Chapter 5

Concerns of small and emerging miners

Introduction

5.1 Small and emerging miners have expressed concern that the Minerals Resource Rent Tax (MRRT) is designed in such a way as to benefit Australia's large and established mining companies, leaving junior miners to bear the burden of the tax. This chapter will examine the concerns of the smaller miners about features of the MRRT. It will address issues raised in relation to the starting base allowance, the threshold for the low profit offset and the effects of the MRRT's simplified tax obligations for smaller miners. The concerns of the emerging magnetite industry will also be covered, as well as a number of other proposed amendments to the MRRT's design.

5.2 Smaller miners have argued that the MRRT will affect the international competitiveness of the resources industry and that Australia's emerging miners will be 'competitively disadvantaged' in both domestic and international markets.[1] The Association of Mining and Exploration Companies (AMEC), which represents 350 companies (mostly smaller miners), argued strongly in its submission that the MRRT's current design does not reflect a recognition that small and emerging miners:

- have different risk profiles;
- do not have significant cash flow levels;
- have smaller economies of scale; and
- consequently have higher unit-cost of production in comparison to large mature miners, 'making it difficult for them to compete with large mature miners in the domestic and global markets'.[2]

Competitive neutrality and unfairness

5.3 Smaller miners have described the MRRT as 'unfair and discriminatory',[3] claiming that the tax does not promote competitive neutrality in that its design delivers advantages for bigger companies.

5.4 The argument being made is, in summary, that the design of the MRRT favours big, established miners, which have considerable assets and substantial

1 Association of Mining and Exploration Companies, *Submission 11*, p. 6.

2 Association of Mining and Exploration Companies, *Submission 11*, p. 5.

3 Association of Mining and Exploration Companies, *Submission 11*, p. 3.

infrastructure in place before 2 May 2010.[4] This increases the allowances, particularly the starting base allowances, they can deduct from their mining profit under the MRRT.[5]

5.5 On the basis of modelling conducted by the University of Western Australia, AMEC claimed that under the MRRT a small miner will be paying an additional effective tax rate of 6 per cent, compared to an additional 2 per cent to be paid by a large miner:

> … there will be at least 4% difference in the level of effective total taxation (including income tax, royalties and the MRRT) between a project that was in existence before 2 May 2010 (mostly the three major iron ore and coal miners), and that applying to less advanced or new developments taking place after 1 July 2012.
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> The modelling shows that before the introduction of the MRRT the average total tax (income tax and royalties) for mining companies would have been around 38% and post MRRT the total effective tax rate increases to over 40% and over 44% for existing and new projects respectively.[6]

5.6 Mr Simon Bennison, the Chief Executive Officer of AMEC, expanded on this view in his evidence to the committee. He argued:

> The current design of the MRRT clearly discriminates against smaller emerging miners … This is a direct result of large mature miners having a significant prior asset base that can be used as a tax shield, if you like, for up to 25 years in the form of a starting base deduction. The starting base deduction provides a significant financial advantage to mature miners, which would have already claimed a depreciation allowance on relevant assets. The different effective tax rate and significant points of difference will make it extremely difficult for small emerging miners to compete with large mature miners in the domestic and global markets and does not provide a level playing field. The differential has been likened to a small corner shop competing with large supermarket chains.[7]

5.7 Professor Henry Ergas made a similar point in his evidence to the committee:

> I do not believe this is a particularly good tax from the point of view of society as a whole, for the reasons that we touched on earlier. I am concerned about its overall effects on our long-term prospects for our mining industry as a whole, but what is also true is that within the mining

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4 The new resource taxation arrangements were announced by the government on 2 May 2010. Consequently, the starting base allowances is linked to this date, as the allowance is intended to recognise investments in certain assets that existed before the tax changes were announced (and certain expenditure on such assets made by a miner between 2 May 2010 and 1 July 2012).

5 See chapter 3 for more information on the calculation of a miner's liability under the MRRT.

6 Association of Mining and Exploration Companies, *Submission 11*, p. 5.

7 Mr Simon Bennison, Chief Executive Officer, Association of Minerals and Exploration Companies, *Proof Committee Hansard*, 21 February 2012, p. 55.

> industry it is designed in such a way as to have a differential effect on different types of miners. As my colleagues and I show in the paper that I referred to at the outset of my remarks, the effective tax rate on smaller, riskier projects and mining operations is many times the tax rate on large, mature operations. That is one of the reasons why this tax will be so distorting in the long run, because for mature operations it is not so onerous a tax but for the newer, riskier ones it has extremely high effective marginal tax rates.[8]

5.8 Treasury commented on the University of Western Australia modelling cited by AMEC:

> It is just demonstrating in one case that the pre-existing miner has the benefit of a starting base, because they have undertaken investment prior to the announcement of the MRRT.[9]

5.9 The Minerals Council of Australia (MCA), whose membership includes the big miners as well as medium and smaller miners, rejected the view that competitive neutrality had been compromised in the design of the MRRT. Its submission argued that the MRRT is consistent with that principle:

> [The tax] 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.[10]

5.10 The MCA's argument was that the MRRT is designed in such a way as to ensure that small and emerging miners will not incur a liability if they have projects that are not yet profitable:

> The MRRT effectively operates as a "top-up" tax, never resulting in lower collection of revenue than exists under the status quo of company tax and royalties, but setting a higher rate for more profitable miners. On this basis, the bulk of MRRT liabilities will fall on larger miners with more profitable projects.[11]

5.11 Treasury also dismissed claims that the MRRT's design bestowed a competitive advantage on large miners over smaller ones:

> CHAIR: … We understand it is in the heads of agreement, but it is characterised to us as being discriminatory vis-a-vis projects from 1 May or 2 May 2010. So, it is in the heads of agreement. It has been agreed between

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8 Professor Henry Ergas, *Proof Committee Hansard*, 21 February 2012, p. 7.

9 Mr Patrick Sedgley, Manager, Business Tax Working Group, Business Tax Division, Department of the Treasury, *Proof Committee Hansard*, 21 February 2012, p. 77.

10 Minerals Council of Australia, *Submission 20*, p. 21.

11 Minerals Council of Australia, *Submission 20*, p. 4.

> the government and the major companies. Why is that? What is the policy behind it? Why is it not discriminatory?
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> Mr Heferen: To the extent that you are in place at that point in time, it applies equally. A range of investment would have gone into enabling whatever discoveries or capital expenditure was in place, and those commitments were made on the basis of the existing tax regime. The tax regime changes and so the rules change with it. As I have said, it is a pretty standard feature of most particularly significant tax changes. There has to be some recognition of people incurring costs or gaining some benefit prior to a change being announced and that being kept in place.
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> Ms Roff: It might be helpful to think of it in terms of those profits that have been brought to tax in later years actually being profits that are in part attributable to the investments that were made by miners before the tax was announced.
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> Mr O'Toole: In terms of a small emerging miner versus big businesses—and I have heard it put in earlier hearings, too—I think it is also important to remember that this is a project based tax. The starting base is attributable to an individual project. To the extent that a larger established miner starts a new project post that date as well then they will be subject to the same treatment.[12]

5.12 On the other hand, in his evidence to the committee, Mr David Ferguson from Atlas Iron stated his belief that, if the MRRT had been in place at the time Fortescue Metals Group (Fortescue) was being set up, it would not have 'got up and running'. In turn, if Fortescue had not gotten off the ground there would not have been an opportunity for the small miners to start their business.[13]

The starting base allowance

5.13 The major form of alleged unfairness in favour of the established miners raised by critics concerns the way in which the existing assets and investment of mining companies is treated.

5.14 Under the MRRT, a starting base allowance will lessen a miner's tax liability by reducing its mining profit. The starting base allowance is designed to recognise investments that existed prior to May 2010 when the resource tax reforms were announced. The Revised Explanatory Memorandum to the MRRT Bills states:

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12 Mr Rob Heferen, Executive Director, Revenue Group; Ms Kate Roff, Principal Advisor, Tax System Division; Mr James O'Toole Manager, Resource Taxation Unit, Indirect Tax Division, Department of the Treasury, *Proof Committee Hansard*, 21 February 2012, pp. 64–65.

13 Mr David Flanagan, Chief Executive, Atlas Iron, *Committee Hansard*, 22 February 2012, p. 23.

> A starting base allowance is one that is used, installed ready to use, or being constructed for use in carrying on the upstream mining operations in relation to a mining project interest at the 'start time'.[14]

5.15 A miner can value its starting base losses for its mining project interest in one of two ways:

(a) the market value of starting base assets (including rights to the resources) at 1 May 2010; or

(b) the most recent accounting book value of starting base assets (not including rights to the resources) available at that time.[15]

Views on the starting base allowance

5.16 Smaller miners have argued that they will be disadvantaged by the arrangements which allow a market valuation for the starting base allowance. AMEC asserted that large miners will have the benefit of a larger 'tax shield' as they will be able to claim a significant deduction for the market value of their starting base assets, whereas smaller miners will not be able to do so. Fortescue expressed similar sentiments, criticising the starting base allowance on the grounds that:

> … it will grant such a large tax shield to existing large producers … that it is likely to shield the bigger miners from paying any MRRT for the entire period that the quasi rent profits are expected to endure … so that in effect the tax falls mainly upon new producers that were not in a position to obtain huge concessions based upon May 2010 market valuations.[16]

5.17 How strong Fortescue's views on the starting base allowance are, however, is difficult to verify; while Fortescue put forward some arguments criticising it, it later acknowledged that it was in the company's interest for a starting base allowance to be included in the MRRT:

> Senator THISTLETHWAITE: Are you saying to us that your organisation is opposed to that initial tax shield in the proposal?
>
> Mr Tapp: It depends whether you are talking about theoretically or as a company. I am not a turkey voting for Christmas here. If somebody gives me a big tax shield, I am not going to say, 'No, thank you, I don't think that is right'.
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> Senator THISTLETHWAITE: I am not trying to trick you. I am just asking you the question: is Fortescue Metals opposed to the legislation?

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14 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 120.

15 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 119.

16 Fortescue Metals Group Ltd, *Submission 26*, p. 2.

> Mr Tapp: No, I cannot say we are opposed to it.[17]

5.18 The submission from the Perth office of accountancy firm BDO Corporate Tax expressed concern that a fall in commodity prices may lead to a 'scenario where emerging miners with a smaller starting base will pay MRRT where mature miners with larger starting bases may not'.[18] In its evidence to the committee it stated:

> We have only gone out a short period with our calculations, but it shows that the large, mature companies, based on the assumptions that we have taken, will not pay MRRT or, if they do, it will be negligible. We have public statements by smaller companies saying that they will pay MRRT in the first year. That strikes me as anomalous. We have tried to recommend some changes. If Treasury has done the modelling right, our proposed changes will not adjust the revenue one iota. If Treasury has the modelling wrong and our concerns are proved to be correct, the emerging companies are not penalised for the anomaly that has been built into the legislation.[19]

5.19 Atlas Iron shared concerns about the tax shield the larger miners it competes with will have, arguing:

> … when the taxation was first brought out, the argument from the multinationals was that there was a retrospective nature to the tax. Everything that was in place, they were having to pay tax on, investments that they had already made. What they got with the starting base valuation is a massive amount of shelter, which meant, because their assets are, say, 50-year mine life—type projects, they were actually able to value those projects over that mine life, and that gave them shelter over that mine life. If you are a smaller company—we actually have made most of our discoveries and acquisitions post 10 May—some of those assets get some consideration but we get nothing like what the majors get.[20]

5.20 In response to the claim that the MRRT promotes inequity because past investments can be recognised at their market value, the MCA stated:

> The starting base allowance provides a form of compensation to miners for the retrospective features of the MRRT, recognising that mining is highly capital-intensive with considerable, high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability.
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> It is based on the key design principle of "prospectivity"—that new tax arrangements should not unduly penalise past investments.[21]

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17 Mr Julian Tapp, Director, Strategy, Fortescue Metals Group, *Proof Committee Hansard*, 21 February 2012, p. 46.

18 BDO Corporate Tax (WA), *Submission 3*, p, 7.

19 Mr John Murray, Director, Corporate Tax, BDO Corporate Tax (WA), *Proof Committee Hansard*, 21 February 2012, p. 50.

20 Mr David Flanagan, Chief Executive, Atlas Iron, *Committee Hansard*, 22 February 2012, p. 10.

21 Minerals Council of Australia, *Submission 20*, p. 22.

5.21 The MCA's submission also quoted a paper prepared by Deloitte Access Economics, which noted that allowing the market valuation of existing assets was a 'well-established principle for easing the transition to new tax arrangements'.[22]

Committee view

5.22 The committee considers that the ability for miners to lessen their liability by claiming a starting base allowance is not inherently biased or discriminatory against smaller companies.

5.23 The committee takes the view that the policy intent of this design feature of the MRRT is to provide due recognition to the value of investments made before the resource tax reforms were announced. Further, it accepts as self-evident the argument that a tax directed to profits made from mining must include an allowance for the starting base assets of the miner, so as not to tax past investment in the industry. A failure to do so would penalise those companies that have a long history in the industry and have made significant investment in it.

5.24 The policy decision, in the view of the committee, is fair and reasonable, taking all relevant factors into account.

Low profit offset

5.25 Division 45 of the MRRT Bill incorporates a 'low profit offset' which will fully or partially relieve small miners of their MRRT liability for an MRRT year. For miners with group mining profits (as measured for MRRT purposes) of $75 million or less, there is nil liability.[23] The low profit offset phases out for profits between $75 million and $125 million to ensure the offset 'does not distort the production behaviour of an entity approaching the $75 million threshold'.[24]

Views on the low profit offset

5.26 The Chamber of Minerals and Energy of Western Australia (CME) stated that while it welcomed an exemption threshold for the MRRT and its increase from $50 million to $75 million, it still held concerns about whether the exemption threshold would provide:

> … the necessary shelter for junior and emerging mines and those producers mining low value resources. Until the impact of the MRRT on Australia's resource industries' international competitiveness and project costing is

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22 Minerals Council of Australia, *Submission 20*, p. 22.

23 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 145.

24 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 145.

> fully understood, CME recommends particular consideration needs to be given to a significant increase to the currently proposed phased threshold.[25]

5.27 AMEC's view was that the low profit threshold did not provide 'sufficient protection' to small miners and did not address the 'uncertainty, nor the inequities and identified discrimination' between small and large miners.[26]

5.28 AMEC asserted that the original $50 million threshold was an 'arbitrary amount without any foundation' and that the amended $75 million threshold remained:

> …a very low return on the significant levels of capital invested upstream (exploring, developing and extracting) of the MRRT taxing point (mine gate), and takes no account of the subsequent investment downstream (crushing, blending, transporting, loading, infrastructure).[27]

5.29 The CME also called for the threshold to be subject to indexation 'to ensure the policy intent of excluding small miners is met in ensuing years'.[28] AMEC echoed the call for indexation to avoid 'bracket creep'[29] and noted that the threshold was also subject to changes in commodity prices and exchange rates.[30]

Suggested alternatives to the low profit offset

5.30 One alternative to the MRRT's low profit offset, proposed by AMEC, would be the establishment of a 'safe harbour' of 10 million tonnes per annum (mtpa) of iron ore or coal per MRRT year. It is noted that, according to AMEC, the current $75 million threshold equates to approximately one to five mtpa of iron ore.[31]

5.31 AMEC proposed that this would be a suitable threshold at which to 'trigger' the MRRT and would provide 'a more equitable shield for new and small emerging miners'. Ultimately, it would also lead to an increased royalty and MRRT revenue stream because small miners would be better able to grow their business and increase production.[32]

5.32 Under the scenario proposed, the $75 million low profit threshold would be retained and a minor amendment would be made to clause 4 of each of the Imposition Bills:

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25 Chamber of Minerals and Energy of Western Australia, *Submission 2*, p. 5.

26 Association of Mining and Exploration Companies, *Submission 11*, p. 6.

27 Association of Mining and Exploration Companies, *Submission 11*, pp. 6–7.

28 Chamber of Minerals and Energy of Western Australia, *Submission 2*, p. 5.

29 Association of Mining and Exploration Companies, *Submission 11*, p. 9.

30 Association of Mining and Exploration Companies, *Submission 11*, p. 7.

31 Association of Mining and Exploration Companies, *Submission 11*, pp. 7–8.

32 Association of Mining and Exploration Companies, *Submission 11*, pp. 7–8.

> …whereby an 'emerging miner factor' of 75% is provided where group production of the taxable resources for the miner for an MRRT year is less than 10 million tonnes. It is anticipated that such an amendment would be close to revenue neutral.[33]

5.33 Treasury, however, has previously rejected the proposed tonnage-based exemption, arguing that it 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.[34]

Committee view

5.34 The committee supports the low profit threshold as a simple way to support small and emerging miners. The switch to a tonnage-based threshold would add unnecessary complication to a tax system based on monetary calculations. Therefore, it does not consider that an alternative tonnage-based exemption should be incorporated into the present design of the MRRT.

5.35 For the same reasons, the committee also considers that the threshold should not be subject to automatic indexation. It notes, however, that issues of this nature are commonly considered as part of the Budget process. It further notes the recommendation of the Policy Transition Group (PTG) that the MRRT be reviewed within five years of its implementation.[35] The committee supports the recommendations of the PTG and feels that that is a more appropriate time for changes to the low profit threshold to be considered.

The simplified MRRT method and the alternative valuation method

5.36 Smaller miners described the restrictions on carrying forward allowances under the simplified MRRT method and the alternative valuation method (AVM) as 'unnecessary and punitive'[36] and argued for their removal.

5.37 Division 200 of the MRRT Bill includes simplified obligations which are designed to shield small miners from administrative burdens. According to the Revised Explanatory Memorandum:

> Some miners have the prospect of being below the low profit threshold for an extended period. Requiring such miners to fully comply with the MRRT

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33 Association of Mining and Exploration Companies, *Submission 11*, p. 8.

34 Department of the Treasury, *Submission 6* to the House of Representatives Standing Committee on Economics' inquiry into the Minerals Resource Rent Tax Bills 2011, pp. 3–4.

35 Policy Transition Group, *Report to the Australian Government: New Resource Tax Arrangements*, December 2010, p. 81.

36 Association of Mining and Exploration Companies, *Submission 11*, p. 10.

> would be burdensome. These miners will have the option of electing to use a simplified MRRT method.[37]

5.38 A miner can elect to use the simplified method for an MRRT year if its group profit falls below certain limits. While a miner which uses this method will have no liability for that particular year, a consequence of choosing this method is that 'its starting base and its allowances are extinguished rather than carried forward'.[38]

5.39 Smaller miners have been critical of these provisions, arguing that the simplified method will not be taken up as the costs of doing so will outweigh the benefits. That is, it will have to perform all the calculations necessary to determine whether it qualifies to use the simplified MRRT method, in which case any benefits from using the method would be lost. For example, the CME's submission claimed that there is an inbuilt disincentive for smaller miners to use the simplified MRRT obligations:

> [W]here 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.[39]

5.40 The CME also argued that the market value of smaller companies would be damaged as a consequence of using the simplified method:

> 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.[40]

5.41 The CME summed up its concerns about the provisions for the simplified MRRT method, stating that 'the consequences for exceeding the threshold are likely to be greater than the administrative concessions of the simplified approach'.[41]

5.42 AMEC also indicated that small miners would be unlikely to adopt the simplified method, preferring instead to maintain full MRRT records. In choosing the simplified method, AMEC voiced concern that small companies would lose any rights to carry forward allowances. Its submission called for the following amendments:

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37 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 148.

38 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 145.

39 Chamber of Minerals and Energy of Western Australia, *Submission 2*, p. 6.

40 Chamber of Minerals and Energy of Western Australia, *Submission 2*, p. 6.

41 Chamber of Minerals and Energy of Western Australia, *Submission 2*, p. 6.

> … if a taxpayer elects for the simplified MRRT method then entitlements to the allowance components are allowed to be carried forward. (This proposal would enable small taxpayers the advantage of a reduced compliance burden, but without the permanent loss of the allowance components).
>
> … the taxpayer be allowed to bring forward all elements of the allowance components into the later year, on the basis of what would have been allowed, had the election not have been made in prior years, and that appropriate records are maintained to support the relevant components.[42]

5.43 The AVM, as set out in Division 175, is designed to assist small miners and miners with 'vertically integrated transformative operations' to calculate their mining revenue attributable to their resources at the taxing point.[43]

5.44 The Revised Explanatory Memorandum describes the reasons for providing this simpler valuation method:

> It can sometimes be difficult to apply the normal methodologies for working out what part of the consideration for selling resources is attributable to the condition and location of the resources at their valuation point. The difficulties may be greater for smaller miners who have less access to the specialist advice necessary to apply those methodologies properly. They can also be greater for miners who transform resources they mine in an integrated operation, such as steel manufacturing or electricity generation.[44]

5.45 To use the AVM, a miner must:

- have group production of taxable resources of less than 10 million saleable tonnes in the year; and/or
- carry on an operation, which existed before 2 May 2010, that supplies things made using the resources extracted from the mining project interest's project area.[45]

5.46 AMEC was critical of the AVM on the same grounds that it argued against the simplified MRRT method. It claimed there would be limited incentive for companies to choose the AVM because of the treatment of allowances in future years:

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42 Association of Mining and Exploration Companies, *Submission 11*, p. 10.

43 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 257. The AVM is a version of the 'retail price' or 'netback' method; under this method, mining revenue for supply, exportation or use of taxable resources is worked out from the miner's transactions relating to the taxable resources, with appropriate reductions for downstream operating costs, depreciation and returns on capital. See Minerals Resource Rent Tax Bill 2011, clause 175-1.

44 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 269.

45 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 270.

> … where an emerging miner elects to use the AVM for a particular year this precludes them from transferring certain allowances and also combining interests in later years…
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> The permanent extinguishment of all allowances is considered to be extremely unfair and discriminatory and should be removed from the legislation. Industry believes that without the ability to include the use of allowances, both the Simplified MRRT Method and the Alternative Valuation Method have limited attraction particularly when giving consideration to a merger or being acquired at a future date.[46]

5.47 In their evidence to the committee representatives of Brockman Resources and Gindalbie Metals, outlined their concerns about the simplified method and the AVM:

> Mr DA Richardson: I was involved with the resource tax implementation group and consultation between Treasury and industry on these issues. From my own observations and comments that others made, we could not think of a single company in the iron ore space that would benefit. In other words, the threshold is so low that it is unlikely to apply to anyone in the iron ore industry. I cannot speak for the coal industry, but not for the iron ore industry.
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> Mr Humphry: I support what Mr Richardson and Mr Bennison said. The penalties for entering into the simplified method just outweigh the benefits that they provide. The message that I got from that was that the government was happy to deal with BHP and Rio but did not really want new entrants or growing companies.
>
> Mr DA Richardson: In terms of the penalties, that is a good point. Certain companies may say that they can benefit from this low tax threshold in their first year or two of production when costs tend to be high and production is good so your profits are lower. The problem with that is that, if you elect to take that low profit threshold, you will lose a lot of potential particularly in relation to things like royalties in the future. If you then get to a point where you exceed that threshold, as Mr Humphry said, it is too big a risk. Even for companies that think they might be able to benefit from that low profit threshold for the first couple of years, you would not take the risk because you are potentially going to lose a lot down the track if you are looking to increase production.[47]

Committee view

5.48 The committee notes that the simplified MRRT obligations and the AVM have been incorporated into the tax's design to reduce compliance and record-keeping burdens for smaller companies. The committee also acknowledges that some smaller miners may choose not to take up these alternatives, preferring instead to be able to

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46 Association of Mining and Exploration Companies, *Submission 11*, p. 7.

47 Mr David Richardson, Chief Financial Officer, Gindalbie Metals; Mr Derek Humphry, Chief Financial Officer, Brockman Resources, *Proof Committee Hansard*, 21 February 2012, p. 61.

carry forward allowances to offset against future MRRT profits. It recognises, though, that the extent to which this happens and the overall effectiveness of the valuation methods will not be known for some time.

5.49 In light of those factors, the committee does not recommend that amendments be made to the simplified MRRT obligations and the AVM provisions of the MRRT Bill. However, the committee does consider that the operation of the simplified MRRT and the AVM be examined as part of the PTG recommended review of the MRRT and, should it become clear during that review that the number of miners adopting the methods is small, that amendments to the legislation be considered to increase their use.

Other issues

5.50 Submissions to the inquiry also canvassed a number of other suggested amendments to the design of the MRRT. These included a proposal for a benchmark MRRT rate and changes to provisions relating to pre-mining losses, default instalment rates and calculation of mining revenue.

Benchmark rate

5.51 A significant amendment to the MRRT Bills recommended by the smaller miners would be the establishment of a benchmark rate, to make the tax liable to be paid only when the first of the large mining companies becomes liable to pay the MRRT. It is argued that this would create a more level playing field across the industry, helping to restore competitive neutrality.

5.52 AMEC argued that the MRRT rate should not exceed a benchmark rate, which would be calculated:

> … by reference to the highest "mature miner" MRRT liability for the MRRT year by applying an agreed formula in relation to each class of taxable resource (either coal or iron ore).[48]

5.53 BDO's submission also argued for a 'safeguard measure' enabling junior 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.[49] [emphasis in original]

Treatment of pre-mining losses

5.54 AMEC also raised the issue of pre-mining losses from exploration expenditure and its concern that under the MRRT legislation, these expenditures

48 Association of Mining and Exploration Companies, *Submission 11*, p. 8.

49 BDO Corporate Tax (WA), *Submission 3*, p, 7.

would not be recognised as adding value to a project. AMEC claimed that such an approach would 'severely undermine the future capacity to raise funds for exploration and the capacity to spread risk'.[50] Its submission contained the following recommendations for amendments to the MRRT to address this:

> That the pre-mining losses provisions are amended to allow exploration on expenditure incurred by an entity prior to earning an interest in the tenement to be included in an entity's pre-mining expenditure.
>
> That exploration expenditure should still qualify as pre-mining expenditure even if it does not lead to the farmee acquiring an interest, and would attach to another pre-mining project interest which relates to the same taxable resource.[51]

Default instalment rate for iron ore

5.55 Another issue raised was the default instalment rate for iron ore in the first year that the MRRT is payable. The CME argued that the eight per cent default rate was too high and should be lowered to three per cent:

> …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.
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> 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 are than that which applies to coal. A default rate of 3% should apply to both iron ore and coal.[52]

5.56 In addition, the CME argued that 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'.[53]

5.57 AMEC also proposed that because of the uncertainty around calculating MRRT instalments, small emerging miners should be exempt from the instalment rates:

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50 Association of Mining and Exploration Companies, *Submission 11*, p. 11.

51 Association of Mining and Exploration Companies, *Submission 11*, p. 12.

52 Chamber of Minerals and Energy of Western Australia, *Submission 2*, pp. 6–7.

53 Chamber of Minerals and Energy of Western Australia, *Submission 2*, pp. 6–7.

> Under the proposed MRRT regulations, default MRRT instalment rates have been prescribed for iron ore and coal of 8% and 3% respectively. A miner can elect to vary their instalment rate; however penalties will apply where the varied amount is less than 85% of the actual amount.
>
> Given the complexity of the MRRT legislation and the difficulty in accurately estimating MRRT instalments, AMEC recommends that small emerging miners (<10mtpa) are excluded from the instalment system for a period of 2 years from the introduction of MRRT, or from commencing production.[54]

5.58 Treasury has previously responded to concerns about the instalment rates, noting that the default rates represented an 'interim regime' in the first year:

> During that first year there would be an indication from firms that wish to vary their instalments, so there would be an early indication as to whether the longer term projections, if you like, are accurate. I expect there would be an opportunity to do something about it. I presume that no firm is going to come forward and say, 'We expect to be massively overpaying in the next year.' Because the incentive is the wrong way round, they will just accept a lower instalment. But, if the ATO identified from key areas instalment variations that were below that calculated figure, we would be alerted to it fairly early.[55]

Calculation of mining revenue

5.59 Smaller miners also raised concerns about the calculation of mining revenue under the MRRT.

5.60 The MRRT specifies a methodology by which to determine the value of the ore at the taxing point designed to ensure:

> … that the profits that are brought to tax under the MRRT law will be profits that relate to the resources in the form and the place they were in when they were at their valuation point. The MRRT law does not seek to tax profits from operations conducted downstream of the valuation point.[56]

5.61 Clause 30-25 requires a two-step process—the miner must calculate its revenue amount and then determine:

> … how much of the revenue amount is reasonably attributable to the taxable resource in the form in which it existed when it was at its valuation point (and) at the place where it was located when it was at its valuation point.

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54 Association of Mining and Exploration Companies, *Submission 11*, p. 12.

55 Mr Paul McCullough, former General Manager, Business Tax Division, Department of the Treasury, *House of Representatives Standing Committee on Economics Hansard*, Inquiry into the Minerals Resource Rent Tax Bills 2011, 9 November 2011, p. 43.

56 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 52.

5.62 The second calculation should be made using:

> … the most appropriate and reasonable measure … having regard to:
>
> (a) the miner's circumstances, including, but not limited to, the functions performed, assets used, and risks borne by the miner in carrying on its *mining operations, *transformative operations and *resource marketing operations for the mining project interest; and
>
> (b) the available information.[57]

5.63 The CME asserted that:

> … 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.[58]

5.64 AMEC was also critical of what it saw as a 'more prescriptive' method of calculating mining revenue and urged that a broader range of mechanisms, consistent with those outlined by the Organisation for Economic Cooperation and Development (OECD), be applicable:

> The legislation also attempts to clarify that certain assumptions must be made when determining the downstream value, and provides a prescribed hypothetical situation which the miner must use in applying the 'arm's length principle', and appears to direct miners towards some form of 'netback' transfer pricing method.
>
> The legislation suggests the use of appropriate transfer pricing methods as described in the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines. AMEC consider[s] this approach sound and recommends that all mechanisms included in the above guidelines should be capable of being applied. In particular AMEC would not wish to see the use of 'profit-split' or similar mechanisms to determine the taxable value excluded.[59]

5.65 The use of the OECD's Transfer Pricing Guidelines is referred to in clause 205-15 of the MRRT Bill, which applies to the determination of any amount for the

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57 Minerals Resource Rent Tax Bill 2011, subclause 30-25(3). Asterisked terms are defined in the MRRT Bill.

58 Chamber of Minerals and Energy of Western Australia, *Submission 2*, p. 7.

59 Association of Mining and Exploration Companies, *Submission 11*, p. 13.

purposes of Division 205 of the MRRT Bill. The use of the OECD Guidelines applies to calculating mining profits, allowances and offset amounts.[60]

Committee view

5.66 The MRRT Bill provides for a number of methods of calculation of the mining revenue, however, whatever is used must be 'the most appropriate and reasonable measure'. The use of the OECD's Transfer Pricing Guidelines appears to have a wide application under the MRRT Bill. It does not appear to restrict the parts of the Guidelines that may be used in calculating mining revenue.

5.67 Nonetheless, the committee recommends that Treasury or the Australian Taxation Office consider whether there is some restriction in the MRRT Bill and, if that is the case, it should examine whether the wider application of the OECD Guidelines to the MRRT is warranted and advise the government accordingly.

The compliance burden

5.68 As the main representative for the smaller miners and exploration companies, AMEC was concerned by the compliance burden that would be placed upon them, even in their early years when they were unlikely to engender sufficient profit to be liable to pay the MRRT:

> Mr Bennison: I think what everyone has to appreciate is that no matter what size you are, you have to start putting the systems in place—and I would invite Mr Richardson and Mr Humphry to come in—to monitor every component of your operations in the context of this tax. It does not matter whether you are still way behind the eight ball; as of 1 July you now have to have everything in play ready to roll.
>
> Mr DA Richardson: I agree with Mr Bennison. The issue here is that this is a very complex tax and it is going to be difficult to administer. Whilst our particular company, Gindalbie Metals, mines magnetite iron ore as opposed to haematite, magnetite iron ore is a low iron content, low-grade ore so it requires a significant beneficiation process to produce a product that you can sell. It has significant, what they call, downstream transformational costs associated with that. There is a lot of subjectivity as to how you calculate those in terms of a netback calculation, returns on assets and everything else. We have to go through the process of putting systems in place so that we can comply with the law even though at this stage we certainly do not expect to have a particularly high MRRT liability or possibly even no MRRT liability in the first couple of years. But that does not mean that we are not going to incur significant costs in terms of compliance. That is the biggest issue. Rather than a fundamental argument over MRRT, if you are a small company with limited resources, like we are,

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60 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 323.

you do not want to spend tens or even hundreds of thousands of dollars a year on compliance to prove that we do not have a liability for the tax.[61]

5.69 The compliance costs of the MRRT were raised by other witnesses:

Senator BOB BROWN: If there is no money in it then what is the problem with it? They are having a tax across the board on—

Mr Hooke: You are going to have an excessively high compliance cost. The efficiency dividend would be negative.[62]

Mr Hooke: We do not think that this new tax is necessary as a top-up to the existing underlying profits tax, the company tax, and the output based royalties tax. It is not a reform and so in that sense it does add substantial complexity and compliance costs for companies.[63]

Senator CORMANN: If I can summarise that, for the newer projects, the smaller and mid-tier companies, to the extent that there are distortions of royalty arrangements they will continue. And for those that are subject to royalties as well as the MRRT they have an additional level of distortion that comes into play?

Mr Tapp: … Those that are not subject to the MRRT because they are below the threshold—or very close to it—are going to end up with all the complexity of having to do the sums to work out whether they are above or below this threshold. This is a tax that administratively is incredibly complex. It is going to cost millions and millions of dollars in compliance costs in just trying to work out whether or not you have to pay this tax.[64]

5.70 Fortescue expanded upon this further in its submission:

… this new tax needs calculations based upon projects and within such projects a split between upstream and downstream activities and potentially also a split between different products where there are products that aren't subjected to MRRT. All of this will require auditing and then probably arguments with the tax office about the methodology chosen and with the risk of penalties being applied for the tax not paid because of the adoption of a subsequently rejected methodology. And finally small companies that escape liability because they come under the threshold will have to go through the same pain each year because they couldn't be certain they won't

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61 Mr Simon Bennison, Chief Executive Officer, Association of Mining and Exploration Companies; Mr David Richardson, Chief Financial Officer, Gindalbie Metals, *Proof Committee Hansard*, 21 February 2012, pp. 56–57.

62 Mr Mitch Hooke, Chief Executive Officer, Mining Council of Australia, *Proof Committee Hansard*, 21 February 2012, p. 32.

63 Mr Mitch Hooke, Chief Executive Officer, Mining Council of Australia, *Proof Committee Hansard*, 21 February 2012, p. 34.

64 Mr Julian Tapp, Director, Strategy, Fortescue Metals Group, *Proof Committee Hansard*, 21 February 2012, p. 43.

> grow and produce above the threshold and so they will also need to undertake this accounting exercise.[65]

5.71 At present the MRRT Bill requires miners to lodge returns at the end of each financial year. AMEC has proposed that the lodgement date for MRRT returns be extended until the end of February of the following year, citing the limited resources available to small miners to calculate liability.[66]

Criticism regarding the non-deductibility of financing costs

5.72 In its submission to the committee, Fortescue claimed that the MRRT would present difficulties for emerging mining companies 'to obtain the necessary finance for their projects thereby raising barriers to entry into an industry that already has substantial barriers to entry'.[67]

5.73 It stated that for a new entrant to the iron ore mining industry, 'the investment in infrastructure will effectively only be allowed to earn a regulated rate of return and anything higher will be subject to the MRRT'.[68] Fortescue argued that this would have a hugely detrimental impact on smaller miners seeking finance for their projects, as debt providers would be deterred from providing funds. It described the MRRT as 'a tax that is biased against debt financing because it doesn't allow financing costs as a deduction'.[69]

5.74 This issue was addressed in 2010 by the PTG as part of its deliberations. The PTG ultimately recommended that the general deduction test in the MRRT be based on the 'income tax concept of an expense being necessarily incurred':

> The value of the resource extracted by a mining company should be independent of an entity's choices about the way it finances its mining operations. The required return to capital invested in a mining operation is recognised through the interest allowance for activities upstream of the taxing point and through arm’s length pricing of downstream activities where the first arm’s length sale is beyond the taxing point. Allowing a specific deduction for interest and other financing costs would amount to a double deduction for the cost of capital. It would also tend to bias financing decisions towards debt. Therefore, consistent with the PRRT, interest and other financing costs should not be deductible under the MRRT.[70]

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65 Fortescue Metals Group Ltd, *Submission 26*, p. 8.

66 Association of Mining and Exploration Companies, *Submission 11*, p. 12.

67 Fortescue Metals Group Ltd, *Submission 26*, p. 2.

68 Fortescue Metals Group Ltd, *Submission 26*, p. 9.

69 Fortescue Metals Group Ltd, *Submission 26*, p. 9.

70 Policy Transition Group, *Report to the Australian Government – New Resource Taxation Arrangements*, December 2010, p. 51.

5.75 The issue of a specific deduction for finance was raised with Fortescue at its appearance before the committee:

> CHAIR: So, you want to argue that the financing cost, which was disproportionately high, should be a tax deduction? But, in fact, what you are seeking to do, when you are raising capital at extraordinarily high interest rates, is you are seeking to transfer the risk from the fundraiser and the provider of capital to the taxpayer via the Commonwealth, are you not?
>
> Mr Tapp: No, I am just saying it is a legitimate cost. It is a legitimate cost of getting a business up. If you raise finance—
>
> CHAIR: But if it is allowed as a deduction you are transferring some of the risk of the project to the Commonwealth via the taxpayer. A deduction does not come from nowhere. It comes from consolidated revenue. Is that not correct?
>
> …
>
> Mr Tapp: You are not paying it in tax; that is correct. But you are not taking any money away from the taxpayer. You are not giving money to the taxpayer, because you have an interest bill to pay.[71]

5.76 Treasury also commented on this issue raised by Fortescue:

> Mr Heferen: … you do not actually look at the interest costs per se; you look at what it has purchased and then it is depreciated and then, of course, the interest cost is also deductible. That is on an income tax. On a cash flow tax the cost of the asset is written off. So, they borrow money, they buy something and the cost of that is written off. I suspect the design feature is such that if the interest cost was deductible as well you would end up getting two deductions for the one bit of profit. That is my brief understanding. I might turn to my colleagues who might be able to throw a bit more light on that.
>
> Mr O'Toole: I might just add a little bit. Mr Heferen's answer pretty well covered it. I would just note that under the cash flow taxes, both the PRRT and the MRRT, to the extent that the losses in terms of the capital that you expended on the capital item, for instance, is not fully written off in the year, it is then subject to an uplift. That is the long-term bond rate plus seven per cent in relation to the MRRT. That effectively proxies, if you like, the financing costs for the item as well.[72]

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71 Mr Julian Tapp, Director, Strategy, Fortescue Metals Group, *Proof Committee Hansard*, 21 February 2012, p. 44.

72 Mr Rob Heferen, Executive Director, Revenue Group; Mr James O'Toole, Manager, Resource Taxation Unit, Indirect Tax Division, Department of the Treasury, *Proof Committee Hansard*, 21 February 2012, pp. 63-64.

Committee view

5.77 The committee accepts the explanation of Treasury officials and agrees with the approach taken by the PTG in deciding not to allow debt financing to be deductible as an allowance under the MRRT for the reasons it has set out.

5.78 In the committee's opinion, the decision by any company to finance its operations through 100 per cent or near 100 per cent debt financing is a risk that should remain with that company. Granting the deduction sought by Fortescue would be equivalent to the risk being transferred to the taxpayer, a situation the committee finds unacceptable.

Concerns of the magnetite industry

5.79 Concerns were raised by magnetite producers about the consequences of the MRRT applying to their projects. The submission from the industry representative body, the Magnetite Network (MagNet), highlighted a number of issues from this emerging industry.

5.80 Magnetite is a form of iron ore that has a lower iron content than other forms such as hematite, which is the form of iron ore usually mined in Australia.[73] Unlike hematite it cannot be sold without extensive processing. Magnetite miners process those large quantities of low grade ore into high iron content magnetite concentrate and pellets.[74] As such, it is argued by producers that magnetite has more in common with minerals not subject to the MRRT than those which are, and so should be excluded from the MRRT regime.[75]

5.81 Additional concerns include the complexity in the valuation methodology to calculate MRRT liability, arising from the need to extensively process magnetite ore to create a saleable product, and the lack of detail from Treasury about forecast liabilities. While noting some 'real improvement' in references to valuation methodology in the legislation, compared to the second exposure drafts of the bills, MagNet emphasised its preference for flexibility for MRRT taxpayers in relation to an appropriate transfer pricing method to calculate the value of the resource at the taxing point.[76]

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73 While it is estimated that magnetite ore represents 34 per cent of Australia's iron ore resources, the vast majority of which are located in Western Australia, only two magnetite projects are currently operating—one in South Australia and one in Tasmania. Two further projects are currently under construction in Western Australia. See Geoscience Australia, *Australia's identified mineral resources 2010*, p. 34 and Ms Megan Anwyl, Executive Director, Magnetite Network, *Committee Hansard*, 22 February 2012, p. 24.

74 Magnetite Network, *Submission 24*, p. 2.

75 Magnetite Network, *Submission 24*, p. 4.

76 Magnetite Network, *Submission 24*, p. 3.

5.82 Should the MRRT apply to magnetite ore, MagNet predicted negative consequences including 'investment uncertainty in an emerging, jobs-intensive industry' and 'significant set-up and ongoing costs'.[77] In her evidence to the committee, Ms Megan Anwyl of MagNet, stated:

> … final investment decisions for the two projects that are under construction were made prior to this tax … in general terms there appears to be less willingness … by a range of investors, to invest in those projects. But I am not telling you, just to be clear, that there will not be any further investment. I am saying that it has made it more difficult.[78]

5.83 MagNet's submission acknowledged that it was unlikely that magnetite concentrate would ultimately be excluded from the MRRT regime and therefore urged the committee to consider recommending a 'simple and effective' means to amend the MRRT legislation to assuage some of their concerns. Noting that similar definitions exist in Western Australian legislation, MagNet suggested:

> … the adoption of a definition of "iron ore" that acknowledges and distinguishes between hematite DSO [direct shipping ore] 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..[79]

5.84 Based on expected MRRT liabilities, however, the need for a special definition for magnetite is not clear. In its submission to the committee, MagNet stated 'Treasury officials have consistently told MagNet that the government was not forecasting MRRT revenue from magnetite. This was recently confirmed publicly by Minister Ferguson'.[80] However, Ms Anwyl told the committee that she could not say for certain that it would have zero liability and, in fact, some members did expect to pay MRRT.[81]

5.85 The view that magnetite would be unlikely to be liable to high levels of MRRT was also shared by the MCA:

> 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.[82]

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77 Magnetite Network, *Submission 24*, p. 2.

78 Ms Megan Anwyl, Executive Director, Magnetite Network, *Committee Hansard*, 22 February 2012, p. 29.

79 Magnetite Network, *Submission 24*, p. 4.

80 Magnetite Network, *Submission 24*, p. 5.

81 Ms Megan Anwyl, Executive Director, Magnetite Network, *Committee Hansard*, 22 February 2012, pp. 25–26.

82 Minerals Council of Australia, *Submission 20*, p. 21.

5.86 Certain features of the industry and expectations for its future also do not support the argument that magnetite should be excluded from, or treated differently under, the MRRT. Magnetite is, after all, one of the principal iron ores. It is apparent that there will be future demand for it. During his evidence to the committee, Mr Julian Tapp from Fortescue stated that the mining companies would move to mining of magnetite if the supply of hematite was to run out, given that the infrastructure was already in place to make that possible and that in the Pilbara 'there is literally trillions of tonnes—centuries' worth of supply'.[83]

Committee view

5.87 The committee accepts that magnetite producers are unlikely to incur significant tax liabilities in the first few years of the MRRT's operation and that magnetite ore differs considerably from hematite ore. However, what the industry is seeking is, in effect, a permanent exemption from the MRRT.

5.88 While it has features in common with the nickel and alumina industries, which are excluded from the MRRT, the magnetite industry also has features in common with the wider iron ore industry. Indeed, the magnetite industry is, in essence, an iron ore mining industry. Further, it can be expected that the larger miners will be more than willing to go into magnetite mining if the supply of hematite ore was to run out or become comparatively less commercially viable. The committee sees this as an indication that it is likely there are considerable profits to be found in that sector, if not immediately, then certainly in the future.

5.89 With these factors in mind, it is the committee's view that a recommendation that the magnetite industry be exempted from or treated differently to other types of iron ore under the MRRT would create an unwise and unwarranted precedent, and accordingly is not supported.

Constitutional concerns

5.90 Questions over the constitutional validity of the MRRT have been raised ever since the announcement of the resource tax reforms in 2010. Critics have suggested that the MRRT, as presently drafted, may breach paragraph 51(ii) and sections 99 and 114 of the Constitution.

5.91 During 2010 and 2011, both the Senate Select Committee on the Scrutiny of New Taxes and the House of Representatives Standing Committee on Economics examined claims over the constitutional implications of the MRRT. Media reports on the MRRT have also alluded to the prospect of mining companies and states such as

83 Mr Julian Tapp, Director, Strategy, Fortescue Metals Group, *Proof Committee Hansard*, 21 February 2012, pp. 40, 46.

Western Australia, Queensland and New South Wales mounting constitutional challenges to the legislation.[84]

5.92 It should be remembered that a challenge cannot be commenced unless the bills are passed into law.

5.93 The Senate Select Committee concluded:

> Whether the proposed MRRT and expanded PRRT are constitutional remains unresolved…
>
> The interaction between the proposed MRRT, expanded PRRT, state and territory royalties and GST sharing arrangements remain unresolved.[85]

5.94 This committee notes that witnesses to the Select Committee's inquiry identified that their ability to consider the issue in any depth was constrained by the fact that the draft MRRT legislation had not yet been released.

5.95 During the recent inquiry into the package of MRRT Bills by the House of Representatives Standing Committee, Treasury advised that it had no concerns that the legislation, once passed, was at risk of successful legal challenge on constitutional grounds:

> If the suggestion is, for example, that this could possibly be taxing the property of the state, thus breaching the Constitution, the design of the tax is such that it is like other transactions of profits taxes, it is not a tax on the property; it is a tax on the profit, thereby not risking that constitutional downside. As to whether somebody somewhere wanted to take an action that is entirely up to them. But our advice is that, the way this is designed, there is no risk.[86]

5.96 The House Committee concluded:

> 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.[87]

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84 For example, see Ainslie van Onselen, 'Mining tax calls for fresh advice', *The Australian*, 16 September 2011.

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

86 Mr Paul McCullough, Department of the Treasury, *House of Representatives Standing Committee on Economics Hansard*, 8 November 2011, p. 13.

87 House of Representatives Standing Committee on Economics, *Advisory Report on the Minerals Resource Rent Tax Bill 2011 and related bills*, November 2011, p. 45.

5.97 In this inquiry, concerns that the MRRT may be unconstitutional were raised in the submissions from Fortescue[88] and the IPA. The IPA observed that:

> The absence of powers relating specifically to mining activities under Section 51 of the Constitution, and the condition under Section 114 that the commonwealth cannot impose any tax on state government property, appears to raise doubts over the constitutional validity of the tax. Issues have also been cited concerning whether the MRRT effectively discriminates against states, which is prohibited under the Constitution.[89]

Paragraph 51(ii) and section 99—discrimination against states

5.98 The committee heard concerns that the MRRT may infringe both paragraph 51(ii) and section 99 of the Constitution on the basis of 'indirect discrimination'. These concerns related to the MRRT providing a full credit for state royalties paid in relation to a mining project. As stated in the Revised Explanatory Memorandum to the MRRT Bills:

> Mining allowances reduce each project's mining profit. The most significant of the allowances is for mining royalties the miner pays to the States and Territories. It ensures that the royalties and the MRRT do not double tax the mining profit.[90]

5.99 Paragraph 51(ii) states:

> 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.

5.100 Section 99 states:

> 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.

5.101 Fortescue's submission advanced the argument that the MRRT, in breach of paragraph 51(ii), will impose a form of indirect discrimination against states:

> If the MRRT Bills are implemented in the form proposed then they will have the effect of exactly offsetting any reduction in royalties that a State may be inclined to give for its own policy reasons…
>
> Once the MRRT is in operation any State which has sought to encourage development or seeks to encourage development will be discriminated against. Although the discrimination is not to be found directly in the form

88 Fortescue Metals Group Ltd, *Submission 26*, pp. 10–12.

89 Institute of Public Affairs, *Submission 12*, p. 23.

90 Minerals Resource Rent Tax Bill 2011 and related bills, *Revised Explanatory Memorandum*, p. 3.

> of legislation its effect will be discriminatory—this is indirect discrimination between the States and therefore contrary to s.51(ii) of the Constitution.[91]

5.102 It also argued that the question of constitutional validity went deeper than paragraph 51(ii):

> [T]he very nature of the tax, which attempt[s] to impose taxation in an area that is the prerogative of the States (not least because they are the owners of the resources; but also because they administer the regulation and control over mining activities within their borders) would appear to be contrary to the implied restrictions on Commonwealth powers that flow from the very nature of the federal structure established by the Constitution. This interference within what is rightfully the jurisdiction of the States would effectively result in the destruction of the State's governmental capacity to encourage exploration and development activity by varying the associated royalty rate and is sufficient to render the MRRT an unconstitutional tax.[92]

5.103 While not raised in submissions to this inquiry, the arguments around discrimination concerning paragraph 51(ii) also apply to section 99.

Section 114—imposing a tax on the property of a state

5.104 The committee also heard concerns that the MRRT would improperly tax the property of a state. Section 114 of the Constitution reads:

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

5.105 The IPA's submission suggested that the rationale for the government's introduction of the MRRT—to give Australians a fair share of the nation's mineral wealth—is based on a false premise:

> … the implicit proposition underpinning these and similar statements—that Australians own all mineral and petroleum natural resources that are therefore subject to commonwealth taxation—is not supported by constitutional and legal conventions that instead provide states and territories with primary legal control over the conditions of exploration, extraction and sale of resources.[93]

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91 Fortescue Metals Group Ltd, *Submission 26*, pp. 11–12.

92 Fortescue Metals Group Ltd, *Submission 26*, p. 12.

93 Institute of Public Affairs, *Submission 12*, p, 21.

Treasury's response

5.106 In documents recently released by Treasury under a Freedom of Information (FOI) request, it was disclosed that advice had been sought from the Solicitor-General on various constitutional elements of the MRRT legislation in September 2011.[94]

5.107 Treasury's view, set out in the FOI documents, is that the MRRT would not contravene section 114 of the Constitution. The legislation spells out clearly that the MRRT is a tax on profits, not a tax on the property of a state:

> As the MRRT objects clause at section 1-10 of the Bill states, the object of the Act is to tax 'above normal profits made by miners (also known as economic rents) that are reasonably attributable to the resources in the form and place they were in when extracted.'
>
> The MRRT taxes profits made [by] miners that are reasonably attributed to the resource. The MRRT does not tax the resource itself. Nor does the MRRT impose tax on a State where the State, or an instrumentality of the State, is itself the miner who makes an above normal profit from the resource (this is made clear by clause 5 of each of the Imposition Bills).[95]

5.108 On the question of indirect discrimination between states, Treasury's view was that the MRRT could not be characterised as contravening paragraph 51(ii) and section 99:

> The MRRT provides miners with a full credit for State royalties paid in relation to the resources.
>
> The rate at which royalties are charged from one State to another is different. Similarly, the manner in which royalties are calculated differ from one State to the next. In other words, the MRRT Bill does not differentiate between or discriminate between the States. Any unequal outcomes arises from the varying royalty regimes that exist from State to State. The MRRT Bill takes the State regimes as it finds them.[96]

Committee view

5.109 The committee notes that the MRRT Bills have been drafted with the intention of ensuring that it is not a tax on the resource but on the taxable profit of a mining project. While the committee has not received a substantial amount of

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94 Department of the Treasury, 'Constitutional legality of the minerals resource rent tax and the petroleum resource rent tax', released 20 January 2012, www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=2292 (accessed 23 January 2012).

95 Department of the Treasury, 'Constitutional legality of the minerals resource rent tax and the petroleum resource rent tax', released 20 January 2012, www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=2292 (accessed 23 January 2012).

96 Department of the Treasury, 'Constitutional legality of the minerals resource rent tax and the petroleum resource rent tax', released 20 January 2012, www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=2292 (accessed 23 January 2012).

evidence on this issue, what information it has received suggests that the MRRT would not be subject to a successful challenge, in that case.

5.110 Further, the questions that have been raised during the inquiry in respect of the constitutional validity of the tax are not supported by the legal advice obtained by the Commonwealth.

5.111 Therefore, the committee believes it is likely that the MRRT legislation would not present any constitutional risks.

Concluding comments

5.112 Having carefully considered the concerns of small and emerging miners about competitive neutrality in the MRRT's design, the committee does not accept that the MRRT embeds discrimination or inequity against smaller miners. While it is possible that the starting base allowance provisions give established miners significant deductions, it must be remembered that the MRRT is a tax directed to profits. As such, a failure to give an allowance for past expenditure would render it a tax on past investment.

5.113 The committee believes that any advantage to those miners is countered by the low profit offset and simplified obligations provisions, which have been specifically incorporated to reduce administrative and compliance burdens for junior and emerging miners.

5.114 Any piece of legislation, and tax legislation more so than most, is subject to review and updating from time to time as circumstances change. The committee believes that while the recommendations for changes to the MRRT made in submissions are from bodies with industry experience, they are also unproven. This is understandable as the legislation is not in place and there is little similar legislation from which accurate comparisons may be drawn. Accordingly, in the committee's opinion the most appropriate time to review the operation of the MRRT is after it has been in place for a number of years.

5.115 In this regard, the committee particularly supports recommendation 63 of the PTG:

> To ensure the MRRT achieves its intended purpose efficiently and equitably, with minimal compliance and administration costs, the Board of Tax should review the operation of the MRRT within five years of its implementation.[97]

5.116 The committee fully expects that all aspects of the MRRT will be examined as part of the review of its operation. However, it would like to place on record its view that consideration should be given to the following issues raised in submissions:

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97 Policy Transition Group, *Report to the Australian Government: New Resource Tax Arrangements*, December 2010, p. 81.

- changes to the low profit threshold, including whether a dollar amount or a tonnage amount or both are more appropriate;
- the operation of the simplified MRRT and alternative valuation methods and their take up rate by miners;
- the adoption of a benchmark rate for the tax;
- the wider application of the OECD Transfer Pricing Guidelines to calculation of mining revenue; and
- the compliance burden on small miners arising from the MRRT, including the frequency and timing of lodging MRRT returns.

5.117 Special issues relating to the magnetite industry have been raised with the committee. While it seems likely magnetite producers will not pay significant amounts of MRRT in the first few years of its operation, the committee does not agree with the proposal for amendments to the bills that would effectively give it a permanent exemption from the MRRT.