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Introduction

Referral of the bills

1.1 On 2 November 2011 the Hon Wayne Swan MP, referred a suite of bills (the Minerals Resource Rent Tax Bill 2011 and related draft legislation) to the Standing Committee on Economics for inquiry and report. The Bills are:

- Minerals Resource Rent Tax Bill 2011
- Minerals Resource Rent Tax (Consequential Amendments and Transitional Provisions) Bill 2011
- Minerals Resource Rent Tax (Imposition—General) Bill 2011
- Minerals Resource Rent Tax (Imposition—Customs) Bill 2011
- Minerals Resource Rent Tax (Imposition—Excise) Bill 2011
- Petroleum Resource Rent Tax Assessment Amendment Bill 2011
- Petroleum Resource Rent Tax (Imposition—General) Bill 2011
- Petroleum Resource Rent Tax (Imposition—Customs) Bill 2011
- Petroleum Resource Rent Tax (Imposition—Excise) Bill 2011
- Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures) Bill 2011
- Superannuation Guarantee (Administration) Amendment Bill 2011.

Origins and purpose of the bills

1.2 The package of Bills covers a range of measures aimed at sharing the benefits of the mining boom across the economy and into the future including:

- applying a 22.5 per cent Mineral Resource Rent Tax (MRRT) on the profits that mining companies make on iron ore and coal on their mining activities only (excluding value adding activities such as transportation and concentration);
- extending the Petroleum Resource Rent Tax to all offshore and onshore gas and oil projects, including coal seam methane;
- increasing the superannuation guarantee from 9 per cent to 12 per cent;
- increasing the age limit for the superannuation guarantee; and
- improving asset-based deductions for small business.

Minerals rent taxation

1.3 The main piece of legislation, the Minerals Resource Rent Tax Bill, establishes a tax on the economic rents miners make from taxable resources (mainly iron ore and coal). 'Economic rent' is the return in excess of what is needed to attract and retain factors of production in the production process. The tax applies to that part of the profits made by miners that relates to the minerals as they are extracted from the ground but before they undergo any significant processing or value add.

1.4 The MRRT is a project-based tax, so a liability is worked out separately for each project the miner has at the end of each MRRT year. A miner has a project when it is entitled to iron ore or coal extracted under a mining lease. The miner's liability for a year is the sum of its projects' liabilities.

1.5 A project liability is worked out by multiplying mining profits (less allowances) by the tax rate of 22.5 per cent (that is, a nominal tax rate of 30 per cent, reduced by 25 per cent to recognise the miner's specialist skills in extracting minerals).[1]

1.6 Mining profit consists of mining revenue less mining expenditure. Mining revenue is mainly that part of the proceeds the miner receives from selling taxable resources that reasonably relates to the resources in the form and

1 Explanatory Memorandum, Minerals Resource Rent Tax Bill 2011, p. 3.

at the place they were in at their valuation point (usually when leaving the run-of-mine stockpile).[2]

1.7 Mining expenditure is principally the costs of finding and extracting the taxable resources and getting them to their valuation point.[3]

1.8 Mining profit may be reduced by allowances for past losses, for the miner's existing investments at 2 May 2010 (called a starting base allowance), and for the miner's Commonwealth, State and Territory mining royalty amounts. Some allowances can be transferred to other projects to reduce their mining profits.[4]

1.9 If a miner's total mining profit from all its projects comes to less than $50 million in a year, there is a low-profit offset that reduces the miner's liability for MRRT to nil. The offset phases out for mining profits between $50 million and $100 million.

1.10 The Bills are linked in their commencement dates to the passage of other legislation, including the Bills for the MRRT.

Background

Royalties

1.11 Throughout Australia, State and Territory governments tax non-renewable resources by applying a royalty to production. Royalties are generally applied on the basis of volume or value and do not take into account how profitable a mining operation is.[5]

1.12 Royalties therefore will only recover a small portion of mining rents when mining profits are high, but will also tax mining operations where no economic rent is present.

Australia's Future Tax System review

1.13 The Minerals Resource Rent Tax has its origins in the recommendations of the Australia's Future Tax System (AFTS) review.

2 Explanatory Memorandum, Minerals Resource Rent Tax Bill 2011, p. 3.
3 Explanatory Memorandum, Minerals Resource Rent Tax Bill 2011, p. 3.
4 Explanatory Memorandum, Minerals Resource Rent Tax Bill 2011, p. 3.
5 Explanatory Memorandum, Minerals Resource Rent Tax Bill 2011, p. 5.

1.14 The AFTS review was charged with reviewing Australia's tax system to examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and enhance Australia's economic and social outcomes.[6]

1.15 The AFTS review found that the royalty regimes applied by the States and Territories are among the most distorting taxes in the Federation and are not particularly flexible.

1.16 As a consequence of being distorting and relatively inflexible, royalties tend to be set at rates low enough for the mining industry to continue to operate in periods of low to average commodity prices. However, this means that royalties will fail to provide an adequate return to the community when commodity prices are high.

1.17 The company tax is a profits-based tax, which generally applies to incorporated businesses and will tend to raise more revenue from mining operations when profits are high. However, the AFTS review found that there would be benefits to the economy more broadly through lowering the company tax rate to assist in attracting internationally mobile capital investment.

1.18 The AFTS review concluded that a lower company tax rate was desirable for Australia but only if a specific profits-based tax was extended to mining operations to ensure a sufficient return to the community in periods of high commodity prices.[7]

1.19 In response to the AFTS review, the Government decided that, from 1 July 2012, the Minerals Resource Rent Tax (MRRT) will apply to profits from coal and iron ore operations, while the Petroleum Resource Rent Tax (PRRT) will be extended to all offshore and onshore gas and oil projects, including coal-seam methane. These commodities account for the bulk of Australia's mineral wealth.

Consultation in the development of the MRRT

1.20 In May 2010, the Government announced that it would introduce a Resources Super Profits Tax (RSPT). The design of the RSPT was largely rejected by the mining industry and the Government began consultation and negotiation with the three largest members of the Australian

6 Terms of reference, are available at http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/reference.htm.

7 Australia's Future Tax System – Report to the Treasurer, December 2009, pp. 217-46.

resources industry and developed a heads of agreement for the Minerals Resource Rent Tax (MRRT). There followed what the Government described as one of the most comprehensive stakeholder consultation processes ever conducted by an Australian government.[8]

1.21 The consultation on the MRRT was driven by the Policy Transition Group (PTG) and the Resource Tax Implementation Group.

1.22 The design of the MRRT is based on the recommendations of the PTG. The PTG was chaired by Mr Don Argus AC and the Hon Mr Martin Ferguson AM MP, Minister for Resources, Energy and Tourism. The PTG consulted extensively across Australia on the new resource tax arrangements and reported to the Government in December 2010, making 94 recommendations.[9]

1.23 In accepting all of the PTG's recommendations, the Government further established the Resource Tax Implementation Group, which comprised representatives from industry and the tax profession, to work closely with the Treasury, the Australian Taxation Office and the Department of Resources, Energy and Tourism to develop the legislation for introduction to Parliament.[10] This represented a cooperative approach between industry and government in the process of tax reform.

1.24 The committee heard widespread criticism from many who were not consulted on the original RSPT or on the MRRT Heads of Agreement with the three large companies. However, the committee heard wide support and satisfaction with the consultation processes that followed.[11] For example, ICAA stated that much of these consultations were a template for the future:

> The fact that the government gave the Policy Transition Group, who were drawn largely from experts in the relevant mining and resources sectors, the opportunity to examine the issues, to go through a consultative process across the country, to talk to stakeholders to hear their concerns and to deliberate and make recommendations about those issues and solutions to those issues

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8 The Hon. Mr Bill Shorten MP, Assistant Treasurer and Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 2 November 2011, p. 2.

9 Policy Transition Group – Report to the Australian Government, New Resource Taxation Arrangements, December 2010; Mr Paul McCullough, Treasury, *Committee Hansard*, Canberra, 8 November 2011, p. 1.

10 The Hon. Mr Wayne Swan MP, Deputy Prime Minister and Treasurer, *Media Release No. 096*, 21 December 2010.

11 Mr Mitchell Hooke and Mr Brian Purdy, Minerals Council of Australia, *Committee Hansard*, 9 November 2011, p. 20.

> demonstrates a very sound way to go about resolving some of the complexities in the policy-making process.
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> Turning to the Resource Tax Implementation Group, features of the RTIG process that I believe would be standout indicators for how we could do things better in other areas of policy design across the tax system would be the fact that you had a combination of experts from within the resources industry, experts from within the tax profession, who typically are engaged on a quite frequent basis with government, Treasury and the tax office in the design and development of policy and law. Certainly, there was the contribution that flowed from the involvement of senior officials from the Australian Taxation Office who could provide a perspective around how they would ultimately want to potentially administer the law once it is in place. Of course, the officials from the Treasury promoting the policy objectives of the government meant that you had quite a well rounded constructive process that did, I believe, deliver a better outcome than might otherwise have been the case had you not employed a consultative process like that.[12]

Policy drivers

Minerals Resource Rent Tax

1.25 The strategic thinking that drives the Bills was summed up by the Treasurer, the Hon. Mr Wayne Swan MP, in a speech that he delivered in Western Australia in mid 2010. In this speech, the Treasurer explained that:

> We are on the cusp of something special here. Our future is looking so much more promising than one year ago. It is about maximising our opportunities – keeping Australia ahead of the pack, just as we were ahead of the pack in dealing with the global recession. It is about managing our resource wealth sustainably, capturing a fairer share for all Australians and turning it into other forms of wealth that last. It is about reinvesting the proceeds of the resources boom to strengthen the resources sector and to broaden

12 Mr Yasser El-Ansary, Institute of Chartered Accountants in Australia, *Committee Hansard*, 9 November 2011, pp. 13-14.

> the whole economy, invest in capacity and boost national savings.[13]

1.26 The challenges to which such thinking responded were described by the Treasurer in some detail in a ministerial statement to the parliament delivered shortly after the speech above. In the words of the Treasurer:

> The Australian people own 100 per cent of Australia's natural resources and they deserve a fairer share of the super profits mining companies make, particularly during this boom. As these profits have risen in recent years the Australian people's share of those profits has fallen.
>
> Before the last boom, the country got $1 in every $3 of mining profits through royalties and resource charges but at the end of that boom, that was down to just $1 in $7. It is impossible to justify a system where Australians pay proportionately more tax as their income goes up, while mining companies pay proportionately less as their profits go up. The companies have been unable to justify this, and I cannot let the situation stand.
>
> Profits were over $80 billion higher in 2008-09 than in 1999-2000 yet governments only collected an additional $9 billion in revenue. The Government simply wants to take the Australian people's share of mining profits back to around where it was in the early 2000s. The Howard Government was not overtaxing the resource sector then, and this Government won't either. In fact, we will get the same share with a more pro-investment tax structure.[14]

1.27 The Treasurer elaborated by stating that the existing arbitrary and ever-changing state royalty regimes result in less mining investment, fewer mining jobs and less mining production. Worse still, royalties tax production and ignore the costs involved in generating that output. This results in too many Australian mines shutting down before they have exhausted the resources available, while suppressing the establishment of other mines. As a result, too many commercially viable resources are left

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13 The Hon. Mr Wayne Swan MP, “Harnessing the Boom: Address to the Chamber of Commerce and Industry of Western Australia”, Perth, 17 May 2010. The speech is available at: http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2010/010.htm&pageID=005&min=wms&Year=2010&DocType=1.

14 The Hon. Mr Wayne Swan MP, “A Stronger Economy and a Fairer Share for All Australians: Ministerial Statement”, House of Representatives, Canberra, 24 May 2010. The speech is available at: http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2010/013.htm&pageID=005&min=wms&Year=2010&DocType=1.

to waste in the ground, for no better reason than that state royalties have made their exploitation uneconomic.

1.28 The committee heard from the Minerals Council of Australia (MCA), which does not agree that resource taxes have failed to keep pace with the boom and have declined as a share of profits. While the MCA supports the concept of a profits based tax, it argues that this needs to involve fundamental reform of state royalty arrangements. However, the MCA accepts the final design of the MRRT as a workable outcome.[15]

1.29 According to the Treasurer, the Government's objective was to ensure that Australia would have something of enduring public benefit to show from the sale of our non-renewable resources, that Australia would not squander the advantages of record global mineral prices.

1.30 The Government has settled on an increased level of national savings as its preferred legacy of the mineral boom. To do this, the Government aims to deliver a package of measures, including boosting savings through an increased Superannuation Guarantee, phased in over ten years, as well as by boosting savings by making superannuation concessions fairer for low income earners.

1.31 This strategic thinking also addresses the demographic challenge of an aging society. Over the next 40 years, Australia's population will age rapidly, as an increasing proportion of the population will be older due to falling rates of mortality and lower rates of birth. There will be increasing numbers of older people to support, and fewer people of workforce age to provide that support.

Superannuation

1.32 Superannuation provides working people with the means to save for their retirement.

1.33 Because superannuation works to reduce welfare dependency, it has been the policy of successive Australian governments to make superannuation available to as many Australians as possible, so that they are able to save for their retirement in a prudentially supervised and concessionally taxed environment.

1.34 The adequacy of retirement incomes is typically assessed using the concept of the replacement rate, defined as the ratio of an individual's income or spending power after retirement to that before retirement.

15 Mr Mitchell Hooke, Minerals Council of Australia, *Committee Hansard*, 9 November 2011, p. 16.

There is no specific target set for the replacement rate, however, a worker on AWOTE might be expected to have a replacement rate of about 63 per cent.[16]

1.35 Related to the adequacy of retirement incomes is the level of household savings. Australia's net household savings was negative from 2002-03 until very recently, which means that households have been borrowing to spend more on goods and services than they could afford based purely on their income. Against this measure, net household wealth has been increasing due to the housing property market, but much of this increase is in the form of unrealised gains that are often not utilised until well after retirement. Individuals retiring while still carrying significant debt (home mortgages and consumer finance) are unlikely to find their retirement incomes to be adequate. Households that do not save while earning pre-retirement incomes will find retirement difficult.

1.36 To some extent the superannuation regime defers income into a compulsory retirement saving arrangement that might otherwise have been spent on consumption.

1.37 The Superannuation Guarantee was introduced in 1992 with a long term ambition to achieve a contribution rate of 15 per cent.[17] A ten-year phase in period followed and the Superannuation Guarantee minimum contribution rate was completed on 1 July 2002 with a rate of 9 per cent. The coverage of superannuation in Australia has grown significantly as a result of the introduction of the Superannuation Guarantee system.[18]

1.38 The Superannuation Guarantee directs some of an employee's current remuneration into improving their standard of living in retirement.

1.39 The previous Government contended that at nine percent there was a balance between employees forgoing current consumption for increases in living standards after retirement. On this basis the previous Government was not inclined to increase the superannuation guarantee rate.

16 Australia's Future Tax System – The retirement income system: Report on strategic issues, May 2009, p. 11.

17 Ms Fiona Reynolds, AIST, *Committee Hansard*, Canberra, 8 November 2011, p. 41.

18 Australian Government, *A More Flexible and Adaptable Retirement Income System,* 2004, p. 2.

Objectives and scope of the inquiry

1.40 The objective of the inquiry is to investigate the adequacy of the suite of Bills in achieving their various policy objectives and, where possible, identify any unintended consequences.

Conduct of the inquiry

1.41 Details of the inquiry were placed on the committee's website. A media release announcing the inquiry and seeking submissions was issued on Thursday 3 November 2011.

1.42 Nine submissions and three exhibits were received. These are listed at Appendix A.

1.43 Public hearings were held in Canberra on Tuesday 8 and Wednesday 9 November 2011. A list of the witnesses who appeared at the hearing is available at Appendix B. The submissions and transcript of evidence were placed on the committee's website at http://www.aph.gov.au/house/committee/economics/index.htm.