstances.⁵
- 3.10 BDO supplied updated modelling to the committee. According to BDO, the further modelling contained:
- Updates to the Rio model include refining the deduction for relevant expenditure incurred in the carrying on of upstream mining operations, while recognising that excluded expenditure has not been deducted due to the difficulties in identifying this non deductible expenditure.⁶
- 3.11 In evidence before the committee, Mr Sedgley of the Treasury said:
- It is a bit difficult to know how to interpret the revised modelling, because BDO have not disclosed the source of the new figures they have inserted into the model.⁷
- 3.12 In spite of submitting BDO modelling to the Committee, both BDO and FMG suggested in evidence that the focus should be on the fairness of the MRRT, rather than modelling assumptions. They submitted that equity would be served by amending the Bill so that any miner other than BHP

4 Fortescue Metals Group, *Submission 1*, p. 2.

5 Letter from the Treasurer and Deputy Prime Minister, the Hon. Mr Wayne Swan MP to Mr John Murray, BDO Corporate Tax (WA) Pty Ltd, dated 8 November 2011, available at: http://www.treasury.gov.au/documents/2223/PDF/MRRT_Response_Letter.pdf

6 Fortescue Metals Group, *Submission 1*, p. 2 of attachment.

7 Mr Patrick Sedgley, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 44.

Billiton, Rio Tinto and Xstrata would have its liability capped to the highest effective rate of MRRT paid by any of those three miners.⁸

Analysis

3.13 In its submission the Treasury expressed the following views on FMG's proposed amendment:

Fortescue's proposed amendments would introduce distortions and could be subject to constitutional challenge. They would also compromise the privacy of taxpayer information.⁹

3.14 The committee is cognisant of the fact that the amendment proposed by FMG is not limited to the benefit of small miners. By its own admission, FMG is not a small miner. However, the amendment it proposes would cap its own liability by reference to that of its competitors. Potentially, this could mean that the effective rate of MRRT paid by FMG is capped to that of its largest competitors simply because those other miners are in a phase of heavy investment (which would reduce their annual MRRT profit).

3.15 The committee is particularly concerned that the proposed cap has the potential to interfere with the normal commercial incentives to invest and grow a project. In the committee's view, the cap would tend to reduce the incentives for all miners to invest in developing their projects. The largest miners would be less inclined to invest than otherwise, because in doing so they would reduce their exposure to MRRT and incidentally reduce the MRRT liability of their competitors. The proposed amendment would create an absurd situation in which the investment of one miner has the effect of providing an effective tax deduction to another. At the same time, smaller miners would also be less inclined to invest than otherwise, because they would know that any costs they incur would be effectively non-deductible if they reduced their effective tax rate below that of their largest competitors. These kinds of distortions are highly undesirable and have the potential to erode the efficiency gains that a profits-based tax like the MRRT seeks to achieve.

3.16 The committee is also concerned that the amendments proposed by FMG could be characterised as amounting to an arbitrary or incontestable tax. It is a basic principle of our system that taxation should be sufficiently certain and contestable. The intent of FMG's amendments is to make the tax liability of one miner directly dependent on the tax liability of another.

8 Fortescue Metals Group, *Submission 1*, p. 2 of attachment.

9 Treasury, *Submission 6*, p. 1.

This means that a miner other than BHP Billiton, Rio Tinto and Xstrata would be unable to work out its own liability to MRRT until each of those large miners had lodged a MRRT return. This reduces the certainty with which a miner can work out its own liability to MRRT and reduces its ability to challenge the Commissioner of Taxation's assessment of that liability.

- 3.17 Like other tax laws, the Bill provides a period in which a miner and the Commissioner can alter the miner's original MRRT assessment to correct any mistakes. In addition, a dispute between the Commissioner and a miner over an assessment may need to be resolved through the courts, which can take many years. During these periods in which the MRRT liabilities of the largest miners are not yet finally settled, the amendment proposed by FMG and BDO has the potential to introduce considerable uncertainty across the industry.
- 3.18 The committee also notes that, while the MRRT liability of a miner would depend on the liability of BHP Billiton, Rio Tinto and Xstrata, it would have no ability to challenge the tax assessment of those others. Without this ability to challenge the basis of its own tax liability, there may be some doubt as to whether the tax was adequately contestable.
- 3.19 These are complex issues, which are not addressed in the FMG submission. The committee is conscious of the Treasury's advice and the evidence of the Institute of Chartered Accountants that:

the proposal, as I understand it, would represent a novel way – that is to say an untested and new mechanism – by which to go about ascertaining the liability of particular taxpayers to MRRT that does not exist anywhere else in our tax system at this point. Once again, any of these ideas could certainly be considered, and the parliament should have the opportunity to put forward any amendments it believes are appropriate, but there are a couple of constraining factors that I think would need to be taken into account in deciding whether or not to do that.¹⁰

Conclusion

- 3.20 The Committee has considered a number of these constraining factors. The amendment proposed by FMG has the potential to interfere with investment decisions, which would harm the industry at large. It also

¹⁰ Mr Yasser El-Ansary, Institute of Chartered Accountants in Australia, *Committee Hansard*, 9 November 2011, p. 15.

introduces significant uncertainty since a miner's liability to MRRT will depend on matters beyond their own control and knowledge. The amendments are also at risk of being seen as imposing an arbitrary or incontestable tax. For these reasons the committee does not support the amendments.

Transition arrangements and the starting base

Background

- 3.21 The starting base is part of the transition arrangements that recognise investments that existed before the announcement of the resource tax reforms on 2 May 2010.
- 3.22 A miner has two choices of starting base, i.e. the tax shield for existing investments:
- either the market value (including value of resource), which is allowed as a deduction spread over 25 years or the life of the mine. This isn't uplifted but unused annual allowances will be uplifted by CPI; or
 - book value (excluding value of resource), is allowed over 5 years and is uplifted by bond rate plus 7 per cent.
- 3.23 Several witnesses to the committee identified the starting base as a proxy for excluding these investments from the MRRT, and so preserving the tax treatment that existed when these investments were made. These witnesses suggested this form of 'grandfathering' was not unusual in the context of a new tax.¹¹ For instance, the capital gains tax does not apply to assets purchased before that tax was announced in 1985.
- 3.24 Submissions and evidence from all mining industry witnesses supported this principle. However, the committee heard concerns expressed on behalf of small miners that the design of the starting base inherently favours existing large producers.
- 3.25 According to FMG and AMEC, this is likely to provide a tax shield sufficient for established large miners to have no significant MRRT liability for the foreseeable future. In contrast, they say, junior miners will not be entitled to a similar starting base. Both AMEC and FMG allege that

11 Mr Mitchell Hooke, Minerals Council of Australia, *Committee Hansard*, 9 November 2011, p. 18.

the MRRT is unfair and discriminatory against small and emerging miners in this respect. In its submission, FMG stated:

Junior miners will mostly be unable to utilise the market method methodology because in the early stages of development the markets heavily discount the expected value of any resource in the ground to reflect the project risk associated with its eventual development or otherwise.¹²

- 3.26 In testimony, FMG and AMEC acknowledged that the discounting on resources in the ground is the same for large and small companies.

Analysis

- 3.27 The Bill gives the same opportunities to miners both big and small to market value the mineral resources for the purposes of the starting base. While it is reasonable to expect that a project that was fully developed on 1 May 2010 will have a larger market value than another project that was in its earlier stages at that time, this itself is not discriminatory as between large and small miners.
- 3.28 Also, miners with large starting bases are likely to have large liabilities. That is, there is a direct relationship between the value of the mineral and the value of the revenues subject to MRRT. Further, under the MRRT, miners, whether large or small, cannot allocate that part of the starting base due to minerals in the ground against other mines.
- 3.29 The fact that established miners are expected to have larger starting bases simply reflects the fact that these miners have made significant investments before the announcement of the resource tax reforms. This is consistent with the policy aim of the starting base, which is to provide a limited recognition of the value of assets (including mineral assets) held by a miner at the time the resource tax reforms were announced. The policy is not to provide the same shield to all miners, it is to provide a shield that reflects the value of mining assets that a miner had before the resource tax reforms were announced and that will be subject to the MRRT.

Conclusion

- 3.30 The committee is satisfied that the design of the starting base is fair and equitable as between large and small miners. It is inevitable that emerging

12 Fortescue Metals Group, *Submission 1*, pp. 2-3.

projects will have lower starting bases than established projects, but this reflects the actual investment and the fact that the starting base is intended to limit the retrospective effect of the MRRT on pre-existing investments.

- 3.31 The committee also notes that, in contrast with past investments that are deductible via the starting base over a period of up to 25 years – or five years depending on the mechanism chosen by the mining company to calculate the starting base – the costs of developing a new project after 1 July 2012 will be immediately deductible under the MRRT. Accordingly, the committee does not agree with those submissions that claim the design of the starting base discriminates against small and emerging miners.

Concessions for small and emerging miners

Background

- 3.32 There is no MRRT liability for miners with MRRT profits of \$50 million or less. To ensure that the low profit offset does not distort the production behaviour of an entity approaching the \$50 million threshold, it phases out for profits between \$50 million and \$100 million.

- 3.33 Commenting on the phase-out, FMG submitted that:

It would have been simpler and more equitable to allow the tax threshold to be a tax free threshold without a clawback mechanism. It would have been even simpler to exclude small miners on the basis of their tonnage rather than MRRT profits as this would have generated certainty and excluded unnecessary compliance costs.¹³

- 3.34 The Chamber of Minerals and Energy of Western Australia (CME) submitted that:

While an exemption threshold is welcome, CME has concerns on how this threshold was determined and 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.

13 Fortescue Metals Group, *Submission 1*, pp. 4-5.

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.¹⁴

Analysis

- 3.35 The committee notes that FMG's suggestion that the \$50 million threshold be treated as a tax-free threshold would mean that the concession would not be targeted to the interests of small miners. Extending the concession to large miners, like FMG, would involve a considerable cost to the revenue. In order to contain this cost, it would be necessary to reduce the level of the threshold. It is difficult to see how a change of this sort would benefit small miners.
- 3.36 In response to FMG's suggestion of a tonnage-based exemption from the MRRT, the Treasury advised the committee that:
- 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.¹⁵
- 3.37 The committee also notes that a tonnage-based exemption would tend to disadvantage miners who produce relatively low grade minerals and those whose value is lower because of distance to market.
- 3.38 Further, a tonnage exemption would not relieve any compliance costs. This is because producers would have to continue to operate as if the MRRT applies in case they go over the threshold and they wish to realise the deductions on their capital from when they started investing.
- 3.39 Like many thresholds in the tax law, the \$50 million threshold for the low profit offset is not indexed to automatically increase each year. Instead, these thresholds are normally reviewed in the context of the Budget.

Conclusion

- 3.40 The committee does not consider that the basis for the low profit offset should be amended. As the MRRT is a profits-based tax, it is appropriate that the exclusion of small miners be based on the size of their profits, not the volume of their production. A tonnage-based exemption has the

14 Chamber of Minerals and Energy of Western Australia, *Submission 5*, p. 5.

15 Treasury, *Submission 6*, pp. 3-4.

potential to apply unfairly and to interfere with normal commercial decisions.

- 3.41 While it may be appropriate for the level of the \$50 million threshold to be reviewed in the future, the committee considers this is best done following a review of whether the threshold is delivering the appropriate policy outcomes, rather than by automatically indexing the threshold.

Compliance costs on small and emerging miners

Background

- 3.42 Some miners may be below the \$50 million profit threshold for some time before they start having an MRRT liability.
- 3.43 The Bill gives a miner the option to choose a simplified system if its profit (as measured for accounting purposes) is below certain limits. The method is simplified in that it excuses a miner from having any MRRT liability and from having to lodge an MRRT return. However, an important consequence of this choice is that the miner's starting base and its allowances are extinguished rather than carried forward to reduce any MRRT liability the miner has in a later year.
- 3.44 The CME submitted that small companies will not choose the simplified system because of the benefits under the MRRT regime of being able to carry forward losses, including investment and royalties, to reduce MRRT liabilities in later years:

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 the losses and unutilised royalty credits.¹⁶

16 Chamber of Minerals and Energy of Western Australia, *Submission 5*, pp. 5-6.

3.45 However, Mr Hooke of the MCA observed that, for growing companies, keeping these records at an early stage of their development was an investment for the future:

there will be compliance costs and, for some companies that are growing, it is not a bad investment on their part to be taking account of the costs that they will incur as they move through the growth cycle. When you do income tax, as you know, you do that on a company platform. But keeping the records for MRRT applicability, and therefore potential liability, is on a project by project basis. So if companies are growing it actually makes good sense to be working through those compliance arrangements and even bearing the costs in the early phases.¹⁷

Analysis

3.46 The intention of the simplified MRRT is to reduce the complexity and compliance costs for those miners who are not likely to bear an MRRT liability immediately and for the foreseeable future. Miners in these circumstances can choose not to keep the records about assets, expenses and revenue so as to minimise the administrative burden of the MRRT. However, a natural consequence of this choice is that without this information it is not possible to take those assets, expenses and revenues into account in the future.

3.47 Inevitably, small miners will have to consider whether it is worthwhile for them to carry the compliance costs associated with tracking assets, expenses and revenues. Some small miners will assess the value of doing so exceeds the costs, and will not choose to use the simplified method. For the others, it is appropriate that they be able to choose the simplified method in the knowledge of the benefits of doing so.

Conclusion

3.48 The committee notes the advice from several witnesses that they will not use the simplified MRRT system, so as to preserve their ability to carry forward allowances to offset against future MRRT profits. However, it is appropriate that small miners be given the option to use the system if they wish. The consequences of choosing this option are an inevitable trade off between the costs and benefits of keeping records for the MRRT.

17 Mr Mitchell Hooke, Minerals Council of Australia, *Committee Hansard*, 9 November 2011, p. 17.

The emerging magnetite industry

Background

- 3.49 The evolution of Australia's iron ore industry has seen the development of a new extractive industry, the processing of low-grade magnetite ore into magnetite concentrate and pellets as a feedstock to the steelmaking process.
- 3.50 The magnetite industry is expected to continue to grow substantially in the future. The Magnetite Network informed the committee that:
- Selected MagNet member projects in Western Australia, alone, represent an initial capital investment of some \$21.8 billion, an estimated \$119.5 billion in annual export revenue, more than 14 750 direct construction jobs and 5 500 direct permanent jobs.¹⁸
- 3.51 Given the extensive processing required to produce magnetite, it is generally expected that its producers will not face high MRRT liabilities. The MCA submitted that:
- Projects mining relatively low value minerals which require significant downstream processing or "beneficiation" (e.g. magnetite ore) are unlikely to have significant (or indeed any) MRRT liabilities.¹⁹
- 3.52 The Magnetite Network submitted that magnetite ore is not a saleable product and has very little value that will be taxable under the MRRT. For this reason, the Magnetite Network suggested that magnetite has more in common with minerals excluded than those included in the MRRT. It proposed that magnetite be excluded from the MRRT on the basis that magnetite projects are unlikely to be liable for MRRT but would incur significant compliance costs that could damage the emerging industry.²⁰

Analysis

- 3.53 Magnetite production involves significant processing and value adding in order to produce high grade concentrate and pellets from low grade ore. Although many of these costs relate to downstream operations (and so are not directly deductible under the MRRT), these costs will be taken into

18 Magnetite Network, *Submission 4*, p. 2.

19 Minerals Council of Australia, *Submission 7*, p. 21.

20 Magnetite Network, *Submission 4*, p. 2.

account in working out the revenue that reasonably relates to the low grade ore before it has been processed. For this reason, it may be reasonable to assume that magnetite producers will face lower MRRT burdens than other miners.

- 3.54 The heavy investment occurring in the magnetite industry will also serve to reduce its exposure to paying MRRT. Upstream investments made before 1 July 2012 will contribute to a starting base that will reduce future MRRT liabilities. Upstream investments made on or after 1 July 2012 will be immediately deductible under the MRRT. This further suggests that magnetite producers may not face significant MRRT liabilities in the near future.

Conclusion

- 3.55 It is appropriate that the resource tax reforms contained in this Bill are robust with respect to these new industries and technologies while ensuring they do not stifle these developments.
- 3.56 The committee considers it appropriate that the MRRT apply to magnetite, as it does to other types of iron ore. Nevertheless, given the high levels of initial investment occurring in the industry and the relatively high processing costs involved, it may be reasonable to expect that magnetite producers will not face significant MRRT liabilities especially in the early years of the MRRT. In that event, the operation of the low profit offset and the option for small miners to use the simplified system adequately address any concerns that the MRRT will impose undue burdens on these emerging miners.

Modelling and revenue estimates

Background

- 3.57 The *Explanatory Memorandum* to the Minerals Resource Rent Tax Bill 2011 shows the following revenue estimates:

Table 3.1 Revenue estimates for the MRRT

2011-12	2012-13	2013-14	2014-15
Nil	\$3.7 billion	\$4 billion	\$3.4 billion

Source *Explanatory Memorandum*, p. 4

- 3.58 In evidence, Treasury stated that it expected that the larger mining companies would be paying the clear majority of the tax. The three large mining companies (Rio Tinto, BHP Billiton and Xstrata) comprise 88 per cent of the market share of iron ore in Australia,²¹ and this mineral will provide approximately 75 per cent of the revenue under the MRRT.²²
- 3.59 These estimates and the way Treasury calculated them were challenged by Fortescue Metals, who engaged BDO, an accounting firm, to model the effects of the MRRT. BDO did not model the MRRT in aggregate, but rather it looked at how the MRRT operated at the firm level. It found that Rio Tinto would have no MRRT liability in the first few years due to its varying deductions. This is clearly inconsistent with the Treasury figures, which imply that large firms could pay up to \$1 billion in MRRT.
- 3.60 The BDO analysis also found that a very profitable smaller miner, with MRRT revenues of over \$500 million and profit levels of 300 per cent, would have an MRRT liability of between \$20 million and \$50 million.²³
- 3.61 AMEC also challenged Treasury's calculations. They commissioned Professor Pietro Guj of the University of Western Australia, who generated calculations of how the tax would affect an emerging producer.
- 3.62 During the hearings, a number of parties requested Treasury to release the data and assumptions underlying their modelling so that these disparities could be resolved.²⁴ For example, ICAA stated:

We as a community should expect full transparency around the implementation of significant new policy like this. I am not sure that we have had that full transparency. I think in the latter part of the consultative process, over the last year or so, there certainly has been a very significant attempt to share information and to share thinking about the policy design and the expectations for the new mining tax. But I do not think it would reasonable to say that we have seen all of the relevant information, nor have we seen certain key aspects of the information such as, for example, the economic modelling that underpins the detailed analysis behind the mining tax.²⁵

21 Mr Colin Brown, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 7.

22 Mr Colin Brown, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 38.

23 Fortescue Metals Group, *Submission 1*, pp. 9-10.

24 Mr John Murray, BDO, *Committee Hansard*, Canberra, 9 November 2011, p. 2; Mr Simon Bennison, AMEC, *Committee Hansard*, Canberra, 9 November 2011, p. 31.

25 Mr Yasser El-Ansary, ICAA, *Committee Hansard*, Canberra, 9 November 2011, p. 14.

Analysis

3.63 There are a number of preliminary points that must be considered. For example, Treasury develops its estimates in a different way to the methods described above.

... it is a bit like saying we would model tobacco excise based on working out which people smoked and how much they smoked and adding that all up. We do not do that. We look at it from the aggregate data end of things – looking at importations, sales and production. So in our modelling we do not end up knowing who is paying it, we only know the overall result ...²⁶

3.64 When looking at the macroeconomic effects of a tax, Treasury's approach of working with aggregate numbers is preferable. If Treasury were to consolidate a large number of estimates of how a tax would work at the firm level, this aggregation would multiply any possible errors and create a great deal more uncertainty about the estimates.

3.65 The other preliminary point is that the modelling provided by BDO has been subject to quality issues. BDO needed to correct a number of errors in previously published work. For example, it included Canadian and Guinean capital expenditure, when the MRRT only applies to Australian projects. However, Fortescue stated that the current iteration was accurate.²⁷ BDO has also made some assumptions that are not realistic, for example:

- assuming that a resource is low value for calculating revenues, but then assuming the resource is high value for calculating the starting base, which acts as a deduction; and
- assuming that a company's investment will be on upstream activities within the mine, and hence a deduction, whereas it is mainly on downstream activities, such as a railway, which means that it will not be a deduction for MRRT.²⁸

3.66 Treasury responded to the transparency point in two ways. Firstly, it stated that it had already released a version of the model on the Internet in response to a Freedom of Information request:²⁹

26 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 42.

27 Mr Marcus Hughes, Mr Julian Tapp, Fortescue Metals Group, Mr John Murray, BDO, *Committee Hansard*, Canberra, 9 November 2011, pp. 7-8.

28 The Hon. Mr Wayne Swan MP, Treasurer and Deputy Prime Minister, *Exhibit 2*, p. [3].

29 Treasury, 'RSPT and MRRT Revenue Estimates,' <http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962> viewed 11 November 2011.

It is available on the Treasury website and it was released under FOI on 14 February 2011. That is the model that we utilise – the only omissions from what was released on the website due to commercial-in-confidence information as the model was extensively informed by information which was provided on a commercial-in-confidence basis by mining companies ...

It is a copy of the model. The assumptions that we used in the model are kind of embedded in there. It is not a precis of it. It was released under FOI, so what we actually published was what we were using at the time.³⁰

- 3.67 There is another important reason for believing that the design of the MRRT will raise the forecast revenue, absent of changes due to movements in economic parameters. The design of the MRRT reflects consultation with the mining industry, including the provision of confidential information to the Treasury. The Government then used this information provided in good faith by the mining industry to determine the appropriate MRRT tax rate and size of deductions. In effect, the Heads of Agreement contains implicit revenue projections based on information provided by the mining industry which were integral to the design of the MRRT.
- 3.68 Treasury stated that the model includes some commercially sensitive information that had been provided to Treasury on a confidential basis. This related to the volume of production, the prices and the starting base:³¹

Those matters were informed by consultation with companies. On an ongoing basis the Treasury renews its forecasts of commodity prices using a range of information, including consultations with industry groups. So that information is, as a result, commercially sensitive and was withheld from what was published on the website. Similarly the starting base that is used in the model was informed by consultations with industry. Again, that information was considered commercially sensitive and was withheld from the model. By the way, that was in consultation with the entities that provided the information. That is a requirement under the FOI Act. If we have third party information we actually have to ask for people's permission to release it.³²

30 Mr Colin Brown, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 38.

31 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 38.

32 Mr Colin Brown, Treasury, *Committee Hansard*, Canberra, 9 November 2011, pp. 38-39.

- 3.69 AMEC has sought to work with Treasury in order to develop its own firm-based modelling. The Association stated in evidence:

When the University of WA did its independent modelling and we took it to Treasury, obviously they were saying, 'The differential you're identifying is because of A, B and C.' We said: 'That's fine. Now you tell us the parameters that you've been using that would enable us to try and line the modelling up so that we're comparing apples with apples.' That is where their constraints started to emerge, in the sense that they were not able to divulge the key parameters that were discussed as commercial-in-confidence in July last year – that is, price, exchange rate et cetera. All we could do was discuss the parameters – that the fact was that the resource was a key component, yet we differed a bit on the valuation of that resource and a couple of other key aspects.³³

- 3.70 Treasury replied that AMEC's modelling accurately drew out a number of features of the MRRT, although it did not demonstrate a difference between large and emerging miners, which was the key point of the exercise.³⁴ Smaller firms have done some early modelling on the effects of the MRRT on their operations and will make formal announcements once the Bills become law.³⁵

- 3.71 Treasury reiterated to the committee that the release of third party information provided to agencies is set down in legislation and that its actions at all times have been as required by law.³⁶ It also noted that its estimates are consistent with those of the large mining companies, who will pay the great majority of the tax:

One miner thinks that they and two other miners are not going to be paying too much tax. The view of one of the other miners, who is on the Resource Tax Implementation Group, is quite different. Their view happens to coincide with the modelling and the estimates that we had done. Mr Brown referred earlier to some information being provided. It is true that, fortuitously, that information reflected what we had already estimated ourselves. The design has, if you like, those two points of corroboration about it.³⁷

33 Mr Simon Bennison, AMEC, *Committee Hansard*, Canberra, 9 November 2011, p. 31.

34 Mr Patrick Sedgley, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 39.

35 Mr Derek Humphrey, Brockman Resources Ltd, *Committee Hansard*, Canberra, 9 November 2011, p. 32.

36 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 41.

37 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 19.

Conclusion

- 3.72 The committee is of the view that Treasury has acted as openly as possible in developing its estimates for the MRRT. In order to design the tax so it operates as intended, it has used commercially sensitive information from large mining companies. Treasury is not able to release this information because the companies have not authorised it. The alternative would be for Treasury to develop taxes without this sort of information, which would lead to inferior policy.
- 3.73 Treasury has a good track record in providing estimates across a range of macroeconomic issues and the committee was not presented with any evidence that suggested otherwise in this case.
- 3.74 Smaller miners stated to the committee that they had some idea of how the MRRT would affect them and that they would make formal announcements when the bills became law. What in fact appears to be their main concern is that they cannot verify that large miners would be paying substantial amounts of MRRT.
- 3.75 At first instance, the tax affairs of these companies, like any other business, are between the government and the taxpayer. Further, both Treasury and the larger miners agree on the amounts that are likely to be paid. Given that Treasury also has a good track record in implementing tax reform, the committee is of the view that the weight of evidence supports its revenue estimates and that further action is neither required nor legally possible.

Mining investment growth

Background

- 3.76 During the inquiry, the committee received a range of views about whether the MRRT would affect mining investment in Australia. For example, Treasury stated that investment growth in Australia is very strong:

In relation to mining investment since the announcement of the mining tax reforms, mining investment has increased from \$35 billion in 2009-10 to \$47 billion in 2010-11 and to an expected \$82 billion in 2011-12. Mining employment has also grown substantially by 24.3 per cent over that period – that is around

44,000 jobs. That compares with employment grown of 2.1 per cent for the whole economy over that same period.³⁸

- 3.77 However, the Minerals Council of Australia argued that investment that has already commenced will continue, but that a smaller proportion of the investment under consideration might eventuate than would otherwise be the case.³⁹
- 3.78 AMEC and the Magnetite Network argued that Australia should be taking advantage of the investment window which now exists. In the medium to long term, iron ore and coal prices will drop because investment is occurring around the world, increasing supply. Investing now is more attractive because it increases the chances of capturing some of these higher prices.⁴⁰

Analysis

- 3.79 As Treasury noted in evidence, determining the extent to which the MRRT causes changes to investment is a difficult exercise.⁴¹ Given the long time lags involved in assessing projects and constructing them, it may be some time before conclusions can be made about what miners actually did in response to the MRRT, rather than what they are currently saying they are doing. However, investment remains strong and growing.
- 3.80 Evidence was not presented about the impact the current royalty regimes, which are a volume based taxes, have on current investment levels. Treasury evidence is that a profits based tax is more neutral than a volume based tax which continues to apply even if a mine is not profitable.
- 3.81 A profits based tax that allows for sufficient return on capital should not affect production and investment. Investors are only taxed if they are highly profitable. Because they can still earn a reasonable return, they should still continue to invest. For the MRRT, investors can earn the bond rate plus seven percent before any tax is charged.
- 3.82 Royalties are taxes on investment and production, and they are implemented arbitrarily with continual changes.
- 3.83 The Minerals Council of Australia, Fortescue Metals, and Treasury made the point during the inquiry that a new tax will change the commercial

38 Mr Patrick Sedgley, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 3.

39 Mr Mitchell Hooke, MCA, *Committee Hansard*, Canberra, 9 November 2011, p. 19.

40 Ms Megan Anwyll, MagNet, *Committee Hansard*, Canberra, 8 November 2011, p. 26; Mr Simon Bennison, AMEC, *Committee Hansard*, Canberra, 9 November 2011, p. 25.

41 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 12.

environment and will become part of a company's considerations in making an investment decision.⁴² The pertinent question then becomes the long term effects on the mining sector of replacing a volume based tax with a profits based one across the life of mines, through high and low prices, and for highly profitable mines and more marginal mines.

- 3.84 In regards to the effect that the MRRT might have on investment, Treasury argued that the minerals sector already faces a number of more practical constraints:

One reason for not updating the estimates of the impact on investment and jobs has been the feedback we received that the MRRT itself is not really a limiting factor on investment levels in the industry or employment. The limiting factors that the industry is facing are more in the nature of things like supply constraints in terms of the supply of capital goods, infrastructure availability, labour shortages and approval processes. Those things are much more of a constraint on growth in investment and jobs in the industry than the MRRT is. As we pointed out yesterday, there is very considerable planned investment in the pipeline, and the factors that are limiting that level of investment really go to things which are not anything to do with the MRRT.⁴³

- 3.85 Because of its fundamental design features, the MRRT is likely to have little if any effect on mining investment. The MRRT revenues fall as mining profits fall, so investment in mining is shielded. This does not happen with royalties, which must be paid regardless of profitability. Because investment returns in a downturn will affect some investment decisions, profit-based taxes are better for investment than production or revenue based taxes such as royalties.

Conclusion

- 3.86 The committee appreciates that capital markets are global and that Australia is competing against other resource rich countries for investment. But the evidence presented to the committee is that mining investment is facing more practical constraints, such as labour, development approvals, and infrastructure.

42 Mr Anthony Portas, MCA, *Committee Hansard*, Canberra, 9 November 2011, p. 22; Mr Marcus Hughes, FMG, *Committee Hansard*, Canberra, 9 November 2011, p. 11; Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 3.

43 Mr Colin Brown, Treasury, *Committee Hansard*, Canberra, 9 November 2011, p. 39.

- 3.87 The committee notes that the MRRT, as a profits based tax, is more neutral in its effect on investment than the volume based tax that it effectively replaces. Actual investment plans indicate strong growth in the mining sector with the full knowledge of the MRRT factored in.

Constitutionality

Background

- 3.88 Opponents and critics of the MRRT have questioned the constitutional validity of the proposed tax.
- 3.89 In 2011 the Senate, through the Select Senate Committee on New Taxes, examined and reported on the proposed MRRT. The Select Committee (which comprised two Government senators and four Opposition senators) pursued the constitutional issue, only to note that: 'Whether the proposed MRRT and expanded PRRT are constitutional remains unresolved.'⁴⁴
- 3.90 The report identifies the alleged impediments to the MRRT in the Constitution as being sections 51(ii), 99 and 114.

Section 51(ii)

- 3.91 Chapter I, Part V of the Constitution sets out the powers of the Parliament. The relevant section reads as follows:
- The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to ...
- (ii.) Taxation; but so as not to discriminate between States or parts of States.
- 3.92 The concern appears to be the differential impact of the MRRT on the States and Territories and their royalty regimes, as the bulk of the affected mining operations take place in Western Australia and Queensland.
- 3.93 In their submission, the Fortescue Metals group wrote that:

44 Senate Select Committee on the Scrutiny of New Taxes, *The Mining Tax: a bad tax out of a flawed process*, 29 June 2011, p. 161.

...the MRRT Bills impose an entirely additional tax, over and above the existing State based royalty regime which still applies with all its alleged inefficiencies and it does so in a manner that prejudices any States seeking to vary their royalty rates in pursuit of their own policy objectives...the way in which the MRRT interacts with the royalty regime – automatically offsetting any royalty reduction with the increased MRRT payments.⁴⁵

3.94 Fortescue propose that this constitutes a form of discrimination, if ‘a more modern interpretation is applied to the concept of discrimination’.⁴⁶

3.95 In their submission, Treasury responded to this claim by stating that:

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.⁴⁷

Section 99

3.96 Chapter IV of the Constitution covers finance and trade. Section 119 reads as follows:

The Commonwealth shall not, by any law or regulation of trade, commerce, or revenue, give preference to one State or any part thereof over another State or any part thereof.

3.97 Once again, the concern appears to be the differential impact of the MRRT on the States and Territories, as the bulk of the affected mining operations take place in Western Australia and Queensland, leaving the mining industry in other States and Territories untouched. The arguments in relation section 51 (ii) appear to also apply here.

Section 114

3.98 Chapter V of the Constitution covers the States. The relevant section reads as follows:

Section 114. A State shall not, without the consent of the Parliament of the Commonwealth, raise or maintain any naval or military force, or impose any tax on property of any kind

45 Fortescue Metals Group, *Submission 1*, p. 5.

46 Fortescue Metals Group, *Submission 1*, p. 5.

47 Treasury, *Submission 6*, p. 4.

belonging to the Commonwealth, nor shall the Commonwealth impose any tax on property of any kind belonging to a State.

- 3.99 The concern of MRRT critics here appears to be that the proposed tax falls on minerals, which belong to the States. However, the intention of the Bill is to tax the profit on the mining operation per se, which means that it is unlikely to breach section 114.

Analysis

- 3.100 The committee pursued the issue of the possible constitutionality of the MRRT with expert witnesses from the Treasury. Asked if the Bill was unconstitutional, Treasury responded by stating, 'not according to our advice'.⁴⁸

- 3.101 When asked if Treasury had sought legal advice, Treasury replied that:

At various stages during the creation of a new law, it is standard practice to seek legal constitutional advice on elements of it. From my memory, that has happened four or five times. I recall that because I am the fellow that signs the bills for it. There have been various aspects we have taken advice on as we have gone through, and obviously we would not be presenting a bill to the parliament if any of those concerns had existed ... Legal advice in the design of the tax is not customarily made public. But you can take my word for you; I am not lying to you. The advice does not show any risk of unconstitutionality that we have identified.⁴⁹

Conclusion

- 3.102 After carefully considering the matter and given the expert advice from Treasury, the committee has formed the view that there is little evidence to suggest that the Bills are unconstitutional. Given the legal advice Treasury has received, the committee accepts that the bills are consistent with the Constitution.

48 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 9.

49 Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 9.

