

## Chapter 3

### **The Henry Tax Review, the government's initial response and Australia's energy and fuel security**

#### **Introduction**

3.1 This chapter discusses the Australia's Future Tax System Review (the Henry Tax Review), the resulting report *Australia's future tax system: Report to the Treasurer* (the Henry Tax Review Report) and the Australian Government's Tax Policy Statement in response to the Henry Tax Review Report, titled *Stronger, Fairer, Simpler: A tax plan for our future* (the government's initial response). In particular the chapter examines the Henry Tax Review Report recommendations relevant to the committee's terms of reference, and the government's initial response to these, in light of the information available at the time of printing.

3.2 The committee has followed the progress of the Henry Tax Review throughout its inquiry, with a particular interest in the influence of the Henry Tax Review Report on the Energy Green and White Papers. As the Henry Tax Review was ongoing for a large portion of the committee's inquiry, the committee encountered some difficulty in obtaining information on issues which were being considered by the Henry Tax Review.

3.3 Following the release of the Henry Tax Review Report and the government's initial response on 2 May 2010, the committee wrote to state and territory governments and key stakeholders to ascertain their views. This chapter discusses the issues raised in those submissions.

3.4 On 2 July 2010, the new Prime Minister announced new/revised resource taxation measures to replace those outlined in the government's initial response. The committee notes that the majority of the submissions discussed below were received prior to the announcement of the new/revised taxation measures and consequently relate mainly to the measures outlined in the government's initial response. The impact of the new/revised tax measures and how they compare with the original measures is discussed at chapter 4.

## The Henry Tax Review

3.5 The Henry Tax Review was announced by the Treasurer on 13 May 2008. It was established to look at Australia's tax and transfer system and make recommendations to simplify and enhance Australia's tax structure.<sup>1</sup>

3.6 The Review Panel was comprised by:

- Dr Ken Henry AC, Chair (Secretary, Department of the Treasury);
- Dr Jeff Harmer (Secretary, Department of Families, Housing, Community Services and Indigenous Affairs);
- Professor John Piggott (Professor of Economics and Associate Dean, Research, Australian School of Business, University of New South Wales);
- Mrs Heather Ridout (Chief Executive, Australian Industry Group); and
- Mr Greg Smith (Adjunct Professor, Economic and Social Policy, Australian Catholic University).<sup>2</sup>

3.7 The Review Panel delivered its final report to the Treasurer in December 2009, and it was released by the Australian Government on 2 May 2010, in conjunction with the government's initial response.<sup>3</sup>

3.8 The Henry Tax Review Report made a total of 138 recommendations, covering personal taxation, investment and entity taxation, land and resource taxes, consumption taxes, taxes to enhance social and market outcomes, the transfer system as well as institutions, governance and administration. A number of the recommendations made intersect with the committee's terms of reference, and these are identified in appendix 12.

## The government's initial response

3.9 The government's initial response to the Henry Tax Review Report, released on 2 May 2010, addressed some of the recommendations made by the review. The measures in the initial government response relating to the proposal for a new Resource Super Profits Tax were subsequently replaced by the new/revised resource tax arrangements announced on 2 July 2010. It is not clear whether the measures

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1 Department of the Treasury, *Australia's future tax system: Timeline*, <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/timeline.htm> (accessed 7 June 2010); and Department of the Treasury, *Australia's future tax system: Terms of reference*, <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/reference.htm> (accessed 7 June 2010).

2 Department of the Treasury, *Australia's future tax system: The Review Panel*, [http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/review\\_panel.htm](http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/review_panel.htm) (accessed 7 June 2010).

3 Department of the Treasury, *Australia's future tax system: Timeline*, <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/timeline.htm> (accessed 7 June 2010).

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proposed by the government address the Henry Tax Review recommendations in their entirety, as the final form of the measures had not been confirmed at the time this report was printed.

3.10 A number of the recommendations made in the Henry Tax Review Report have not yet been responded to. The government has indicated that further measures covering other aspects of the Henry Tax Review recommendations will be announced over the coming months. The government has also stated that some of the recommendations made in the Henry Tax Review Report are not government policy and will therefore not be adopted. Those recommendations which intersect with the committee's terms of reference, but which will not be adopted by the government are identified in appendix 12.<sup>4</sup>

3.11 While the government's initial response outlines measures regarding taxation for small business and superannuation guarantees and contributions, this chapter discusses the measures outlined in the government's initial response *Stronger, Fairer, Simpler: A tax plan for our future*, which relate to the committee's terms of reference. These measures are namely the:

- Resource exploration rebate
- Resource Super Profits Tax
- Cutting the company tax rate
- State infrastructure fund

#### *Concerns regarding the government's initial response*

3.12 The details of the measures proposed by the government in its initial response had not been finalised at the time that submissions were sought. Submitters raised concerns about a lack of certainty which they hoped would be addressed through further consultation with the government.<sup>5</sup>

3.13 The committee sought information about the consultation process that took place in relation to the government's initial response. Dr Ken Henry AC, Secretary of the Department of the Treasury, explained:

There was some consultation. I am not sure that I am personally aware of all the consultation that occurred between ministers and others; in fact I would be pretty sure that I am not aware of all of the consultation that would have occurred. I am aware of some consultation that occurred, in particular with senior people in the resources sector. Of course, as I indicated earlier, all of the review panel's consultations, or the outcomes of

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4 The Hon. Kevin Rudd MP, Prime Minister, and the Hon. Wayne Swan MP, Treasurer, 'Stronger, Fairer, Simpler: A tax plan for our future', Media Release, 2 May 2010.

5 Woodside Energy Ltd, *Submission H8*, p. 1; and Energy Supply Association of Australia (ESAA), *Submission H10*, p. 1.

those consultations, were available to the government in its consideration of its response to the report as well.<sup>6</sup>

3.14 The Australian Petroleum Production and Exploration Association (APPEA) noted the ability of governments to undertake fiscal reform, however, stated that this must be well informed:

From a fiscal perspective, the Australian taxation framework has provided a stable basis for companies to make large scale investment commitments. The industry recognises that governments can change fiscal settings, however reforms must take account of the impact on both current and future investments.<sup>7</sup>

3.15 APPEA does not agree with the basis on which the government justified the proposed tax reform:

The case for reform to the taxation of resource extraction activities was in part justified by the Government on the basis of an estimated decline in the contribution made by the sector since 2000. APPEA does not agree with the basis of this claim.<sup>8</sup>

3.16 APPEA explained that, as demonstrated in figure 1, if the amount of tax paid by the oil and gas sector is separated from the aggregated amount of tax paid by the resources sector as a whole:

Overall, what is clear is that the petroleum industry's total taxation contribution to governments (resource taxes plus company tax) has approximately (and consistently) equated to the industry's net profit for the entire decade. It is APPEA's contention that this dispels any suggestion that the industry 'has not paid its way'.<sup>9</sup>

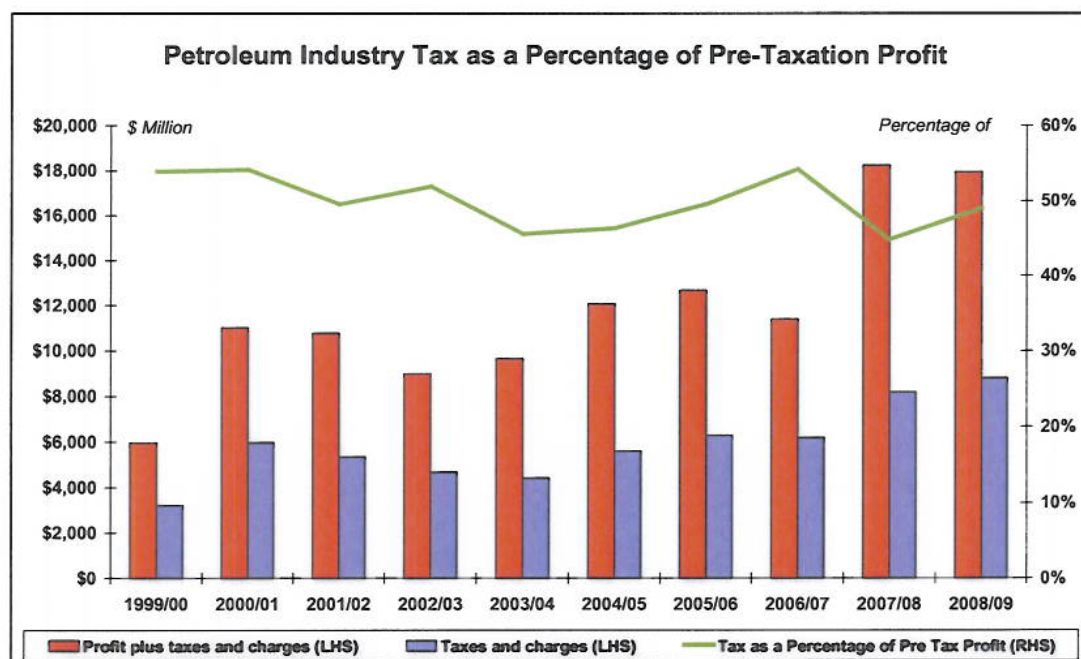
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6 Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 4.

7 Australian Petroleum Production and Exploration Association (APPEA), *Submission H17*, p. 1.

8 APPEA, *Submission H17*, p. 2.

9 APPEA, *Submission H17*, p. 2.

**Figure 1-Total Petroleum Industry Tax Contribution**

Source: APPEA Annual Financial Survey

Source: Australian Petroleum Production and Exploration Association (APPEA), Submission H17, Attachment 1, p. 6.

### **Resource exploration rebate**

3.17 The Henry Tax Review Report recommended that a refundable tax offset for companies which incur exploration expenses be implemented:

Recommendation 32: If earlier access to tax benefits from exploration expenses (relative to other expenses) is to be provided, it should take the form of a refundable tax offset at the company level for exploration expenses incurred by Australian small listed exploration companies, with the offset set at the company income tax rate.<sup>10</sup>

3.18 The government largely addressed this recommendation in its initial response, proposing a refundable tax offset at the company level, set at the prevailing company tax rate, for exploration expenditure where the exploration was undertaken in Australia, and the expenditure was incurred on or after 1 July 2011.<sup>11</sup>

10 Australia's Future Tax System Review Panel, *Australia's future tax system: Report to the Treasurer*, December 2009, p. 87.

11 Australian Government, *Resource Exploration Rebate*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/5\\_Fact\\_sheet\\_Resource\\_Exploration\\_Rebate\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/5_Fact_sheet_Resource_Exploration_Rebate_Final.pdf) (accessed 6 May 2010).

3.19 However, the government's proposed measure was to be available to all companies, not only Australian small listed exploration companies as suggested by the Henry Tax Review recommendation.<sup>12</sup>

3.20 The proposal for a resource exploration rebate was to be the substitute for a flow-through share scheme which had been promised by the government before the 2007 election.

3.21 The resource exploration rebate (RER) also provided for an expansion of the definition of exploration expenditure to include expenditure incurred in exploring for geothermal energy.<sup>13</sup>

3.22 Under the measure, expenditure on depreciating assets that were first used for exploration could be written off immediately, and subject to various eligibility criteria, expenditure incurred in exploring or prospecting for minerals, petroleum or quarry minerals could be immediately deducted.<sup>14</sup>

3.23 According to the government's initial response, the measure was to provide a stronger incentive to carry out exploration. The government intended to consult on the exposure draft legislation which was to give effect to the rebate.<sup>15</sup>

3.24 On 2 July 2010, the Prime Minister announced that the RER will not be pursued, however, resource exploration costs will continue to be deductible and a Policy Transition Group will consider the best way to promote future exploration.<sup>16</sup>

#### *Comments on the resource exploration rebate*

3.25 The Australian Geothermal Energy Association (AGEA) noted that the RER was to provide important assistance to the geothermal energy industry, but expressed concern about the commencement date of the measure, particularly due to investors' aversion to risk in the aftermath of the global financial crisis, and consequently recommended bringing the commencement date forward to 1 July 2010:

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12 Australian Government, *Resource Exploration Rebate*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/5\\_Fact\\_sheet\\_Resource\\_Exploration\\_Rebate\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/5_Fact_sheet_Resource_Exploration_Rebate_Final.pdf) (accessed 6 May 2010).

13 Australian Government, *Resource Exploration Rebate*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/5\\_Fact\\_sheet\\_Resource\\_Exploration\\_Rebate\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/5_Fact_sheet_Resource_Exploration_Rebate_Final.pdf) (accessed 6 May 2010).

14 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, p. 22.

15 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, pp 22-23.

16 The Hon. Julia Gillard MP, Prime Minister, the Hon. Wayne Swan MP, Deputy Prime Minister and Treasurer, and the Hon. Martin Ferguson MP, Minister for Resources and Energy, 'Breakthrough agreement with industry on improvements to resources taxation', Press Release, 2 July 2010, p. 1, <http://www.pm.gov.au/node/6868> (accessed 21 July 2010).

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A number of the leading companies now have joint venture agreements with other energy companies who have choices about where to spend funds for a quicker return and these decisions are outside of the control of the geothermal companies. Our members with these investors have warned that neither their own finances nor those of their investors/partners will be spent on any activity likely to gain a benefit from the proposed RER before July 1 2011. As most of the activity undertaken by the industry is considered to be in the exploration stage, little or no activity is likely to occur in the industry over the coming 12 months if the start date is not bought forward.<sup>17</sup>

3.26 AGEA further stated that clarification of the definition of exploration activity was required:

Exploration activity in the geothermal sector is all activity prior to the commencement of commercial expansion or that point in the project where a reserve can be announced. Before that point a decision to expand to commercial scale development on the basis of the capacity of the available resource to support a commercially viable project is not made. The activity prior to this point would typically include traditional geoscience work, shallow drilling, deep drilling, rig mobilisation and demobilisation, proof of concept testing, demonstration drilling, reserves delineation drilling and reservoir enhancement testing. For a typical EGS or HSA project this can incur tens of millions of dollars in expenditure to get to this point with most of these funds being raised from the private sector.<sup>18</sup>

3.27 The Australasian Convenience and Petroleum Marketers Association (ACAPMA) noted their expectation that the resource exploration rebate would have encouraged exploration for resources:

During the 1990s and again in 2004 and 2008, the Australian Government introduced measures into the PRRT to encourage petroleum exploration. These included the ability to transfer undeducted exploration expenditure to other projects held by the same entity, an uplift of 150% on PRRT deductions in designated offshore frontier areas and a 'look back' rule to allow for retention leases on sites to be explored with deductions on expenditure allowed where a production is derived. We believe that the implementation of resource exploration rebate would only bring other mined products into line with the upstream petroleum industry.<sup>19</sup>

3.28 The New South Wales (NSW) Government observed that the RER would have increased incentives to conduct exploration:

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17 Australian Geothermal Energy Association (AGEA), *Submission H6*, pp 2-3.

18 AGEA, *Submission H6*, p. 4.

19 Australasian Convenience and Petroleum Marketers Association (ACAPMA), *Submission H5*, p. 2.

Compared to the current high degree of risk to investors that is inherent in mining exploration, the proposed tax rebate should reduce the level of risk exposure and increase their incentive to invest.<sup>20</sup>

3.29 The Australian Workers' Union (AWU) noted that the RER would have been particularly beneficial for smaller exploration companies:

Small exploration companies currently do not get a tax benefit from their deductible exploration expenses until they become profitable. For many companies this means waiting for many years to receive a benefit – years in which a project may stall and jobs can be lost...By providing the opportunity for immediate rebates for exploration spending, the RER will provide a boost to the competitiveness of smaller miners for whom existing tax arrangements preclude deductions until a profit is made.<sup>21</sup>

3.30 BP also noted that the RER would have only affected smaller companies:

The resource exploration rebate will have no material beneficial impact on oil and gas exploration, as it does not apply a multiplier on frontier exploration expenditure. Therefore only companies that make a tax loss will see a benefit in the form of a cash refund, but typically such companies are not large enough to participate in substantial oil and gas exploration.<sup>22</sup>

3.31 The committee heard evidence that exploration incentives are needed to encourage small to mid-tier companies to explore for Australian oil, and the withdrawal of the RER may have placed that in jeopardy:

**All small companies certainly want to become big companies, but the ability to become a big company is the ability to grow and is dependent to some extent on the ability to raise capital to support exploration.** They also are the companies that can go or are willing to go to places that the big companies are not able to commercially justify. They are the ones who can go into the nooks and crannies of some of the basins to where it is commercially viable for them to do something but not for others. In other words, they play a very, very important and somewhat unacknowledged role in the integrated nature of Australia's oil and gas industry.

**Because they tend not to pay PRRT, up until now they have not been able to pass through the deductions that might be associated with exploration against a PRRT because they do not have a PRRT liability and possibly are unlikely to do so even under the new regime. From an investment point of view, that makes it difficult for them to attract capital, so this industry has very long argued for what was called a flow-through share scheme, which was in fact incorporated into the government's election platform in the 2007 election. That has since been replaced, post Henry tax review, by a resource exploration rebate,**

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20 New South Wales (NSW) Government, *Submission H20*, p. 2.

21 Australian Workers' Union (AWU), *Submission H18*, p. 8.

22 BP, *Submission H19*, pp 1-2.



**which we also warmly welcomed.** It certainly was not the flow-through share scheme. Some members preferred it; some members preferred the flow-through share scheme, but it is certainly true to say that it retained the notion of the need and the acknowledgement of the need to provide incentive for the small cap to midcap players to continue to explore in Australia. That was acknowledged. **Under the new package now, we have been quite disturbed to see that that has been dropped.** The government have gone on to say that they would like the new policy transition group to explore, so to speak, other incentives for exploration... We are optimistic that it will have a look at this issue. It is a very real issue. We would very much like—and I think it is in Australia's best interest—to have Australia's small and midcap players exploring for our oil rather than going overseas and exploring for somebody else, particularly in the context of Australia now producing around 50 per cent of what it is consuming, with a deficit of around \$16 billion in liquids, in oil, compared with only 10 years ago, where we had a net surplus in oil and we were producing around 108 per cent of what we were consuming. These are issues of the national interest, and certainly exploration incentives for the small to midcap companies are an important vehicle for being able to address those. *[emphasis added]*<sup>23</sup>

3.32 APPEA noted its support for a flow-through share scheme, as promised by the government before the 2007 election, over the RER:

APPEA has consistently advocated the benefits that would arise from an appropriately structured and targeted flow through share regime. The advantage of such a system is that it will assist companies in raising capital from equity markets. The exploration credit measure announced by the Government targets the existing tax distortion that prevents companies without assessable income from gaining the full after company tax value of exploration expenditure. While the rebate will address this distortion, the advice from member companies at this stage is that it may not address the challenges of raising equity capital. This is because the benefit accrues at the company, not the subscriber level.<sup>24</sup>

3.33 This support was echoed by Mr Simon Bennison, Chief Executive Officer (CEO) of the Association of Mining and Exploration Companies (AMEC):

The whole issue for the exploration sector is that to get the amount of capital that is required to drive exploration in this country requires the raising of significant capital. That is done through equity finance, and that is why the flow-through shares, for want of a better description, had been proposed from industry and were supported by government in the election platform, as opposed to the rebate itself, which was cash back—after you had made the expenditure you would go and claim the rebate and get reimbursed the rebate. That is fine, but that allows you only to put a certain amount—at that stage it was 30 per cent—back into exploration and other

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23 Ms Belinda Robinson, Chief Executive, APPEA, *Committee Hansard*, 13 July 2010, pp 22-23.

24 APPEA, *Submission H17*, p. 5.

expenses, whereas if you were raising the full equity from the flowthrough shares arrangement you would be putting all that expenditure on an annual basis, and any other further raisings, back into the full exploration program.<sup>25</sup>

3.34 Further, Mr Mike Young, Managing Director of BC Iron noted to the committee that a flow-through share scheme would introduce more investor confidence for the industry.<sup>26</sup>

3.35 Noting industry support for a flow-through share scheme, the committee questioned why the Henry Tax Review recommended the RER over a flow-through scheme. Dr Henry explained to the committee that:

The [Henry Review] committee was not of the view that there was a need to provide further exploration incentives. There was also—and I do not know if this was reflected in the report but I am nevertheless happy to say it—a view that something like a flow-through share scheme would introduce an additional level of complexity to the tax system. That was a consideration... And we came to the view that there was a simpler, neater and, dare I say, more elegant way of providing much the same incentive for exploration were the government to judge such an incentive to be important. That was the background of the [Henry Review] committee's recommendation.<sup>27</sup>

3.36 Given evidence received about the potential benefits of the RER for smaller companies, the committee sought information on why the measure will no longer be pursued. Dr Henry merely stated to the committee "That is a government decision."<sup>28</sup>

3.37 The committee was told that industry was disappointed about the removal of the RER, as Mr Stephen Pearce, Chief Financial Officer (CFO) of Fortescue Metals Group (FMG) explained:

...In our discussions with the government prior to the MRRT being announced, we had certainly argued that the exploration rebate should be retained. So we were particularly disappointed that the exploration rebate had not continued or that the flow-through share scheme proposal, which has been on the table for probably the last decade, also has not progressed.<sup>29</sup>

3.38 Mr Bennison of AMEC explained to the committee that while industry had preferred a flow-through share arrangement, they had welcomed an RER. However, the RER has been removed, and has not been replaced with a flow-through share

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25 Mr Simon Bennison, Chief Executive Officer (CEO), Association of Exploration and Mining Companies (AMEC), *Committee Hansard*, 13 July 2010, p. 98.

26 Mr Mike Young, Managing Director, BC Iron, *Committee Hansard*, 13 July 2010, p. 102.

27 Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, pp 46-47.

28 Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 45.

29 Mr Stephen Pearce, Chief Financial Officer (CFO), Fortescue Metals Group (FMG), *Committee Hansard*, 13 July 2010, p. 77.

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scheme. Mr Bennison went on to explain to the committee that there are significant differences between the two programs:

Mr Bennison—The industry has always welcomed an RER and has made this known to the government on a number of occasions. Given the amount of conjecture that has been around this over recent times we have actually put a chronology together that identifies the times at which government has been engaged in this process from when the RER was first announced. We have gone to great lengths to explain to government that the RER is very different to what the industry was initially asking for and what the government committed itself to in the 2007 election policy platform, which was really an exploration development program modelled around the flow-through shares. The flow-through share arrangement was there to address a taxation asymmetry problem that we had and a distortion that we believed needed to be addressed. That was there to provide equity finance for the sector; versus an RER, which was more or less there to rebate industry, and also in part address that asymmetry, but which really was not addressing the issue of raising equity finance, which is the major hurdle for exploration and exploration development within this country.

CHAIR—If I can paraphrase what you are saying, the resource exploration rebate was better than nothing—

Mr Bennison—Absolutely.

CHAIR—It was not as good as what you had been promised before the last election by the government when they promised flow-through shares but it was better than nothing, but you have actually now ended up with nothing.

Mr Bennison—Correct. I think the important thing is there are distinct differences in the roles of both programs.<sup>30</sup>

### ***Resource Super Profits Tax***

3.39 The Henry Tax Review Report made a series of recommendations regarding the application of a resource rent tax, and the form it should take. In summary, recommendations 45, 46 and 47 recommend that a uniform resource rent tax be imposed and that it:

- replace existing resource charging arrangements on non-renewable resources;
- be administered by the Australian Government;
- be levied at a 40 per cent rate, which is adjusted to offset any changes in the company income tax rate to ensure a combined statutory tax rate of 55 per cent;

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30 Senator Mathias Cormann, Chair, Senate Select Committee on Fuel and Energy, and Mr Bennison, AMEC, *Committee Hansard*, 13 July 2010, p. 98.

- apply to non-renewable resource projects, such as oil, gas and minerals, with the exception of lower value minerals which would continue to be subject to existing arrangements where appropriate;
- measure rents as net income, less an allowance for corporate capital, and that the allowance be set at the long-term government bond rate;
- require a rent calculation for projects;
- allow losses to be carried forward with interest or transferred to other commonly owned projects, and that the tax value of any residual losses be refunded when a project is closed;
- be allowed as a deductible expense when calculating income tax, with any loss refunds treated as assessable income;
- not provide concessions to encourage exploration or production activity at a rate faster than the commercial rate or in a particular geographic area;
- should not allow deductions above acquisition costs to stimulate investment;
- allow existing projects to be transferred into the new system with an appropriate adjustment to the starting base for the allowance for corporate capital;
- be implemented in accordance with a time-frame set out by the Australian Government; and
- is implemented with clear guidelines as to how existing investments and any investment in the interim will be treated under the new resource rent tax.<sup>31</sup>

3.40 In response to these recommendations, the government announced its proposed Resource Super Profits Tax (RSPT), which was to commence on 1 July 2012, at a rate of 40 per cent on profits made from Australia's non-renewable resources.<sup>32</sup>

3.41 It was proposed that the RSPT would replace the crude oils excise, and would operate in parallel with state and territory royalty regimes. The Australian Government was to provide resource companies with a refundable credit for royalties paid to state or territory governments, allowing the states and territories to continue to

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31 Australia's Future Tax System Review Panel, *Australia's future tax system: Report to the Treasurer*, December 2009, p. 89.

32 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, p. 21.

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collect a stable stream of revenue from royalties, while removing the effects that royalties have on investment and production.<sup>33</sup>

3.42 It was intended that those projects already covered by the current Petroleum Resource Rent Tax (PRRT) would remain in the scope of the PRRT unless they elected to transfer to the RSPT. However, any election into the RSPT was to be irrevocable.<sup>34</sup>

3.43 The government explained the operation of the RSPT in a fact sheet as follows:

The RSPT will apply to super profits made from all non-renewable resources on or after 1 July 2012 at a rate of 40 per cent. RSPT liabilities will be deductible with RSPT refunds being assessable for income tax purposes.

Through the RSPT, the Government will effectively make a contribution of 40 per cent to the costs of the project outlaid by the entity. An entity will be able to access the contribution by deducting the costs outlaid on a project from: the project's RSPT income; from income of another project owned by the entity or owned by another entity of the same wholly owned company group.

Any remaining costs will be carried forward to be deducted as a loss against future income or be refundable at the 40 per cent rate on a reasonable basis, such as when an entity exits the resource sector. The basis for refundability will be determined through consultation with stakeholders.

Delays in utilising the costs could occur due to costs exceeding income and due to depreciating assets being expensed over the life of the asset. These undeducted costs are held in an account called the RSPT capital account. The government will compensate an entity for this delay by providing an interest allowance on the balance in the RSPT capital account. The RSPT allowance rate will be set at the long term government bond rate.

Entities that have interests in existing projects that will be subject to the RSPT will be given an RSPT starting base to recognise past investment. Special arrangements will be provided to allow the starting base to be used over the first five years of the operation of the RSPT to reduce the RSPT payable on these projects interests. Any unused starting base can be carried forward to be deducted against future income of that project interest, though

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33 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, p. 21; and Australian Government, *Resource Super Profits Tax*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/10\\_Fact\\_sheet\\_Resource\\_Profit\\_Tax\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/10_Fact_sheet_Resource_Profit_Tax_Final.pdf) (accessed 6 May 2010).

34 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, p. 21; and Australian Government, *Resource Super Profits Tax*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/10\\_Fact\\_sheet\\_Resource\\_Profit\\_Tax\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/10_Fact_sheet_Resource_Profit_Tax_Final.pdf) (accessed 6 May 2010).

it cannot be deducted against income from other project interests and is not refundable.

Investment expenses by an entity between the time of announcement and commencement of the RSPT will be given the same treatment as for that outlaid post commencement.<sup>35</sup>

3.44 The government stated that it intended to consult with stakeholders on RSPT design issues including the taxing point and transitional arrangements for existing projects prior to the commencement of the measure. The consultation process commenced with the release of the Announcement Paper, *The Resource Super Profits Tax: a fair return to the nation*.<sup>36</sup>

3.45 Shortly after the release of the government's initial response, the initial round of discussions with the Consultation Panel began, followed by public consultations in various capital cities commencing from 24 May 2010.<sup>37</sup>

3.46 On 2 July 2010, the Prime Minister announced that the RSPT would be replaced by a new Minerals Resource Rent Tax (MRRT), and an expanded PRRT. Details of the new arrangements are discussed at chapter 4.

#### *Concerns regarding the Resource Super Profits Tax*

3.47 A number of the submissions received by the committee regarding the Henry Tax Review and the government's initial response noted that at the time submissions were sought, industry and stakeholders had not had the opportunity to undertake any detailed analysis on the consequences of the RSPT, particularly as the draft legislation was unavailable at the time, and consultations between a number of stakeholders and the government were ongoing. However a series of initial concerns were raised.

#### *The removal of state royalties and the consultation process*

3.48 The committee asked questions about the level of consultation which took place on the resource rent tax measure as recommended by the Henry Tax Review. The committee confirmed with the Department of the Treasury that the original resource rent tax proposed by the Henry Tax Review was designed to replace state royalties:

CHAIR—The resource rent tax model which was recommended by your review was based on the proposition that state royalties would be abolished

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35 Australian Government, *Resource Super Profits Tax*, Fact Sheet, pp 3-4, [http://www.futuretax.gov.au/documents/attachments/10\\_Fact\\_sheet\\_Resource\\_Profit\\_Tax\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/10_Fact_sheet_Resource_Profit_Tax_Final.pdf) (accessed 6 May 2010).

36 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, p. 21; and Australian Government, *Resource Super Profits Tax*, Fact Sheet, pp 1 and 6, [http://www.futuretax.gov.au/documents/attachments/10\\_Fact\\_sheet\\_Resource\\_Profit\\_Tax\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/10_Fact_sheet_Resource_Profit_Tax_Final.pdf) (accessed 6 May 2010).

37 APPEA, *Submission H17*, p. 3.

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altogether and be replaced with a profit based resource rent tax. Were state and territory governments ever formally consulted on that proposition as far as you are aware?

Dr Henry—Yes, at officials level certainly and at political level also.

CHAIR—And you are quite certain about that?

Dr Henry—I am absolutely certain.

CHAIR—And that was before this was announced?

Dr Henry—Yes.

CHAIR—But presumably the response then was that state and territory governments were not going to abolish their royalties and hence the government decided to refund them under certain circumstances? That is right, isn't it?

Dr Henry—That was the government decision...<sup>38</sup>

3.49 The committee notes that Dr Henry made it very clear that the RSPT was designed to replace state royalties, if not straight away, then over time. Dr Henry also conceded that under the RSPT, there could be a nil return to the community from the exploitation of these non-renewable resources if there was no 'super profit' and all state royalties were either refunded or abolished:

Dr Henry—That was the government decision. Whether it is the case that the government decided on that particular formulation because the states had indicated they were not going to abolish their royalties is another matter. I am not sure that that is the reason why the government settled on that particular design. I think, rather, the issue was that that would be the easiest way of introducing new taxation arrangements, at least in some transitional period. I must say—or rather, I do not have to say it but I will say it—that it was my expectation as an adviser that, were the government able to legislate that particular package and that particular design, at some point, not immediately, obviously, but at some point, state royalties would disappear. So I saw the government's proposal as an interim arrangement with respect to royalties.

CHAIR—So, when you say it was part of the transitional arrangements and interim arrangements, your assessment or your take on it was that the refunding of state royalties was going to be a temporary measure?

Dr Henry—That is a personal judgement. As far as I know, the government did not come to any particular view on that matter. But it just seemed to me that, with the business of states levying royalties and then the Commonwealth refunding those royalties to taxpayers and levying the Commonwealth tax instead, at some point states would see that there was no need for them to levy the royalties in the first place. But that is a personal judgement.

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38 Senator Cormann, Chair, Senate Select Committee on Fuel and Energy, and Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 4.

CHAIR—If the federal government had gone along with your judgement and I guess with the proposition of your review and state royalties had been abolished or would be abolished then wouldn't it be the case that some mining companies would get access to our non-renewable resources for free—i.e. if they are not making a super profit under the RSPT or if they are not subject to the MRRT?

Dr Henry—Yes, that is certainly the case. It is certainly the case that under the RSPT, the MRRT and, for that matter, the petroleum resource rent tax, if businesses are not making a significant rate of return on the extraction of the mineral resources then, in the absence of royalties, there would be no tax. That is of course why, in the committee's report and also in the government's initial response to the committee's report, the abolition of royalties was said to remove a considerable distortion in the taxation arrangements applying to natural resources, and it is why the report and the government's response to the report indicated that it was very likely that minerals investment would actually increase under these taxation arrangements.<sup>39</sup>

3.50 The committee notes the concerns the Western Australian Department of Treasury and Finance raised in relation to the Commonwealth's 'unwelcome intrusion' into the area of state royalties:

Turning next to the issue of the state's autonomy over mining and petroleum royalties, we view the Commonwealth's proposed mining tax regime as an unwelcome intrusion into an area of state government responsibility, undermining the state's autonomy and budget flexibility. While the proposed MRRT and expanded PRRT are currently envisaged to operate alongside state royalties, with a tax credit available for state royalty payments, we are concerned that over time there is a significant risk that states will effectively be crowded out of this revenue base, at least in respect of iron ore, coal and petroleum. The intentions of the Henry review committee were quite clear in this regard. Industry is also likely to bring pressure to bear on states to abolish their royalties so that companies need comply with only one regime, rather than two. Such an outcome would increase WA's reliance on Commonwealth grants and exacerbate the already high vertical fiscal imbalance between the Commonwealth and the states. A related issue is the extent to which the Commonwealth government will seek to cap the royalties that are creditable against liabilities under the MRRT and expanded PRRT. In our view, it is essential that states have full flexibility<sup>40</sup> to alter their royalty regimes as appropriate to their specific circumstances.

3.51 Despite Dr Henry's assurances about consultation with state and territory governments impacted by the RSPT proposal, the committee heard concerns about the

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39 Senator Cormann, Chair, Senate Select Committee on Fuel and Energy, and Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 5.

40 Mr Michael Barnes, Acting Under Treasurer, Department of Treasury and Finance, Western Australia, *Committee Hansard*, 13 July 2010, p. 3.



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lack of consultation on the RSPT measure, including the possible future abolition of state royalties, from the Western Australian Department of Treasury and Finance:

CHAIR—Did the Australian Treasury contact you before the release of the superprofits tax?

Mr Barnes—Before the original public announcement the Commonwealth Treasury did give a very general heads-up of the direction that the recommendations were heading in, but at no stage prior to public release did we actually see the recommendations, nor—by definition, given that we did not see the recommendations—were we asked to comment or provide input on the recommendations.

CHAIR—The original proposal was for the resource superprofits tax to replace state royalties and that state royalties would be abolished. As far as you are aware, has anyone from the federal government at an official or government-to-government level discussed the prospect of abolishing state royalties with WA Treasury or the WA state government?

Mr Barnes—In the initial heads-up that I mentioned, that prospect was flagged as the direction that the Henry review committee was heading in.

CHAIR—What was your response to that?

Mr Barnes—We were not really given the opportunity to respond; it was more in the nature of a one-way communication that that was the direction the review was heading in.<sup>41</sup>

CHAIR—...You are in Canberra today; why wouldn't Ken Henry and others pick up the phone or sit down with you and give you some answers to all these questions?

Mr Barnes—You would probably have to ask Ken Henry that question. We have sent off a letter or two and emails to try to get clarity around some of these issues, but so far it has been to no avail.

CHAIR—How many letters and emails have you been sending to federal Treasury or the federal government?

Mr Barnes—I can recall two.

CHAIR—So you have been trying to have a meeting or discussion but so far that has not eventuated.

Mr Barnes—Yes—certainly not to the level of detail that we need.<sup>42</sup>

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41 Senator Cormann, Chair, Senate Select Committee on Fuel and Energy, and Mr Barnes, Department of Treasury and Finance, Western Australia, *Committee Hansard*, 13 July 2010, p. 7.

42 Senator Cormann, Chair, Senate Select Committee on Fuel and Energy, and Mr Barnes, Department of Treasury and Finance, Western Australia, *Committee Hansard*, 13 July 2010, p. 8.

3.52 The committee heard from Western Australian Department of Treasury and Finance that revenue from royalties has increased with commodity prices because the royalty system in Western Australia is value based not volume based:

CHAIR—Because there seems to be a general lack of understanding on how royalties are operating. I am just asking you to explain it for the benefit of the public. One of the arguments that has been used by senior cabinet ministers at a federal level, and all of the government members and senators who run through the talking points around the super profits tax and its success, is that state royalties are volumes based, taxes based on volumes, so they have not enabled the community to get their fair share of increasing commodity prices and only a profits based resource rent tax will enable the community to get a fair share of the increased value of those commodities. Would you care to comment (1) on the operation of state royalties in Western Australia, which I understand to be values based, and sensitive to price; and (2) on whether in fact a profits based resource rent tax is the only way to achieve a fair return to the community?

Mr Barnes—The vast majority of Western Australia's royalty regime is an ad valorem, or value based royalty system, not volume based; therefore our royalty revenue rises in line with increases in commodity prices and in line with increases in volumes. The chart I have in front of me shows that royalty revenue has increased substantially over the last four or five years, reflecting the increase in commodity prices that we have seen over that time. In 2004-05 our royalty revenue was less than \$1½ billion; in 2008-09 our royalty revenue was approaching \$3½ billion.

CHAIR—So there have been significant adjustments to your revenue as a result of the increase in commodity prices?

Mr Barnes—Absolutely.<sup>43</sup>

3.53 The committee heard evidence from the Western Australian Department of Treasury and Finance stating that 'if there is a view that the community is not receiving a fair return' for its non-renewable resources then the department would prefer the Commonwealth and states work together to design enhancements to the royalty regimes:

CHAIR—You recommended that this minerals resource rent tax should not proceed. Can you summarise the basis for your view that the MRRT should not proceed?

Mr Barnes—I guess it is because of some of those risks that I outlined in my opening statement. It is also as a result of the general principle of a concern that the Commonwealth is intruding in what is historically and, arguably, constitutionally a state responsibility not a Commonwealth responsibility and the implications of that for the current vertical fiscal imbalance between the Commonwealth and the states and the implications

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43 Senator Cormann, Chair, Senate Select Committee on Fuel and Energy, and Mr Barnes, Department of Treasury and Finance, Western Australia, *Committee Hansard*, 13 July 2010, p. 9.

for the revenue autonomy and policy flexibility of the states. They are issues that we are very concerned about.

Our preference, therefore, is that the MRRT not proceed. If there is a view that the community is not receiving a fair return from resource companies, however a 'fair return' is defined—a very subjective thing to define—we would prefer that the Commonwealth and the states work together to design enhancements to the royalty regimes of the states to address that issue.<sup>44</sup>

### *Design*

#### 3.54 APPEA emphasised that the measure should not reward failure:

The industry does not support the introduction of a risk sharing provision (via a rebate or refund at the end of a project life). Rather, a higher priority should be placed on the application of appropriate uplift rates to reflect the risks associated with exploration and development decisions in the industry.<sup>45</sup>

#### 3.55 BP noted, that while in principle, a 'true rent tax' is efficient, the RSPT as it was initially proposed, was flawed:

Firstly, setting the uplift on expenditures at the Long Term Bond Rate does not adequately reflect project risk, and the proposal to offer a refundable offset for loss-making projects does not work as a proxy. Secondly, depreciating capital investments over long time lines does not reflect the very deep capital requirements in industries such as Liquefied Natural Gas (LNG), and would see projects paying a "profit" tax when they are still many years away from breaking even on a cash flow basis. Thirdly, imposing the change retrospectively on projects that were sanctioned on a fundamentally different basis is both unfair and, because it impacts different companies differently, is inequitable. For example the North West Shelf Venture appears to be alone amongst current oil and gas projects in Commonwealth waters to be denied the option to opt-in to the RSPT or to remain on current arrangements.<sup>46</sup>

#### 3.56 APPEA were particularly concerned to ensure that existing projects would not be disadvantaged under the transitional provisions provided:

Any fundamental shift in the investment framework must be very carefully considered and managed, with projects transitioning into the new regime not being adversely impacted. In addition, value adding activities post the taxing point should not be taxed via the RSPT. Changes should only be

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44 Senator Cormann, Chair, Senate Select Committee on Fuel and Energy, and Mr Barnes, Department of Treasury and Finance, Western Australia, *Committee Hansard*, 13 July 2010, p. 15.

45 APPEA, *Submission H17*, p. 3.

46 BP, *Submission H19*, pp 1-2.

introduced on a prospective basis, while retrospective impacts must be avoided, or the impacted parties should be fully compensated.<sup>47</sup>

3.57 APPEA further noted that 'Competitive neutrality must underpin the design of any new system.'<sup>48</sup> In their submission, APPEA argued that it is essential that taxation neutrality is maintained for commodities competing for the same market, so it is important that natural gas is not disadvantaged in relation to coal and other fuels.<sup>49</sup>

#### *Markets, production and investment*

##### Energy industry

3.58 The Australian Energy Market Operator (AEMO) and the Australian Energy Market Commission (AEMC) both noted that the impact of the RSPT would have varied between market participants:

The impact of any tax on the cost of generation would then not only relate to the incidence of the tax on the supplier but also the specific terms of the contract between parties.<sup>50</sup>

3.59 AEMC commented that the RSPT could have potentially impacted on input costs for market participants, explaining that:

The market rules are designed such that changes in input costs for market participants can be reflected in market offers – on the basis of which the market is dispatched, and prices are set. Price expectations are the main signal for new investment. Hence, price signals might change, but there is no obvious detriment to ongoing security of supply – and is no different in principle to other cost changes that the market routinely accommodates.<sup>51</sup>

3.60 ESAA expressed some concern about the possible impact of the RSPT on energy prices, noting:

esaa observes that, to the extent that the RSPT serves to increase the input costs of coal and gas for electricity generation (and gas as a direct domestic energy source), it would be rational economic behaviour to expect industry participants to attempt to pass through such costs to end consumers.<sup>52</sup>

3.61 AEMO noted that increased costs and prices could impact on competitiveness and investment outlook:

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47 APPEA, *Submission H17*, p. 3.

48 APPEA, *Submission H17*, p. 3.

49 APPEA, *Submission H17*, p. 3.

50 Australian Energy Market Operator (AEMO), *Submission H3*, p. 2; See also, Australian Energy Market Commission (AEMC), *Submission H1*, p. 2.

51 AEMC, *Submission H1*, p. 2.

52 ESAA, *Submission H10*, p. 1.

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Should a generator suffer an increase in marginal fuel supply cost due to the processes described above, it would be expected that its marginal offer price would increase as a consequence. Where those impacts fall differently on different participants, they could also impact on relative competitiveness and the dispatch of generation. Any impacts of the proposed tax will first be observed in the short term market outcomes. There may also be longer term impacts arising from any changes in the investment outlook for the various sectors of the energy industry.<sup>53</sup>

3.62 AEMO further noted that if the RSPT had impacted on investment for certain sectors, this may have affected future energy demand:

It should also be noted that extractive and processing industries represent a significant proportion of energy demand in our markets. Forecast future demand for energy is premised upon strong growth in these sectors. Any change to investment in these industries, either positive or negative, would impact on future energy demand.<sup>54</sup>

3.63 The Australian Academy of Technological Sciences and Engineering (ATSE) also expressed:

...considerable concerns about the proposed change in taxation arrangements for resources due to the heightened sovereign risk it implies and the consequent reduction in potential investment in badly needed new energy infrastructure.<sup>55</sup>

3.64 A key concern for ATSE has been the lack of investment in new electricity generating capacity, due largely to uncertainty regarding carbon pricing, and changing policies on renewable energy targets, and support for renewables in general. ATSE noted:

Investors have made it clear that even before the *RSPT* proposal, Australia had moved from being regarded as a low return/low risk investment prospect to a low return/high risk environment. With the potential for higher domestic costs for coal and gas under a new tax regime, appetite for investment will be further reduced.<sup>56</sup>

#### Resources industry

3.65 Woodside Energy noted that they are concerned to ensure there is certainty for their existing projects, most of which currently operate under the PRRT with the exception of the North West Shelf Project, which operates on a royalty regime. Woodside have noted that they would be very concerned if a change in taxation

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53 AEMO, *Submission H3*, p. 2.

54 AEMO, *Submission H3*, p. 2.

55 Australian Academy of Technological Sciences and Engineering (ATSE), *Submission H14*, p. 1.

56 ATSE, *Submission H14*, p. 1.

regime resulted in a loss of value of its projects. Woodside further suggested that consideration be given to extending the PRRT regime to cover all oil and gas projects.<sup>57</sup>

3.66 The impact of uncertainty on industry investment was illustrated by FMG:

The uncertainty has a major impact on a company like Fortescue at this point in time. We have, per our stock exchange release of a month or two ago, deferred any investment decisions on both the Solomon project and the Western Hub. The sorts of sums involved that we are talking about are \$15 billion to \$20 billion of investment. We would love to have certainty around these issues so that we can move forward as a company, expand rapidly and create jobs for Australia.<sup>58</sup>

3.67 In its submission in June 2010, the AWU argued that large mining companies would be able to absorb the new tax, and the RSPT would actually benefit smaller mining companies:

It is only taxing super normal profits, and the features of the tax have a lot of benefits to smaller, less profitable mines, operating on narrower margins than the majors.

These smaller players constitute hundreds of companies employing thousands of members. These companies produce gold, uranium, copper, zinc among others.

Compensation for royalty payments and the cut in the company tax rate will be particularly beneficial to the smaller players.<sup>59</sup>

3.68 However, Mr Pearce of FMG, in setting out FMG's concerns with the government's consultation process over the MRRT pointed out that changes to the original RSPT favoured larger mining companies at the expense of the smaller miners:

There are seven key items that we believe still need to be addressed to provide clarity and certainty to the industry. With respect to interest deductibility, we remain opposed to a tax of this scale being calculated and levied prior to the deduction of interests and other costs, particularly in a project's first five years of operation. With respect to the uplift rate, the current proposal clearly favours the large multinational companies with access to cheaper funds over emerging companies. In relation to the infrastructure recharge, clarity is required so that the arm's length basis evidenced by external third party agreements forms the basis of the net back charge. There is also the issue of the extraction allowance. Similar to LNG, iron ore is a capital intensive path to market and this allowance should be structured to encourage innovation and new technology. It is essential to better recognise infrastructure capital in the transition arrangements and to encourage ongoing large-scale infrastructure investments. The MRRT

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57 Woodside Energy Ltd, *Submission H8*, p. 1.

58 Mr Pearce, FMG, *Committee Hansard*, 13 July 2010, p. 73.

59 AWU, *Submission H18*, p. 5.

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threshold should be increased to \$100 million to encourage growth of the smaller players. And we believe magnetite mines should be excluded.

FMG acknowledge that individual companies in the iron ore industry will be impacted differently by each of these factors. The two items that impact Fortescue most significantly are clarity around the arm's length principle to be applied and a better balanced approach to the transition arrangements that recognise the large dollar value invested in high-risk infrastructure assets. Investment in infrastructure should be encouraged and companies should be rewarded to risking the large sums of capital for the benefit of all Australians.

I have a couple of closing comments on the process. FMG have been a loud and constant opposer of the flawed RSPT for a number of key reasons: (1) the devastating impact that such an ill thought-through tax would have had on the whole Australian mining industry; (2) the obvious flaws in the economic theory and the gap between the elegant economics and the practical reality; and (3) the lack of process and consultation with the industry prior to announcing one of the most significant changes to Australia's taxation system.

**The Gillard government chose a different path of consultation and worked with three large multinational, multicommodity companies. In my view, they do appear to have addressed a number of the key issues with the RSPT, but a number of key factors have been negotiated that tend to favour them.** Genuine consultation and clarity are urgently required to provide certainty to an industry that has the capacity to build the next generation of Australia's wealth. We need certainty of process, manageable legislative risk and delivery of a fairer outcome for all elements of the iron ore industry. And we need the key principles addressed prior to moving to detailed implementation of the heads of agreement that do not adequately represent all elements of the industry. *[emphasis added]*<sup>60</sup>

3.69 ATSE noted concerns that the RSPT may have had a negative impact on overseas investment in Australian projects:

Application of the new tax on existing operations will further scare overseas investors as they will see it as a potential precedent which could expand to industries using Australian resources in the event they are perceived as making more than bond rate returns on capital. International energy companies have many alternatives for investing their capital, particularly in higher growth markets in Asia where governments are prepared to make long term agreements guaranteeing not to vary taxation and other conditions for the lifetime of the project.<sup>61</sup>

3.70 APPEA were also concerned to ensure that exploration and investment in Australia would not be discouraged as a result of the RSPT. In their submission to the

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60 Mr Pearce, FMG, *Committee Hansard*, 13 July 2010, p. 66.

61 ATSE, *Submission H14*, p. 1.

committee they noted that while the potential impact of the RSPT had been uncertain, it could have affected investment decisions in two ways:

Firstly, it may influence incremental investment decisions on existing projects and secondly, it will be important in determining final investment decisions for future projects and activities. Until such time as the final details are determined (including the critical transitional details), the medium to long term impacts will remain uncertain.<sup>62</sup>

3.71 A significant concern for ATSE was the impact the RSPT could have had on gas supply:

The bridge between coal based power and new low emission technologies in the next decade or more will be gas. The *RSPT* could well reduce exploration for new gas resources and therefore the potential domestic supply, at least on the east coast, so increasing power prices by more than would have otherwise been the case.<sup>63</sup>

3.72 Griffin Energy explained to the committee that coal supply contracts in Western Australia are often high volume and low margin, and consequently:

While the final details of the RSPT are yet unknown, it is clear that taxing the profits above the long term bond rate of existing (and depreciated) mining operations at up to 40% will lead to lower long term revenues for these operations. Reducing the returns of these marginal businesses may lead to a future reallocation of capital away from these mining operations, when further investment is required to maintain mining output. Reduction in mining output or mine closure would have devastating impacts on the town of Collie and the surrounding district.<sup>64</sup>

3.73 BlueScope Steel noted that while they did not expect an immediate impact from the RSPT, as a consumer of a range of domestic mineral raw materials they were concerned about:

...the potential medium term impact of the tax on the cost and availability of raw materials, especially those raw materials that are not readily substitutable by imports...If the RSPT was to cause a reduction in the development of new minerals resources in Australia, this could contribute to reduced supply, which would increase prices of these minerals. Our ability to pass on such price increases through increased selling prices for our steel products would be constrained by the internationally traded nature of these products. This would erode margins for our domestic iron and steelmaking operations.<sup>65</sup>

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62 APPEA, *Submission H17*, p. 4.

63 ATSE, *Submission H14*, p. 1.

64 Griffin Energy, *Submission H9*, p. 2.

65 BlueScope Steel, *Submission H13*, p. 1.



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Renewable energy industry

3.74 AGEA noted that while the RSPT would not have directly applied to the geothermal energy sector, any impact on the mining sector may have adversely affected the geothermal industry, as the mining industry will be a very important early customer of geothermal energy:

While it is AGEA's understanding that the proposed RSPT will not apply to the geothermal energy sector, the industry is concerned about any dampening of activity in the broader mining industry as it will be an important early customer of geothermal energy. This is particularly the case in central South Australia and the Pilbara and Mid-West regions of Western Australia Where geothermal energy is the ideal source of renewable energy for mining projects given its abundance and base load character.<sup>66</sup>

*Employment*

3.75 ACAPMA noted that the RSPT may have affected employment in the upstream sector:

...the tax on profits reduces the net income of upstream companies, and this may have an impact on an upstream operator's appetite to employ.<sup>67</sup>

3.76 APPEA noted that if investment in potential projects was hindered by the RSPT, the potential job opportunities that these projects offer may have been lost:

The final impact on jobs and employment will hinge on the way the new regime influences project economics, particularly those in the process of making final investment decisions. Australia has the potential to see significant growth associated with the development of the nation's gas resources, with upside potential of more than \$200 billion in capital investment and the creation of around 50,000 jobs. Many of the proposed development [sic] in the industry require significant capital and human resourcing in regional areas. Poorly structured fiscal settings may see many of these opportunities lost.<sup>68</sup>

3.77 This argument was echoed by BP, who stated:

The main driver of employment in the oil and gas sector is the construction of new projects. Current projects that have been confirmed to remain covered by the PRRT should be unaffected, however projects that either pre- or post-date the PRRT appear to be covered by RSPT. A reduction in sanctioned projects will have an impact on employment. This applies at established projects such as the NWSV as well as Greenfields projects,

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66 AGEA, *Submission H6*, p. 2.

67 ACAPMA, *Submission H5*, p. 2.

68 APPEA, *Submission H17*, p. 4.

because many incremental investments continue to be made through the life of a development.<sup>69</sup>

3.78 AGEA expressed concern that if the mining sector, as an important early customer of geothermal energy, was negatively impacted by the RSPT, this would affect the ability of the geothermal energy industry to develop projects and provide jobs:

...the sector could be employing in the region of 17,300 people by 2050 and 3,800 by 2020. While most of these jobs can reasonably be expected to be associated with research and development activities in the sector and projects that are not dependant on the demand from off grid or mining projects, it is reasonable to expect that there will be some impact on these jobs in the shorter term.<sup>70</sup>

3.79 Given evidence received by the committee raising concerns about the possible impact of the RSPT on jobs and investment, at its public hearing of 5 July 2010, the committee sought information on the potential impact of the RSPT. Dr Henry explained to the committee:

...the RSPT itself, by design, is a neutral tax. The RSPT itself, by design, should not affect investment decisions, should not affect employment decisions, should not affect output decisions and so on. Given that the RSPT, a neutral tax, was in economic substance replacing royalties, because they were going to be refunded, one could be pretty confident conceptually that activity would expand, not contract. Now, as we have discussed, particularly in some of the questions that the chair asked earlier, **it is not possible to make such a conclusive statement in respect of the interplay between the MRRT and the royalties, principally because the royalties are now being credited against an alternative tax—that is, the MRRT—not refunded and secondly because—the chair also went to this question—one cannot be absolutely sure that the MRRT provides a neutral uplift rate, whereas the RSPT does by definition.** [*emphasis added*]<sup>71</sup>

#### *Energy and fuel security*

3.80 The South West Interconnected System (SWIS) electricity grid in Western Australia relies on coal fired generation for 40 per cent of its installed capacity. Griffin Energy argue that if mining operations had been negatively impacted, and consequently the supply of coal to the SWIS had been reduced, this may have affected the security of supply in the SWIS as:

...there are no fuel-substitution alternatives for coal to provide the balanced generation portfolio that maintains security of supply in the SWIS. In other

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69 BP, *Submission H19*, p. 2.

70 AGEA, *Submission H6*, pp 2-3.

71 Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 30.

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words, it will be unlikely that the State can allow these operations to fail. The only way to do this (in the event of the withdrawal of private capital) is for the State to step in and subsidise the mining operations. Reducing royalty obligations would have little or no impact (given royalties are netted from the overriding 40% RSPT take). This means contracts would need to be renegotiated between coal suppliers and state-owned utilities, which would warrant either an increase in electricity tariffs or a direct taxpayer subsidy. Either way, the impact would distort the electricity market.<sup>72</sup>

3.81 BP noted that due to the need of incremental investment in some established projects such as the North West Shelf Gas Venture, the RSPT could have had an impact on resource exploration and production, thereby affecting supply and security:

Undermining the economics of the Venture will make these investments harder to justify, reducing resource recovery. The same is true of future offshore projects, if they are forced to operate under the RSPT rather than the more appropriate framework of the Petroleum Resource Rent Tax (PRRT). However it is not possible to be precise on the impact in the absence of further clarity on the RSPT details.<sup>73</sup>

3.82 While APPEA observed that the impact of the RSPT on Australia's energy and fuel security would have to have been assessed in light of the final detail of the measure, stating that:

Factors critical to Australia's fuel and energy security are the commercialisation of discovered resources and the exploration for new petroleum deposits. The RSPT can be expected to impact on both exploration and development decisions.<sup>74</sup>

*Need for further detail*

3.83 ESAA noted that as a number of details regarding the tax remained to be finalised via consultation at the time submissions were sought, it was difficult to determine the possible impact of the RSPT, for example:

As highlighted in the initial Government briefing documentation, a key issue which will need to be resolved is the determination of appropriate methodology to determine the value of a resource for taxation purposes. This is particularly problematic where operations exhibit a high degree of vertical integration between mine and production facility as is sometimes the case in the electricity generation sector.<sup>75</sup>

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72 Griffin Energy, *Submission H9*, pp 1-2.

73 BP, *Submission H19*, p. 2.

74 APPEA, *Submission H17*, p. 4.

75 ESAA, *Submission H10*, p. 2.

### ***Cutting the company tax rate***

3.84 The Henry Tax Review Report recommended that the company income tax rate be reduced, as follows:

Recommendation 27: The company income tax rate should be reduced to 25 per cent over the short to medium term with the timing subject to economic and fiscal circumstances. Improved arrangements for charging for the use of non-renewable resources should be introduced at the same time.<sup>76</sup>

3.85 In response the government initially proposed to reduce the company income tax rate from the current level of 30 per cent, to 29 per cent for the 2013-2014 income year, and then to 28 per cent from the 2014-2015 income year, in conjunction with the introduction of the RSPT on 1 July 2012.<sup>77</sup>

3.86 The Prime Minister's announcement of 2 July 2010 stated that under the new/revised tax arrangements, the company tax rate will continue to be cut to 29 per cent from 2013-14 but will not be further reduced under current fiscal conditions. Small companies will benefit from an early cut to the company tax rate to 29 per cent from 2012-13.<sup>78</sup>

### ***State infrastructure fund***

3.87 Recommendation 48 of the Henry Tax Review Report suggests that the Commonwealth and state governments should negotiate the allocation of revenues and risks arising from the resource rent tax.<sup>79</sup>

3.88 In light of this recommendation, the government's initial response proposed the establishment of a state infrastructure fund, using some of the proceeds from the RSPT. The fund was to be created to assist states and territories in investing in infrastructure, and it was intended that the funding would be distributed in a manner

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76 Australia's Future Tax System Review Panel, *Australia's future tax system: Report to the Treasurer*, December 2009, p. 86.

77 Australian Government, *Cutting the Company Tax Rate*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/1\\_Fact\\_sheet\\_Company\\_Tax\\_Cut\\_Final.pdf](http://www.futuretax.gov.au/documents/attachments/1_Fact_sheet_Company_Tax_Cut_Final.pdf) (accessed 6 May 2010).

78 The Hon. Julia Gillard MP, Prime Minister, the Hon. Wayne Swan MP, Deputy Prime Minister and Treasurer, and the Hon. Martin Ferguson MP, Minister for Resources and Energy, 'Breakthrough agreement with industry on improvements to resources taxation', Press Release, 2 July 2010, p. 1, <http://www.pm.gov.au/node/6868> (accessed 21 July 2010).

79 Australia's Future Tax System Review Panel, *Australia's future tax system: Report to the Treasurer*, December 2009, p. 89.

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which appropriately recognised the significant infrastructure demands of resource-rich states.<sup>80</sup>

3.89 According to the government's initial response, the funding was intended to be provided as projects were built, so that states did not have to wait until projects were complete and production commenced to receive funds. The government's initial response stated that the fund was to be paid to the states each year, commencing in 2012-2013 at an amount of \$700 million and was expected to grow over time.<sup>81</sup>

### ***Credibility of the proposed regional infrastructure fund***

3.90 It appears to the committee that the state infrastructure fund is now referred to as the regional infrastructure fund. The proposed regional infrastructure fund is intended to provide \$6 billion to invest in critical infrastructure projects with potential partner funding from state governments, private investors and/or local governments. The government states that the fund will recognise the large infrastructure demands of resource-rich states. It is intended that the fund will be distributed in accordance with the value of mining production paying the tax.<sup>82</sup> Details of the fund are still not available. The committee is concerned about the lack of transparency provided in the detail available about where the government expects the revenue to come from under the proposed regional infrastructure fund.

3.91 The committee notes that it is difficult, if not impossible, to assess whether the allocation of expenditure from the proposed fund to individual jurisdictions is appropriate when the government is not prepared to reveal where the revenue will come from on a geographical basis.

3.92 The Western Australian Department of Treasury and Finance noted in evidence that the operation of the fund was an issue. They also noted that the government's 2007 election commitment to Western Australia was still outstanding:

Another outstanding issue is the operation of the proposed Regional Infrastructure Fund, including states' share of the funding and its treatment under the Commonwealth Grants Commission process. Finally, there is a need for clarity on the status of Commonwealth election commitments relating to a Western Australian infrastructure fund financed from Gorgon

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80 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, pp 6 and 21-22; and Australian Government, *State Infrastructure Funding*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/4\\_Fact\\_Sheet\\_State\\_infrastructure\\_funding.pdf](http://www.futuretax.gov.au/documents/attachments/4_Fact_Sheet_State_infrastructure_funding.pdf) (accessed 6 May 2010).

81 Australian Government, *Stronger, Fairer, Simpler: A tax plan for our future*, May 2010, pp 6 and 21-22; and Australian Government, *State Infrastructure Funding*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/4\\_Fact\\_Sheet\\_State\\_infrastructure\\_funding.pdf](http://www.futuretax.gov.au/documents/attachments/4_Fact_Sheet_State_infrastructure_funding.pdf) (accessed 6 May 2010).

82 Australian Government, *Regional Infrastructure Fund*, Fact Sheet, p. 1, [http://www.futuretax.gov.au/documents/attachments/Fact\\_Sheet\\_infrastructure\\_fund.pdf](http://www.futuretax.gov.au/documents/attachments/Fact_Sheet_infrastructure_fund.pdf) (accessed 10 July 2010 and 26 July 2010).

and/or Pluto project PRRT revenues and a flow through share scheme to encourage exploration activity.<sup>83</sup>

3.93 The committee is concerned that the proposed regional infrastructure fund will be yet another repetition of the government's promised fund from 2007. The committee notes that Western Australia is still waiting for that fund to eventuate.

3.94 The committee's view is that this proposed regional infrastructure fund is part of the government's strategy to encourage acceptance of its new tax, the MRRT/expanded PRRT. The committee is concerned that while the MRRT/expanded PRRT has the potential to raise tens of billions of dollars in revenue over a decade, the government is only intending to contribute \$6 billion under the fund to infrastructure over the same period. On this basis the committee highly doubts that this proposal is a serious attempt to invest in infrastructure.

## **Other issues arising out of the Henry Tax Review Report**

### ***Energy and fuel security***

3.95 Given the substantive nature of the review, the committee sought information on the possible impact that taxation arrangements could have on energy security and was informed that:

It is possible that taxation arrangements could have an impact on energy security in two ways that occur to me immediately. The first is that taxation arrangements could affect the level of investment in various energy technologies, potentially in an adverse way if not properly structured. There is also the possibility that taxation arrangements could be structured in such a way as to lead to a diversification of energy sources. Of course, the present tax law contains such provisions that encourage, for example, renewable energies.<sup>84</sup>

3.96 However, Dr Henry explained to the committee that the recommendations of the Henry Tax Review Report did not address energy and fuel security:

...I think it is fair to say that none of the recommendations were specifically designed to enhance Australia's energy security.<sup>85</sup>

### ***Cash bidding for exploration permits***

3.97 The committee asked Dr Henry for further information on recommendation 49 of the Henry Tax Review Report, which states:

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83 Mr Barnes, Department of Treasury and Finance, Western Australia, *Committee Hansard*, 13 July 2010, p. 3.

84 Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 2.

85 Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 3.

The Australian and State governments should consider using a cash bidding system to allocate exploration permits. For small exploration areas, where there are unlikely to be net benefits from a cash bidding system, a first-come first-served system could be used.<sup>86</sup>

3.98 The committee asked Dr Henry about the reasoning behind the recommendation:

CHAIR—...Can you explain the rationale for promoting cash-bidding allocation of exploration permits? Wouldn't that cause a shift in the grant of exploration permits leading to explorers allocating their budgets to cash bids rather than actual, tangible exploration work?

Dr Henry—That rather assumes that the companies we are talking about here have fixed budgets. I am not at all sure that the companies do have fixed budgets. I know they talk as if they do, but they do not seem to have a lot of trouble accessing additional financial capital when commodity prices increase, so I am not at all sure that their financial capital is fixed. In fact, I know it is not. I do not know if there would be such an effect as you have postulated, but we did not consider such an effect. Instead what we were motivated by was something that we have discussed earlier, which was ensuring that the Australian community generally gets a fair value for its resources.

CHAIR—But I guess we have already gone there, because the Australian community might get as little as \$0 for the resource if—

Dr Henry—Yes, but if somebody is prepared to pay money to secure rights over those resources then it is appropriate that that money go to the community. That is all.<sup>87</sup>

### ***Road transport taxes and fuel excise***

3.99 The Henry Tax Review Report also made a series of recommendations surrounding road transport taxes, including congestion charges, charges for heavy vehicles, fuel taxes, road user charges, taxes on motor vehicle ownership and road infrastructure.

3.100 In particular, the Henry Tax Review Report recommended that the current fuel excise be phased out over time in favour of road user charges, and that if fuel excise is retained all fuels should be taxed equally:

Recommendation 65: Revenue from fuel tax imposed for general government purposes should be replaced over time with revenue from more efficient broad-based taxes. If a decision were made to recover costs of roads from road users through fuel tax, it should be linked to the cost of

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86 Australia's Future Tax System Review Panel, *Australia's future tax system: Report to the Treasurer*, December 2009, p. 89.

87 Senator Cormann, Chair, Senate Select Committee on Fuel and Energy, and Dr Henry, Department of the Treasury, *Committee Hansard*, 5 July 2010, p. 47.

efficiently financing the road network, less costs that can be charged directly to road users or collected through a network access charge. Fuel tax should apply to all fuels used in road transport on the basis of energy content, and be indexed to the CPI. Heavy vehicles should be exempt from fuel tax and the network access component of registration fees if full replacement charges are introduced.<sup>88</sup>

3.101 The committee notes that the government has announced that that it will not index fuel tax to the Consumer Price Index (CPI).<sup>89</sup>

3.102 ACAPMA noted their support for the recommendations in the Henry Tax Review Report regarding road transport charges:

The removal of all fuel excise and registration taxes, if replaced by more efficient road user charges, would be positive progress. By removing the fuel excise, which is largest component of the board price after production costs, the motorist would be able to understand the relationship of board price to the wholesale price. By then charging, as recommended in the Henry Tax Review, congestion taxes as well as 'mass-distance-location' charges, motorists would be able to better manage their personal transport requirements. This, in some cases, could reduce the cost of transport when managed correctly.<sup>90</sup>

3.103 The Australian Automobile Association noted its support for the introduction of a road user charge to replace fuel excise, as recommended by the Henry Tax Review.<sup>91</sup>

#### *The introduction of fuel excise on gas products*

3.104 In 2004, an energy white paper, *Securing Australia's Energy Future*, was released proposing that all fuels which can be used in an internal combustion engine should be subject to fuel tax. Consequently legislative reforms were made in 2006, which provided for the introduction of an excise on liquefied petroleum gas (LPG), liquefied natural gas (LNG) and compressed natural gas (CNG) from 1 July 2011. The excise is to be phased in over four years commencing at 2.5 cents per litre in 2011, and reaching a maximum excise rate of 12.5 cents per litre in 2015.<sup>92</sup>

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88 Australia's Future Tax System Review Panel, *Australia's future tax system: Report to the Treasurer*, December 2009, p. 93.

89 The Hon. Kevin Rudd MP, Prime Minister, and the Hon. Wayne Swan MP, Treasurer, 'Stronger, Fairer, Simpler: A tax plan for our future - Attachment', Media Release, 2 May 2010.

90 ACAPMA, *Submission H5*, p. 2.

91 Mr Mike Harris, Chief Executive, Australian Automobile Association, 'Henry Report Recommendations', Media Release, 2 May 2010.

92 Richard Webb, *Excise taxation: developments since the mid-1990's*, Parliamentary Library Research Brief, No. 15, 2005-06, 13 April 2006, <http://www.aph.gov.au/library/pubs/rb/2005-06/06rb15.htm> (accessed 2 June 2010).



3.105 The LPG industry have raised concerns about the negative impact which will be created by the introduction of an excise on LPG in conjunction with the amendment of the LPG Vehicle Rebate Scheme in 2009, which reduced the rebate level for LPG conversion of vehicles from \$2000 every year at a rate of \$250 every year over four years to \$1000 until it reaches \$1000 per annum:

The imposition of fuel excise on LPG and continued reduction of the LPG Vehicle Rebate Scheme will have a negative, immediate and sustained impact on; the private motorist, small businesses and their employees, the Australian vehicle manufacturing and transport industries and, most importantly, the Government's assurance and credibility with regard to Australia's energy security and the clean energy debate.<sup>93</sup>

3.106 LPG Australia made extensive comment on the introduction of a fuel excise on LPG, noting concerns that the excise will remove incentive for investment in LPG, particularly due to the reduction in the price differential between LPG and unleaded petrol, and consequently:

Severely and negatively impacts on 3,300 Australian small businesses and ~20,000 employees who are engaged in the LPG vehicle equipment supply and conversion industry.<sup>94</sup>

3.107 The committee received comment from BOC as to the impact of the implementation of the excise:

The application of excise to LNG will significantly change the relative economics of LNG compared to diesel for heavy vehicles...There is already an excise rebate for diesel and the proposed tax on LNG will in fact negate the price incentive for heavy vehicle fleet owners to switch from diesel to LNG. By 2015, LNG will incur an excise of 12.5 cents per litre which, on an equivalent basis, is the same excise as applied to diesel.<sup>95</sup>

3.108 LPG Australia further argued that introduction of the excise, and reduction of the rebate will impact on Australia's energy and fuel security in respect of manufacturing, reduced choice in LPG options, reduced demand for LPG Autogas, and a significant impact on small business and employment in the LPG sector.<sup>96</sup>

3.109 BOC sees a contradiction in the government's acknowledgement of LNG's role in Australia's energy future, and the introduction of the excise:

While the Government continues to acknowledge the role LNG plays in ensuring Australia's energy security, some of the benefits to local industry in developing this alternative fuel are offset by the proposed Alternative Fuel tax. What this fledgling industry needs is greater support from

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93 LPG Australia, *Submission H11*, p. 4.

94 LPG Australia, *Submission H11*, pp 3-4.

95 BOC, *Submission H16*, p. 2.

96 LPG Australia, *Submission H11*, pp 3-4.

Government to grow the industry that will ultimately support Energy Security in Australia.<sup>97</sup>

3.110 LPG Australia stated that 'LPG, as an indigenous, abundant, clean and economical alternative transport fuel directly supports the Government's energy framework.'<sup>98</sup> Consequently they call for a delay in the introduction of a fuel excise for 5 years, and reinstatement of the rebate at \$2000 per annum for five years.<sup>99</sup>

### **Committee comment**

#### ***Risk to investment and competitiveness of the Australian industry***

3.111 The committee notes that through the RSPT the government sought to impose an internationally uncompetitive new tax on mining, an industry of significant importance to the Australian economy.

3.112 The committee notes industry concerns that the RSPT would have a significant negative impact on investment and Australia's international competitiveness. Of particular concern is the evidence the committee received regarding the damage the RSPT could have done to Australia's attractiveness as an investment destination. The committee remains concerned that due to uncertainty regarding Australia's changing resource taxation arrangements, Australia's investment reputation could remain damaged for some time.

3.113 The committee specifically notes announcements made by FMG and Xstrata suspending a series of projects due to the announcement of the RSPT.<sup>100</sup>

3.114 The committee is particularly concerned that a decrease in investment in Australia due to the government's taxation reforms would affect resource production and consequently energy supply – a situation which would obviously be detrimental to Australia's future fuel and energy security. Consequently, the committee considers that future taxation reform should give more serious consideration to its impacts on Australia's future fuel and energy security.

#### ***Impact on jobs***

3.115 The committee remains concerned that the government announced and intended to proceed with the RSPT, a new tax which due to its impact on investment decisions and company income, would have had significant implications for Australian jobs.

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97 BOC, *Submission H16*, p. 2.

98 LPG Australia, *Submission H11*, pp 4-5.

99 LPG Australia, *Submission H11*, pp 4-5.

100 'List of projects shelved or under review', *The Age*, 3 June 2010, <http://www.theage.com.au/business/list-of-projects-shelved-or-under-review-20100603-x370.html> (accessed 22 July 2010).

3.116 The committee is particularly concerned about the potential for new taxes on mining to impact on consumer prices, noting evidence provided by industry highlighting the possibility of industry participants passing through any additional cost burden to customers.

3.117 The committee is concerned that the government has not sought any assessment of the impact of its new/revised mining tax arrangements on jobs and investment in the mining industry.

3.118 The committee is particularly concerned about the impact of the reforms on jobs and the economy, given Dr Henry's confirmation that the impact of the MRRT/expanded PRRT arrangements on jobs and investment in the mining industry would be worse than the impact from the previously proposed RSPT.

***Thorough consultation with all stakeholders is imperative***

3.119 The committee harbours significant concerns about the lack of consultation with state governments, industry and relevant stakeholders throughout the government's entire taxation reform process.

3.120 In particular, the failure of the government to appropriately consult with state governments on the proposal to abolish state royalties highlights the flawed policy process followed in establishing the government's taxation reform measures.

3.121 In the committee's view it was a lack of consultation which led directly to the failure of the government's proposed RSPT. The committee believes it is inexcusable that the government failed to properly consult with industry about the implications of the proposed tax on them.

***Impact on state royalties***

3.122 The committee is astounded that the government would consider proceeding with a tax designed to replace state royalties without engaging in a thorough and genuine consultative process with state and territory governments.

3.123 The change to the RSPT proposal prior to the 2 May 2010 announcement from abolishing state royalties to refunding them appears to have been made very late in the process and without much conviction. Indeed, Treasury Secretary Dr Henry indicated to the committee that he considered it to be an 'interim arrangement'.

3.124 The committee does not share the view that a Resource Super Profits Tax ensures a fairer return for the community where state royalties supposedly do not.

3.125 The committee is concerned about the confusion, even among senior government ministers, about the operation of state royalty regimes. Contrary to assertions made by government ministers and others, state royalties on mineral resources are invariably value based. Suggestions that the community does not receive an increased return from royalties as commodity prices increase are plainly wrong.

Royalties are a charge on production rather than profits, with the community receiving a certain and reliable return from the exploitation of those non-renewable resources irrespective of whether a profit is made. Federal income and company tax arrangements already provide for the taxation of mining profits.

3.126 The committee notes that under a profit based resource rent tax regime without state royalties in place (or with state royalties refunded) Australians are not assured of a fair and certain return from the exploitation of those non-renewable resources.

3.127 Furthermore, royalties are imposed by state governments on state owned resources on behalf of the people in respective states. Royalties are an important part of state budgets in resource rich states, helping to fund schools, hospitals, police and many other important services. All Australians get a fair return from increased royalty revenue for those states through the Commonwealth Grants Commission process.

### ***Implications for Australia's energy and fuel security***

3.128 The committee finds that in imposing a significant new tax on mining, the Henry Tax Review failed to consider the risks to Australia's future fuel and energy security.

3.129 Further the committee is concerned that the introduction of an excise on gas products will be detrimental to Australia's future energy and fuel security, and is of the view that the government's measures contradict purported acknowledgement of gas products in ensuring Australia's future energy and fuel security. In addition, the committee considers that these measures will negatively affect the incentive for Australians to adopt gas power supplies as a lower emission alternative.

### ***Need for exploration incentives***

3.130 The committee notes that the RER would have provided benefits to the geothermal energy industry, and considers that any future exploration incentive program should also provide for expenditure incurred in exploring for geothermal energy.

3.131 The committee notes concerns that now that the RER will no longer be pursued by the government, the incentive it was to provide to encourage investment in exploration, particularly for small to mid tier companies is longer apparent. The committee considers that the Policy Transition Group must give priority to developing a well considered exploration incentive scheme in close consultation with industry.

3.132 The committee draws attention to the notable industry support for a flow-through share scheme, and considers that the Policy Transition Group should give serious consideration to implementing such a scheme, in close consultation with industry.

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## **Recommendations**

### **Recommendation 1**

**3.133** The committee recommends that government proposals to make major structural changes to Australia's tax system should involve meaningful consultation on draft proposals with all relevant stakeholders, prior to making final policy decisions. This will help ensure:

- a more transparent assessment of the merits of any such proposal; and
- a more meaningful opportunity to provide input into the policy development process for all relevant stakeholders, including state and territory governments whose revenue would be impacted by any proposed change.

### **Recommendation 2**

**3.134** The committee recommends that proceeds from a proposed tax should not be included in the Budget until the consultation process regarding that tax has been completed and the legislation has been introduced or is imminent.

### **Recommendation 3**

**3.135** The committee recommends that any future tax reform process give proper consideration to Australia's future energy and fuel security in formulating relevant taxation reform measures.

### **Recommendation 4**

**3.136** The committee recommends that the government should not implement any future taxation reform without first providing the Australian public with independently verified modelling demonstrating any impact of the proposed reform on:

- Employment;
- Investment;
- Industry;
- Australia's global competitiveness;
- Cost of living; and
- The Australian economy as a whole.

### **Recommendation 5**

**3.137** The committee recommends that as a matter of priority, the government consult with small and mid-tier mining companies, on the design of incentives to encourage investment in exploration.

