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Senator Alan Eggleston
Deputy Chair
Senate Economics Legislation Committee
Parliament House
Canberra ACT 2600

E-mail: economics.sen@aph.gov.au

Dear Senator Eggleston,

**Inquiry into the Carbon Pollution Reduction Scheme Bill 2009 and related bills**

Rio Tinto welcomes the opportunity to make a submission to your Committee's "Inquiry into the Carbon Pollution Reduction Scheme Bill 2009 and related bills". No part of this submission is confidential.

This submission deals first with three areas of particular concern with the Exposure Draft that have not been addressed in the Bill:

(a) the allocation of liability under the Carbon Pollution Reduction Scheme (*CPRS*) in the case of jointly-owned facilities;

(b) the treatment under the CPRS of coal exports; and

(c) the failure of the proposed legislation to spell out the key parameters of the emissions-intensive trade-exposed assistance program.

The submission then concludes with a summary of those critical policy concerns raised by Rio Tinto in its submission to the Department of Climate Change (*DCC*) on the Exposure Draft which continue to be of concern, despite the changes announced by the Government on 4 May 2009 to the CPRS.

Executive summary

- The Bill should impose liability directly on those who have operational control of a facility; ie, on those parties in the best position to drive improvement in the carbon emissions of a facility. Imposing liability on the parent company of the largest shareholder or participant in a facility will only drive perverse environmental and commercial outcomes.

- The recognition by the Government that there was a drafting oversight in the Exposure Draft relating to the treatment of coal exports is welcome, but the solution proposed in the Bill is still deficient from a practical perspective.

- Even though it is essential that affected industries have a clear picture of what the EITE assistance program will look like, much of the important detail of the program continues to be omitted from the Bill and left to be drafted later in regulations.

- Looking beyond the drafting of the Bill, Rio Tinto still has five key policy concerns with the CPRS as currently proposed, based on their potential adverse impact on investment and employment.

- Rio Tinto wishes to continue working constructively with the Government to help shape the CPRS in such a way that it meets the objectives and needs of both the Government and industry.

<u>Allocation of liability - wholly-owned subsidiaries and jointly-owned companies</u>

A central problem with the liability regime under the CRPS is that unlike, say, the EU emission trading scheme, the CPRS seeks to impose liability in the first instance on controlling corporations, and not on those entities that have actual operational control of emitting facilities. This effectively distorts existing commercial arrangements with customers, and in the case of jointly-owned companies also effectively distorts existing commercial arrangements with the other shareholders, and will lead to perverse environmental and commercial outcomes:

(a) There is no assurance under the current structure of the Bill that the cost of acquitting Australian Emission Units (*AEUs*) can be passed onto the buyers of carbon-intensive goods and services, even where sellers and buyers have previously agreed that new costs, taxes and charges resulting from new legislation should be passed through. Neither wholly-owned subsidiaries nor jointly-owned companies will be able to utilise many typical pass-through provisions to ensure there is appropriate price-signaling.

(b) There is no incentive for minority shareholders in any entity which produces carbon-intensive goods and services, but who can avoid an obligation being imposed on that entity to acquit AEUs, to invest their share of the cost of technology and process improvements designed to minimise carbon emissions. There will be little incentive to invest in new technology and process improvements if the burden of that investment will not be shared appropriately.

(c) A controlling corporation is left at a disadvantage in the market compared with an entity described in paragraph (b) simply because the current structure of the Bill affixes liability on the controlling corporation, and it is then left to the controlling corporation to seek an appropriate allocation of the cost of acquitting AEUs to cover the emissions of a facility among all those parties that share an economic interest in that facility. The CPRS may thus create an uneven playing field.

*Liability Transfer Certificates*

The issue described in paragraph (a) immediately above goes to the efficacy of the Liability Transfer Certificate (or *LTC*) mechanism in the Bill. The Exposure Draft contemplated that a controlling corporation and the subsidiary could agree to transfer the CPRS liability from the former to the latter, and the Bill retains this approach. Rio Tinto's concern with such a voluntary LTC mechanism was that the cost then incurred by the subsidiary in acquitting AEUs would not be the result of a change in law, but rather a voluntary act. Under typical change-in-law provisions in supply contracts, the seller can only pass through this type of cost if it is the result of a change in law. If the cost of carbon emissions cannot be passed through, one of the objectives of the CPRS - appropriate price-signaling to buyers of carbon intensive goods and services - is thus defeated.

Prior to the introduction of the Bill and subsequent to that, the DCC has been exploring with industry participants how the efficacy of the LTC mechanism might be improved. Rio Tinto would like to record its appreciation of the preparedness of the DCC to continue with this dialogue. The fact remains, however, that the alternatives proposed thus far suffer from a number of defects, including:

(a) Legal doubt over whether the alternative mandatory LTC mechanism could be said to result in the subsidiary incurring a cost as a result of a change in law such as to enable the subsidiary to rely on a change-in-law provision in a supply contract. The alternative mandatory LTC mechanism proposed by the DECC enables the controlling corporation to apply for an LTC without the subsidiary's agreement,

(b) The minority protection remedy contemplated by the DCC. This remedy, as currently proposed, has the effect of preventing liability being transferred by a controlling corporation to a subsidiary where the subsidiary did not have the ability in its supply contracts to pass through the cost of acquitting AEUs. But not all supply contracts have change-in-law pass-through provisions. Preventing a transfer of liability in these circumstances would thus make a controlling corporation's share of liability dependent on how a whole range of supply contracts may have been drafted over many years.

**The simplest solution is to impose liability on the entity which has operational control of the facility.** This would obviate the need for debate over the efficacy of any LTC mechanism, as the entity that has operational control over the facility (and which almost invariably is the entity that sells the output of that facility) will incur the cost of acquitting AEUs as the result of a change in law.

The ability to pass through the cost of acquitting AEUs is an important issue in terms of appropriate price-signaling to the market. It is, however, recognised that over time it will become less important as supply contracts expire and are renewed or replaced with provisions negotiated in recognition of the advent of the CPRS.

*Allocation - shareholders in jointly-owned companies*

What emerged as a more significant issue over the longer term, on detailed examination of the Exposure Draft, was the ability of liable entities to ensure that the cost of acquitting AEUs is shared appropriately among those parties entitled to a share of production of emission-intensive goods and services. Where the producing entity is a company in which there is a shareholder with more than 50% control over the company, so that this shareholder's controlling corporation would bear 100% of the CPRS liability, the Exposure Draft was predicated on the assumption that the shareholders would be motivated to agree to an appropriate allocation among them of the CPRS liability. Rio Tinto believes this is commercially naïve, as no minority shareholder is going to simply agree to share a financial burden where it is under no legal compulsion to do so. Moreover, in most corporate structures there will be a range of minority protections, if not in legislation then in shareholder agreements or company constitutions, which prevent a majority shareholder from simply imposing even an appropriate share of liability on the other shareholders.

The Bill has not addressed this issue. **Again, the simplest solution is to impose liability on the entity which has operational control of the facility.** This would obviate the need for any negotiation of the terms upon which the minority shareholders may or may not agree to assume an appropriate share of the majority shareholder's obligation to acquit AEUs.

*Allocation - unincorporated joint venture participants*

A related but separate issue arose with the Exposure Draft's treatment of unincorporated joint ventures (or *UJVs*). A significant proportion of Australia's minerals and energy output is produced by enterprises structured as UJVs. The genesis of UJVs in the minerals and energy sectors lies in the long-term, high-risk and capital-intensive nature of these enterprises. Companies come together in UJVs to pursue particular enterprises, with risk being shared in proportion to each participant's interest, and each participant entitled to a like proportion of the output of the enterprise. In many cases an operator will be appointed to manage the enterprise on a day-to-day basis, but all significant operating

and capital expenditures, annual plans and budgets, strategic plans, major expansions and a host of other fundamental decisions will require super-majority or unanimous approval by the participants.
The Exposure Draft proposed that participants in a UJV would have to nominate one of them to be the responsible entity, which would have the obligation to acquit all of the AEUs necessary to cover the emissions attributable to the activities of the UJV. Failure to nominate one of the participants to be the responsible entity would result in a civil penalty for all the participants. Further, the commentary accompanying the Exposure Draft suggested that, where the UJV participants failed to nominate a responsible entity, yet to be drafted amendments would apportion liability for emissions equally among the participants; ie, even if the interests of, say, four participants in a UJV were 60%, 20%, 15% and 5%, each of them would be affixed with an obligation to acquit 25% of the AEUs attributable to their jointly-owned facility. The Bill gives effect to this proposal.

The first issue arising out of the above approach is that the participants may simply be unable to agree on the participant that is to be primarily liable for the emissions associated with the joint venture's activities. One obvious reason is that it could entail just one of the participants assuming a significant statutory liability; for example, how could a participant with a 51% interest in a facility be expected to assume 100% of the statutory liability. In these circumstances, the imposition of a civil penalty is a particularly blunt instrument that fails to recognise the commercial underpinnings of most UJVs.

Moreover, where no entity is nominated, the Government's proposed default position of equal apportionment of liability may result in the participants bearing a share of that liability which bears no relationship to their respective interests in a facility. That would be inequitable.

**In the case of UJVs where the UJV participants (and not the operator) have operational control over the relevant facility, the simplest solution is to impose liability on each of the participants in proportion to their interest in the relevant facility, as these are the entities which share operational control of the facility.** This would obviate the need for any negotiation of the terms upon which all other participants may or may not agree to assume an appropriate share of the obligation to acquit AEUs in respect of the facility.

Moreover, it would provide the basis for overcoming another policy defect in the Exposure Draft that has not been dealt with in the Bill. That is where there is an operator that has operational control over a UJV's activities. Under the Exposure Draft that operator was only able to transfer its CPRS liability to one entity and not, for example, to all of the participants in proportion to their interests in the UJV. This was notwithstanding that in most if not all UJVs financial control will from a practical standpoint be shared among all (or at least a super-majority) of the participants. The Bill does not attempt to address this, but instead simply contemplates that liability may be transferred by the operator to just one of the participants provided no other participant has a larger interest. This results in a misalignment between interests in a facility and the obligation to acquit AEUs in respect of that facility.

*Ease of administration and enforcement*

The concerns expressed by the Government about administrative complexity and enforceability where liability is imposed directly on the entity or entities with operational control of a facility are misplaced, for the following reasons:

(a) The increased number of reporting entities will not increase the overall administrative burden for the Government, as many of these same entities will, for example, need to obtain government-issued OTNs to quote for their fuel purchases. In the absence of statutory support for the imposition of liability directly on those who have operational control of a facility, it will be practically impossible for industry to comply with the obligations imposed under the CPRS within the time-frame envisaged for

implementation of the CPRS when the allocation of liability is in each case likely to be a long and difficult negotiation.

(b) Imposing liability on those who have operational control of a facility is likely to significantly reduce the number of applications for LTCs by controlling corporations.

(c) In the case of UJVs, as is the case with the oversight of UJVs by the Australian Taxation Office (*ATO*), the Government will be able to readily verify whether the participants are each reporting in a consistent manner (ie, so that there are no gaps in liability). If such gaps are identified, the participants can be audited and action taken as appropriate where one or more of them have not reported the full amount of their attributable emissions and acquitted the required AEUs. This will ensure the continued integrity of the CPRS.

(d) In the case of UJVs, imposing liability directly on each of the joint-owners of the facility in proportion to their interests in the facility aligns liability under the CPRS with all other liabilities assumed by each participant in a UJV, including liability to the ATO for the correct reporting of its share of the UJVs tax-deductible expenditure and earnings from sales of its share of the facility's output.

(e) In no other area where a government in Australia imposes a significant tax, charge or other impost on an enterprise is the parent company of a subsidiary that happens to be the majority owner of that enterprise required to meet that liability on behalf of all other parties having a direct interest in that facility. It is unclear why the Government believes that there is a materially higher risk of default in acquitting AEUs by those other parties than there is in meeting any other tax, charge or other such impost.

*Legislative solution*

**The necessary amendments to the Bill to effect just the two changes described above are very simple, and need not delay unnecessarily passage of a final Bill that meets the objectives and needs of both the Government and industry.** Set out in the Appendix to this submission is an outline of the necessary amendments to the Bill. These amendments would simply affix the liability to apply for an LTC on the entity with operational control of a facility, or in the case of a UJV, as an alternative to affixing it on the operator of the UJV, on all the entities which share effective control of the UJV.

These amendments would, however, need to be made before the legislation is passed by Parliament. Deferral until there was an appropriate opportunity to present to Parliament's amendments to a CPRS Act would only create uncertainty among all affected parties, particularly in terms of how they ought to seek to adjust their commercial affairs to deal with any such amendments.

Treatment of coal exports

The effect of a drafting oversight in the Exposure Draft was that producers of export coal would incur liability for the emissions embodied in that coal even if the coal was not combusted or used in Australia. This was because liability would be incurred where the purchaser of the coal did not quote an Obligation Transfer Number (*OTN*). A foreign purchaser of coal is generally neither required nor entitled to obtain an OTN.

This was contrary to the intent of the White Paper, which was that the export of fossil fuel would not attract liability, as liability for emissions from the combustion of fossil fuels would only be imposed on entities that first supplied those fossil fuels "for use in the domestic market". The Government acknowledged this oversight and a correction was made in the Bill such that producers of coal can net out the carbon emissions embodied in coal that has been exported. The problem is that section 33(4) of the Bill requires that there first be an on-shore supply of coal from the producer to another person, and after that it is only after that on-shore supply that the recipient then exports the coal.

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Rio Tinto cannot understand the reason for requiring this intermediate step. Such an intermediate step will in many cases be commercially unattractive or impracticable, and would only add a layer of needless complexity to a typical export coal supply chain. **Section 33(4) of the Bill should be modified to remove the requirement for this intermediate step.**

Emissions-intensive trade-exposed activities

In the Exposure Draft much of the detail of the emissions-intensive trade-exposed (*EITE*) assistance program was left to the regulations. In commenting on the Exposure Draft Rio Tinto acknowledged that as the emissions-intensive trade-exposed assistance program was still being developed, not all of its details could be enshrined in the Exposure Draft, and that it would be desirable to include some aspects of the program in regulations to enable them to be amended more easily. This program is, however, of such fundamental importance to industry that it requires some certainty as to at least the key parameters of the program. Accordingly, Rio Tinto proposed that the following elements of the emissions-intensive trade-exposed assistance program could usefully be included in the Bill, while still retaining the flexibility necessary to enable the details of that program to be developed and to enable new activities to be added to the program:

(a) the provision of 5 years' notice of any modifications to the program (except to the extent those modifications are required for Australia's international trade obligations);

(b) the test for trade-exposure, being that the share of imports and exports of the output of the activity as a proportion of domestic production in any one of 2004/5, 2005/6, 2006/7 or 2007/8 exceeds 10 per cent or there being a demonstrated lack of capacity to pass through costs due to the potential for international competition;

(c) the test for emissions-intensive, being that the industry-wide average weighted emissions intensity of the activity exceeds a specified $tCO_2$-e/\$million of revenue or value added;

(d) the specified thresholds for assistance, being:

    (i) 90 per cent (and now 94.5 per cent for the first 5 years) for all activities with more than 2,000 $tCO_2$-e/\$million of revenue or 6,000 $tCO_2$-e/\$million of value added; and

    (ii) 60 per cent (and now 66 per cent for the first 5 years) for activities with between 1,000 and 2,000 $tCO_2$-e/\$million of revenue or between 3,000 and 6,000 $tCO_2$-e/\$million of value added (so as to prevent discrimination against the Australian coal industry);

(e) with the exception of the coal industry, the allocation of assistance in the form of free AEUs being based on production and the amounts of such units being calculated by reference to direct emissions, emissions associated with steam use, the increased cost of electricity, and the increased cost of natural gas-based feedstocks;

(f) in the case of the coal industry, the allocation of assistance in the form of free AEUs being based on the production and historical emissions intensity of each operation and the amounts of such units being calculated by reference to direct emissions, emissions associated with steam use, the increased cost of electricity and the increased cost of natural gas-based feedstocks;

(g) fugitive coal mine emissions should be the subject of a comprehensive policy solution that adequately address the issues that make inclusion of fugitive emissions from coal mines in the CPRS problematic; such a policy should provide for:

(i) the development of robust, auditable methodologies to accurately assess the gas reservoir in an open-cut coal mine and determine how this relates to liability under the CPRS; and
(ii) an international assessment of the treatment of fugitive emissions with respect to ownership, liability and measurement to ensure Australia's approach to these difficult issues is informed by and aligned with other countries;

(h) a clear process for coal-mining companies to be granted compensation from the government for the costs of purchasing excess permits when subsequent measurements demonstrate that CPRS liabilities calculated using default factors are materially incorrect; this is to account for the fact that the current default factors will overestimate fugitive emissions by several hundred per cent for some mines; and

(i) that there should be no reduction in the level of EITE allocations assistance over the first 10 years of the CPRS,

with it being left to the regulations to define concepts such as revenue and value added (for the purposes of the emissions-intensive test), and production, direct emissions, steam-related emissions, electricity cost and natural gas feedstock cost (for the purposes of the allocation of assistance).

Though Rio Tinto welcomes the increases in the levels of EITE assistance announced by the Government on 4 May 2009, the Bill still leaves most of the detail of the EITE assistance program to be set out in the regulations.

Five critical policy concerns yet to be adequately addressed in government policy

The section summarises five key policy areas to Rio Tinto that Government Policy and CPRS design fail to adequately acknowledge and address that have important ramifications for Australia's export-focused minerals industry and mining industry jobs. Rio Tinto considers that policy changes in these areas will make the CPRS more sustainable and contribute to Australia's economic well-being.

*1.3% Decay in permit allocations to Emissions Intense Trade Exposed Industries*

Current government policy for the scheme includes a 1.3 per cent annual erosion of permit allocations to EITE industries. This will progressively and significantly reduce the competitiveness of Australian trade-exposed businesses. For example, Rio Tinto calculates that over the first decade the cumulative operating cost increase of permit decay on its EITE eligible aluminium smelting, alumina refining and pig iron smelting industries will be around $400 million. Consequently the 1.3 per cent permit decay measure will hit eligible businesses hard because of their decreasing ability to attract sustaining and new investment capital. Operations unable to attract the necessary capital will quickly move further up the cost curve. Progressively reduced employment and closure of some operations then becomes inevitable.

Rio Tinto retains the position that all EITE activities should maintain their initial percentage allocation of permits (ie, 60 per cent and 90 per cent as well as the additional recession buffer) until 80 per cent of all carbon emissions globally are covered by a comparable carbon constraint.

Rio Tinto seeks acknowledgement that under the current EITE eligibility process, and supported by the Australian alumina refining industry provision of audited data to the DCC, the industry will receive the 94.5 per cent allocation it needs to expand employment and investment and not the 66 per cent that is referred to in the White Paper.

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*Renewable Energy Target*

For the aluminium smelting industry the renewable energy target (*RET*) under current COAG proposals adds a further third to total climate policy costs over the first decade. This is a decadal increase in electricity costs to Rio Tinto of around $300 million dollars; this cost increase excludes any additional policy-induced increased electricity, transmission and reliability charges and the direct CPRS carbon charges. Combined with the CPRS, the impact on aluminium smelting will be a decrease in allocation of the sustaining capital that is essential for the survival of operations.

Australian Governments to date have not adequately acknowledged the specific impacts of RET on Renewable Affected Trade Exposed (*RATE*) industries as distinct from those on EITE industries under the CPRS. The design of measures for RATE industries needs to recognise that RET disproportionately impacts electricity intense businesses. Currently it does not, and the Government's stated 90 per cent consideration is in fact only about 57 per cent over the first decade.

Rio Tinto's position is that RATE-qualifying activities (ie, those exceeding 4000 MWhr/$M revenue) should receive a *true* 90 per cent exemption from both the *current and expanded* RET. Even with this exemption, the aluminium smelting industry would still be bearing the largest cost exposure to the RET.

*Coal*

The inequitable and discriminatory treatment of the coal industry needs to be addressed. Rio Tinto acknowledges and welcomes the Government's recent efforts to redress this situation through the ongoing dialogue between the Parliamentary Secretary for Climate Change and the Australian Coal Industry. Under the Government's own definition, coal mining qualifies for 66 per cent EITE permit allocation. It should be accorded this status, instead of an inadequate and short lived 'compensation package'. According to Rio Tinto's analysis, some Rio Tinto coal mines that are 'long life' would close around 2020 under the scheme due to this treatment. Any reduction in Australian coal exports will be taken up by competitors in countries without comparable climate policy, thus negating any environmental benefits.

The Government singles out the coal industry for inadequate treatment relative to its EITE peers. Although the Australian coal industry meets the 1000t $CO_2$-e/$M revenue threshold for 66 per cent EITE allocation, it will receive no permits. Instead, it qualifies for a $750 million adjustment package over five years, an offer equivalent to approximately 6 per cent of permit needs over the first decade of the scheme. The package does not recognise the vital role coal plays in maintaining secure power supply globally or as Australia's leading export earner. Investment timelines for the coal industry are measured in decades, so a five-year package does not mitigate the disincentive to continue to invest in the Australian coal industry. Unlike EITE activities, allocations will not apply according to production in the sector. Two-thirds of the proposed assistance will go to a limited number of the gassiest underground mines.

Of particular concern is the premature inclusion of fugitive emissions from coal mining within the scope of the CPRS. Contrary to claims made in the White Paper, abatement technologies are not readily available. No other operating or proposed emissions trading scheme in the world currently includes fugitive emissions from coal mining. Adequate methodologies describing how to measure fugitive emissions from coal mines do not exist. The NGERS guidelines for direct measurement, though a good start, are not sufficiently robust to establish clear auditable methods, particularly with respect to sampling requirements determining what the liability of an open-cut mine could be from fugitive emissions. The only alternative for open-cut mines is to use default fugitive

emission factors which can be incorrect by a factor of ten or more, and act effectively as a tax on production. Transitional arrangements are required to support the development of robust methodologies to assess fugitive emissions from coal mines to an auditable standard. They are also needed to allow the assessment and further development of abatement technologies before fugitive emissions are included within the scope of the CPRS.

The Government has justified not extending to the Australian coal industry the same allocation afforded to other EITE industries due to the skewed distribution in methane emissions across Australian coal mines. If the Government were to adapt its own preferred allocation methodology (ie, allocate permits equal to each mine's historic emissions intensity), this would remove any windfall gain risk.

Rio Tinto's mines do not qualify for anything approaching adequate assistance in spite of contributing between 10-15 per cent of Australian coal production. Using Rio Tinto investment criteria and a carbon price similar to the Treasury's CPRS-5, half of Rio Tinto's open-cut coal mines would be likely to close around 2020. Moreover, investment in these mines for the purpose of developing expansion or life-extension options would not proceed without a significant opportunity cost.

*Technology development and deployment*

During technology development and first-of-a-kind deployment, the current allocation methodology for EITE industries is not appropriate. Specifically, the CPRS will act as a disincentive to low-emissions technology demonstration in Australia by not taking account of higher than 'design' emissions during the ramp-up to an industrial scale demonstration plant, and because of the lag in permit allocations.

The HIsmelt® Kwinana plant is currently on care and maintenance due to the very low world pig iron prices. Additional costs will make recommencement harder. Prior to shut-down, it had been reaching close to nameplate productivity levels with emissions intensities continuing to fall and improving plant reliability. Rio Tinto believes that in addition to fair EITE allocations for pig iron production, assistance over a number of years should be provided to encourage technology development and deployment via an *Innovation in Climate Change* package that would take account of emissions associated with ramp-up and testing regime of a first-of-a-kind demonstration. The package should be intimately linked to the scheme to ensure no unintended consequences and ensure Australia continues to develop and deploy low-carbon technologies. This would apply not only to HIsmelt®, but also to clean coal technologies as they are developed and initially deployed. Failure to consider the special circumstances of emergent low-emission technologies could serve to damage Australia's climate change credentials and result in a failure to capitalise on our abundant intellectual resources and capacity to encourage and support global action.

*Taxation*

Rio Tinto made submissions in relation to the tax provisions of the Exposure Draft of the Carbon Pollution Reduction Scheme (Consequential Amendments) Bill. Several positive changes were made to the final Carbon Pollution Reduction Scheme (Consequential Amendments) Bill introduced into Parliament on 14 May 2009 which address some of these issues. There are, however, two aspects of the tax provisions of the CPRS that Rio Tinto believes require further amendment:

- the removal of emissions units from the GST; and
- expanding the tax valuation methods for emissions units on hand at year end.

*Goods and Services Tax (GST)* - The Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009 introduces changes to the GST law that classify the Australian emissions units (and Kyoto Units) as a personal property right, therefore the 'normal' GST rules apply. Rio Tinto continues to have concerns with the policy aspects of this decision for the following reasons:

- The GST treatment under standard rules will increase the cost and the complexity of the scheme as well as the administration of GST. It should be noted that this is one of the key reasons that the New Zealand (NZ) Government zero-rates the supply of emissions units.

- Treatment under the normal rules will hinder the proposed harmonisation of emissions trading systems with NZ.

Under the normal rules emissions units could be GST-free, taxable or out-of-scope depending on how and from where they were obtained. This creates an unnecessary level of complexity (compared to the alternative) and taxpayers (particularly small and medium enterprises) will be required to be educated as to the different tax treatments.

*Emissions Units Valuation Methods* - The Bill provides three options for valuing emissions units on hand at year-end: actual cost, FIFO cost or market value. In addition to these options, Rio Tinto strongly recommends that taxpayers be allowed to adopt the values reported in their financial reports when valuing emissions units at year-end. The method would allow taxpayers to value emissions units on hand at year-end based on the values reported in their financial reports, provided they prepare audited financial reports in accordance with the accounting standards.

The Explanatory Memorandum to the Bill states that the existing choices for valuing units "allow taxpayers to select the method that best suits their business practices". Rio Tinto believes that this additional option would serve to enhance this objective of the legislation. Additionally, this option would provide some administrative relief for taxpayers already faced with considerable complexity in tracking and accounting for emissions units under the CPRS, as the preparation of a separate tax register of emissions units could be avoided.

Rio Tinto notes that several existing tax provisions use accounting information in the determination of taxation liabilities (eg, the fair value election under TOFA (taxation of financial arrangements) and the thin capitalisation provisions), and therefore this approach would not be without precedent.

Rio Tinto further notes that to date the International Accounting Standards Board (*IASB*) and the Australian Accounting Standards Board (*AASB*) have not issued any guidance on accounting for emissions trading. If the IASB and AASB issue guidance that requires a different accounting valuation method for emissions units than that prescribed in the tax legislation, this additional option would be desirable. As the Government wishes to enact the CPRS legislation before any accounting guidance has been issued, Rio Tinto believes it is prudent to amend the draft legislation in anticipation of a different accounting valuation method for emission units.

* * *

Rio Tinto appreciates the diverse interests and multiple objectives that confront policy-makers in designing the CPRS. Rio Tinto supports a balanced approach where the burden of reducing Australia's emissions is shared across the community. It is crucial, however, that the policy framework is geared towards wealth creation, not the distribution of revenues drawn from Australia's most efficient industries. No country can tackle climate change from a position of economic weakness. Similarly, no regime of household

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assistance can compensate for the economic insecurity that flows from declining export competitiveness and loss of investment and jobs overseas for no environmental gain. Without the additional actions proposed in this submission, Rio Tinto believes that the CPRS has the potential to undermine Australia's economic growth to the detriment of the nation as a whole, not least those who rely on a strong mining sector.

Yours sincerely,

**Stephen Creese**
**Managing director, Rio Tinto Australia**

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## APPENDIX - OUTLINE OF THE NECESSARY AMENDMENTS TO ADDRESS ALLOCATION OF LIABILITY ISSUES

Imposition of liability on subsidiary with operating control

1. Insert a new section 70A which is to apply if a company passes the category A transfer test in relation to a facility and that company has operational control of the facility (cf. s.70(1)). For the purposes of this new section:
   - the company must apply to the Authority for the issue to the company of a liability transfer certificate in relation to the facility unless the controlling corporation mentioned in section 69 consents in writing to the company not making that application (cf. s.70(2));
   - sections 70(3) (except paragraph (i)), 70(4), 72(3)(c), (4) and (5), and 79(2((a) (except paragraph (a)(ii)) (or substantively the same provisions as these) are to apply in respect of such an application;
   - the Authority may, by written notice given to an applicant, require the applicant to give the Authority, within the period specified in the notice, further information in connection with the application, in which case the applicant must comply with that requirement (cf. s.71(1), (2));
   - after considering the application, the Authority must issue to the applicant a liability transfer certificate in relation to the facility unless the Authority is satisfied that either the applicant does not pass the category A transfer test in relation to the facility or the applicant does not have (and is not likely to continue to have) the capacity, access to information and financial resources referred to in section 70(3)(b) (cf. s.72(2), (3)).

2. A liability transfer certificate issued under new section 70A is only to come into force earlier than its issue date with the consent of the holder (cf. s.77) and is only to be surrendered with the consent of the Authority and the agreement of the holder's controlling corporation (cf. s.78).

Imposition of liability on the members of a UJV where an operator has operating control

3. Insert a new section 73A which provides for a person to pass an alternative category B transfer test in relation to a facility if (cf. s.73):
   - the person (the ***operator***) has operational control of a facility; and
   - the facility is under the financial control [as defined in s.81] of another person or persons none of whom are individuals (the ***financial controllers***).

4. Insert a new section 74A which is to apply if a person passes this alternative category B transfer test in relation to a facility and the financial controllers are members of a joint venture [as defined in s.5] (cf. s.74(1)). For the purposes of this new section:
   - the operator may apply to the Authority for the issue to all (but not only some) of the financial controllers of a liability transfer certificate in relation to the facility (cf.s.74(2)) - this requirement is not to apply where a financial controller already holds such a certificate;
   - sections 74(4) (except paragraph (c)(i)-(iii)), 74(5), 76(3)(c), (4) and (5), and 79(2)(b) (or substantively the same provisions as these) are to apply in respect of such an application;
   - the Authority may, by written notice given to an applicant and/or the financial controllers, require the applicant and/or financial controllers to give the Authority, within the period specified in the notice, further information in connection with the application, in which case the applicant and the financial controllers (as the case may be) must comply with that requirement (cf. s.75(1), (2));
   - after considering the application, the Authority must issue to each relevant financial controller a liability transfer certificate in relation to the facility unless the Authority is satisfied that either the applicant does not pass the alternative

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category B transfer test in relation to the facility or any of the relevant financial controllers do not have (and are not likely to continue to have) the capacity, access to information and financial resources referred to in section 76(3)(b) (cf. s.76(2), (3)); and

- the effect of the issue of a liability transfer certificate to a financial controller is that the provisional emissions number of the financial controller (or its controlling corporation, if any) is that proportion of the total (carbon dioxide equivalent) amount of greenhouse gases emitted from the operation of the facility during the eligible financial year as equates to the financial controller's percentage interest in the joint venture as at the end of that financial year.

5. A liability transfer certificate issued under new section 74A is only to come into force earlier than its issue date with the consent of the holder (cf. s.77) and is only to be surrendered with the consent of the Authority and the operator (unless the holder ceases to be a financial controller of the facility, in which case the operator will assume the liability that would otherwise accrue to the previous financial controller by virtue of it holding the liability transfer certificate) (cf. s.78).

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6. Insert new sections 18A and 22AA that apply respectively if a facility (other than a landfill facility) or a landfill facility was under the operational control of the members of a joint venture [as defined in s.5] throughout any part of an eligible financial year. These sections should be similar to sections 18 and 22 except that the provisional emissions number of each such member (or their controlling corporations, if any) for the eligible financial year is to be the proportion of the total (carbon dioxide equivalent) amount of greenhouse gases emitted from the operation of the facility during the eligible financial year (or part of it) as corresponds to the percentage interest of that member in the joint venture as at the end of the eligible financial year.

7. The resultant provisional emissions number will need to be excluded from provisional emissions numbers that are calculated under sections 17, 18, 20 and 21 to the extent that calculation would otherwise include that number.