Chapter 2

An overview of the development of recent Resource Rent Tax proposals

Introduction

2.1 This chapter provides an historical overview of the development of recent resource rent tax proposals from the original Henry Tax Review recommendation to the Resources Super Profits Tax (RSPT) and its successors, the Mineral Resources Rent Tax (MRRT) and the expanded onshore Petroleum Resources Rent Tax (PRRT).

2.2 The overview presented in this chapter identifies the key issues that are elaborated upon in more detail elsewhere in this report. They include the:

- deeply flawed and secretive process which has dogged the development of the RSPT and its successors the MRRT and expanded PRRT;
- poor design of the MRRT and expanded PRRT, which:
  - introduces a new tax on top of the existing royalty and income tax arrangements making our tax system more complex and less fair;
  - reduces Australia's international competitiveness as an attractive investment destination;
  - gives an unfair competitive advantage to the three big multi-national, multi-commodity and multi-project companies who were given the exclusive opportunity by the government to negotiate the design of this new tax with all their competitors and other stakeholders locked out of the process;
  - makes federal budget outcomes hostage to decisions by state and territory governments about their royalty arrangements;
  - raises serious and unresolved constitutional issues; and
  - links a highly volatile and downward trending revenue stream to a projected increasing cost of related budget measures, which will worsen the Commonwealth Budget's structural deficit over time.

2.3 Following the election of the Labor Government in 2007, the Treasurer Wayne Swan announced a comprehensive review of Australia's tax system, the *Australia's Future Tax System Review* (also known as the Henry Tax Review). In announcing the review the Treasurer stated:

> [w]e need a tax system that is fairer, that is simpler, that better rewards people for their hard work, that responds to our environmental and

> demographic challenges, that makes us internationally competitive, and that creates the incentives to invest in our productive capacity.[1]

2.4 A full extract of the Henry Tax Review terms of reference can be found in Appendix 3.

2.5 The Henry Tax Review final report was presented to the Treasurer in December 2009 but not publicly released until 2 May 2010. The Henry Tax Review panel hoped that the report would support 'an informed debate about future tax and transfer policy' in Australia[2].

2.6 The Henry Tax Review identified nine broad areas of reform[3] and made 138 recommendations. The review report suggested that the reforms identified would deliver a robust tax and transfer system which encourages workforce participation, savings and investment, reduces compliance costs making interactions easier and simpler, and improves accountability.[4] The vast majority of these recommendations were either rejected by the government or ignored altogether.

2.7 The Henry Tax Review made recommendations to introduce a national Resources Rent Tax to apply to Australia's non-renewable natural endowments to replace State and Territory royalties.

2.8 The key recommendations from the Henry Tax Review in relation to a resources tax, were:

- The current resource charging arrangements should be <u>**replaced**</u> with a uniform resource rent tax administered by the Australian government. (emphasis added)
- A uniform resource rent tax should be set at a rate of 40 per cent.
- It would use an allowance for corporate capital system, with taxable profit associated with a resource project equal to net income less an allowance for un-deducted expenses or unused losses.

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1 The Hon Wayne Swan MP, Treasurer of the Commonwealth of Australia, *Budget Speech*, 13 May 2008.

2 Australia's Future Tax System Review, *Report to the Treasurer*, December 2009, p.iii.

3 The 9 broad areas of reform were identified as being: (i) concentrating revenue raising on four efficient tax bases; (ii) configuring taxes and transfers to support productivity, participation and growth; (iii) an equitable, transparent and simplified personal income tax; (iv) a fair, adequate and work supportive transfer system; (v) integrating consumption tax compliance with business systems; (vi) efficient land and resource taxation; (vii) completing retirement income reform and securing aged care; (viii) toward more affordable housing; and (ix) a more open, understandable and responsive tax system. Source: Australia's Future Tax System Review, Report to the Treasurer, December 2009, pp xvii-xxiv.

4 Australia's Future Tax System Review, *Report to the Treasurer*, December 2009, p. xvii.

- The allowance rate would be set by the long-term government bond rate, as the government would share in the risks of projects by providing a loss refund if the tax value of expenditure is otherwise unable to be used.
- Subject to transitional arrangements, the new rent-based tax should apply to existing projects, **replacing** existing charging arrangements. (emphasis added)
- The allocation of revenue and risks from the new tax **should be negotiated between the Australian and State and Territory governments**. (emphasis added)
- A cash bidding system could also be adopted to supplement the resource rent tax and promote the efficient allocation of exploration rights.

2.9 The policy rationale for these recommendations given by the Henry Tax Review was that:

- Such a tax would provide a more consistent treatment of resource projects and promote more efficient investment and production outcomes.
- It would also ensure that the Australian community receives an appropriate return on its non-renewable resources … .Non-renewable resources such as petroleum and minerals are a significant asset of the Australian community. Australia has the world's largest economically demonstrated resource reserves of brown coal, lead, mineral sands (rutile and zircon), nickel, silver, uranium and zinc and the second largest reserves of bauxite, copper, gold and iron ore (contained iron).
- The current charging arrangements distort investment and production decisions, thereby lowering the community's return from its resources.
- Further, they fail to collect a sufficient return for the community because they are unresponsive to changes in profits, particularly output-based royalties. For example, existing resource taxes and royalties have collected a declining share of the return to resources over the recent period of increasing profitability in the resource sector (see Chart 6.1).[5]

2.10 The key features of the Henry Tax Review Resource Rent Tax were:

- RATE: 40 per cent taxation rate.
- APPLICATION: Applied to non-renewable resources (oil, gas and minerals) projects, except lower value minerals which provide no net benefits.
- TRANSFERABILITY: Allows losses to be carried forward with interest or transferred to other commonly owned projects.
- DEDUCTIBILITY: Allowed as a deductible expense in the calculation of income tax, with loss refunds treated as assessable income.

5 Australia's Future Tax System Review, *Report to the Treasurer*, December 2009, pp 232–246.

- ROLYALTIES: State and Territory royalties would be fully refunded. The Australian and State governments should negotiate an appropriate allocation of the revenues and risks from the resources rent tax.[6]

The Government's Response to the Henry Tax Review

2.11 Six months after receiving the final Henry Tax Review report and on the same day that report was first publicly released, the Treasurer and then Prime Minister issued a joint media release outlining the government's response to the Henry Tax Review's comprehensive report.[7]

2.12 The government's limited and narrow response to its comprehensive Henry Tax Review included the proposal to introduce a RSPT. Treasury modelling indicates the RSPT would have raised $100 billion in additional revenue over ten years.[8] Some of that revenue the government said would be used to offset reductions in income tax revenue as a result of a phased increase in compulsory superannuation contributions, a reduction in company tax from 30 percent to 29 per cent by 2013-14 and then to 28 per cent by 2014-15 and $6 billion investment in infrastructure over ten years.[9]

2.13 Having announced the government's response to the Henry Tax Review, the then Prime Minister Kevin Rudd and Treasurer Wayne Swan committed to consulting broadly on the changes, with businesses, the states and the community.[10] Contrary to the recommendations made by the Henry Tax Review, at the time of the announcement there had been no negotiation with state and territory governments, nor had there been any consultation with any other stakeholders or the community on the Government's plan to introduce the RSPT which had replaced the Henry Tax Review proposal for a Resource Rent Tax.

The Government's proposed RSPT

2.14 The RSPT announced on 2 May 2010 was intended to commence on 1 July 2012, at a rate of 40 per cent imposed on profits made from the mining of Australia's non–renewable resources. It differed from the model proposed in the

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6 Australia's Future Tax System Review, *Report to the Treasurer*, December 2009, Recommendations 45 – 50, pp. 89–90.

7 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 No. 28, 2 May 2010.

8 Department of the Treasury, Documents released under Freedom of Information relating to revenue estimates for the RSPT and the revised MRRT, released on 14 February 2011. http://www.treasury.gov.au/documents/1962/PDF/MRRT_Model.pdf (accessed on 20 June 2011)

9 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 No. 28, 2 May 2010.

10 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 No. 28, 2 May 2010.

Henry Tax Review report as rather than replacing state and territory royalties, the RSPT was to operate in parallel with those royalty arrangements. Taxpayers liable for the RSPT would receive a refund of the royalties paid creating, it was argued, the same economic effect as replacing them to achieve the stated objective of eliminating investment distortions associated with the state royalty systems and to ensure there was no 'double taxation' of resource profits.[11] Table 2.1 below provides a contrast between the Henry Tax Review recommended Resource Rent Tax and its replacement, the RSPT:

Table 2.1: A comparison of the Henry Tax Review Resource Rent Tax and the Resources Super Profits Tax[12]

Taxation feature	Resource Rent Tax	Resources Super Profits Tax
Rate	40%	40%
Application	Applied to non-renewable resources (oil, gas and minerals) projects, except lower value minerals which provide no net benefits.	Applied to the extraction of all non-renewable resources in Australia.
Transferability	Allows losses to be carried forward with interest or transferred to other commonly owned projects.	Transfer to other projects or carried forward.
Deductibility	Allowed as a deductible expense in the calculation of income tax, with loss refunds treated as assessable income.	An allowable deduction for income tax purposes.
Royalties	The Australian and State governments should negotiate an appropriate allocation of the revenues and risks from the resources rent tax.	States and territories keep existing royalty regimes. Royalties remain payable with a rebate. Unused rebate can be refunded or transferred.
Company taxation rate	Not applicable.	2013-14: 29% 2014-15: 28%
Superannuation Guarantee	Not applicable.	9% to 12% by 2019-20
Regional Infrastructure Fund	Not applicable.	Established a $6 billion Regional Infrastructure Fund.
Scope	2500 companies affected.	2500 companies affected.

11 Australian Government, *Stronger Fairer Simpler – A tax plan for our future, Fact Sheet – Resource Super Profits Tax*, 2010, p. 1.

12 Sources: Australia's Future Tax System, *Final Report*, December 2009, (Recommendations 45 – 50); KPMG, *Reform in Focus: Implications of tax reforms for Australian business*, 15 July 2010 (10TiF-037) *Changes to resources taxation and company tax rate*; Clayton Utz 2010, *Minerals Resource Rent Tax replaces RSPT*.

2.15 At the time of the RSPT's announcement, the government stated that a resource tax consultation panel would also be established to communicate the design features of the RSPT and liaise with industry to both implement the government's policy objective whilst minimising compliance costs and ensuring simplicity.[13] While the government wanted to move the debate onto the implementation of the RSPT, key industry stakeholders who had not been consulted on the design or structure of the RSPT were fiercely resistant to the proposed new tax.

2.16 The announcement of the RSPT was followed by a robust public debate. Criticism of the proposed tax was widespread with the Minerals Council of Australia, the Association of Mining and Exploration Companies and other peak industry and business organisations campaigning openly against the tax.[14]

2.17 In a policy brief published in June 2010, the Minerals Council outlined their argument against the RSPT. Whilst not opposed to genuine reform, they argued any such reform should be based on comprehensive and genuine consultation. They also criticised the effect that the proposed tax would have on the mining industry.

> Australia's minerals resources industry supports tax reform that is in the long-term national interest. Such reform is best achieved through broad and comprehensive consultation between Federal, State and Territory governments, industry and the community. This ensures that the design and implementation of tax changes are informed by an understanding of the industry's contribution to Australia's welfare as well as the commercial realities and wider economic ramifications of proposed changes.
>
> ...
>
> Regrettably, the Australian Government is not following this process in the development of its proposed Resource 'Super Profits' Tax (RSPT). The industry was not adequately nor constructively consulted during the 'Henry Review' into Australia's Future Taxation System. The limited engagement with the Minerals Council of Australia, related representative organisations and individual companies during the Henry Review and the Government's consideration of its recommendations was either perfunctory at best or deliberately exclusive at worst. The Government's announcement of its 'super tax' on 2 May 2010 limited consultation to transitional detail of the new tax system and 'identify[ing] any issues in the implementation of the RSPT that could undermine the Australian Government's policy intentions'. This excludes any discussion of the fundamental design

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13 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 No. 28, 2 May 2010.

14 M, Davis, 'Mining industry dug deep to shaft Rudd over tax', *The Age*, 2 February 2011, http://www.theage.com.au/national/mining-industry-dug-deep-to-shaft-rudd-over-tax-20110201-1acfi.html (accessed 2 February 2011).

> elements, their underlying justification and the real implications for investment and growth in Australia's minerals resources industry.[15]

2.18 The Fortescue Metals Group also expressed its dismay about the tax. In a letter from its Chairman, Mr Herb Elliot AC, to all of its shareholders:

> We are bewildered by the Government's inability to consult on this poorly thought proposal. They introduced the tax with no consultation before they took it into their budget and no real consultation since.
>
> In short, we believe the Resources Super Profits Tax (RSPT) is bad for every Australian. It harms the mining industry and especially Fortescue and we are urging the Government to drop this proposal and to open a new forum for dialogue with all industries to discuss tax reform.[16]

2.19 These concerns were echoed by the majority of those who made public comment. The public storm that erupted over the mishandling of the RSPT within less than two months contributed to the removal of a first-term Prime Minister by the Labor Party caucus.

2.20 Concerns regarding the RSPT were also expressed by professional economists. For example, one of Australia's leading experts on mineral taxation, Professor George Fane of the Australian National University, wrote that:

> The RSPT rules are so complicated that they could be changed with negligible electoral consequences. To adapt an aphorism attributed to Ed Murrow, anyone who is not confused by the RSPT cannot have understood it. The accounting rules are too hard for economists, the economics are too hard for accountants and it is all too hard for everyone else.[17]

2.21 Under significant political pressure, the government attempted to go back to the drawing board and save the RSPT. On 24 June 2010 the new Prime Minister Julia Gillard announced that the Government would seek consensus on the proposed RSPT.[18] The new Prime Minister made the commitment:

> ... [t]o reach a consensus, we need do more than consult. We need to negotiate. And we must end this uncertainty which is not good for this nation.

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15 Minerals Council of Australia, *Minerals resources, tax, and the prosperity of all Australians – A policy brief from the Minerals Council of Australia*, June 2010, pp. 2-3.

16 Letter (undated), Mr Herb Elliot AC, Chairman of Fortescue Metals Group.

17 G. Fane, 'Reputation of Nation on the Line', *The Australian*, 31 May 2010, http://www.theaustralian.com.au/news/opinion/reputation-of-the-nation-on-the-line/story-e6frg6zo-1225873225249

18 Joint Press Conference, The Hon Julia Gillard MP, Prime Minister, and The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, Thursday 24 June 2010 http://www.pm.gov.au/press-office/joint-press-conference-deputy-prime-minister-wayne-swan

> That is why today I am throwing open the Government's door to the mining industry and I ask that in return, the mining industry throws open its mind. ...[19]

2.22 That commitment was followed by an announcement just 8 days later that an agreement had been reached, however not with the mining industry but only with three mining companies who had been exclusively involved in the secret negotiations on the design of the MRRT.

2.23 Correspondence between the Office of the Treasurer and BHP Billiton provide an insight into the way in which the MRRT was settled between the government and the big three miners.

2.24 On Wednesday, 30 June 2010, Gerard Bond of BHP Billiton sent a draft of the MRRT Heads of Agreement by email to the Treasurer's then Chief of Staff, Chris Barrett and the Minister for Resources' then Chief of Staff Tracey Winters. The next day, on 1 July, Mr Barrett provided the email to David Parker who was at the time the Treasury Executive Director of the Revenue Group as well as to another senior Treasury officer along with Ms Winters:

> David,
>
> Please see the draft heads of agreement sent yesterday by BHP. We aim to sign this 5pm today with all three companies. Can your troops read it and ensure all the elements are OK? Please get back to me with any problems asap. Tracey, you might want to check it with DRET [Department of Resources, Energy and Tourism].
>
> I will send a separate email on the $50 million threshold, which is new, but helpful, I think.
>
> Regards,
>
> Chris[20]

2.25 On 1 July 2010, Mr Barrett sent an email to Mr Gerard Bond of BHP Billiton:

> Gerard,
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> Final, clean version for your signature. Please let me know if any issues at your end.
>
> Regards,
>
> Chris[21]

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19 Joint Press Conference, The Hon Julia Gillard MP, Prime Minister, and The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, Thursday 24 June 2010. http://www.pm.gov.au/press-office/joint-press-conference-deputy-prime-minister-wayne-swan

20 Email by Mr Chris Barrett, Chief of Staff, Office of the Treasurer, the Hon Wayne Swan MP. Email dated 1 July 2010 released under Freedom of Information: http://www.treasury.gov.au/documents/1936/PDF/103_email_agreement_with_BHP_design_MRRT.pdf, (accessed 20 June 2011)

2.26 It seems extraordinary that the MRRT Heads of Agreement entered into by the government in the shadow of the last election and which is to be the basis of this new tax on mining was in fact drafted by BHP Billiton. Not only was the mining tax deal negotiated exclusively and in secret with the three biggest tax-payers, excluding their competitors and state and territory governments and other stakeholders from that process – but one of those, BHP Billiton appears to have drafted it. Ms Katherine Murphy appropriately observed, in *The Age*, that:

> Documents released under freedom-of-information laws suggest it was BHP Billiton that drafted the terms of the peace deal with the Gillard government over the mining tax - ultimately costing taxpayers up to $60 billion.[22]

2.27 While BHP Billiton was drafting the peace deal with the overnment, the Prime Minister's own department was sidelined from the process of developing the MRRT and expanded PRRT proposal:

> Senator CORMANN: I have a series of questions of officers that provided advice to the Prime Minister on the mining tax deal that was entered into in July last year—including whether or not and when this is going to be dealt with at COAG. First up, I assume that PM&C [Department of the Prime Minister and Cabinet] did provide advice to the Prime Minister before she signed, along with the Treasurer and the Minister for Resources and Energy, the so-called MRRT heads of agreement with BHP Billiton, Rio and Xstrata?
>
> Dr English: We provided advice to government on a range of matters around the minerals resource tax arrangements in 2010. So at various times we have, yes.
>
> Senator CORMANN: So the answer is yes?
>
> Dr English: I am not confirming a particular briefing at a particular time; I am just saying that we have supported, as best we can, the Prime Minister on this matter.
>
> Senator CORMANN: … My very specific question is for you to confirm that the Prime Minister's department provided advice to the Prime Minister in relation to the proposed mining tax deal before the Prime Minister decided to sign on the dotted line along with the Treasurer and the Minister for Resources and Energy.

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21 Email by Mr Chris Barrett, Chief of Staff, Office of the Treasurer, the Hon Wayne Swan MP. Email dated 1 July 2010 released under Freedom of Information: http://www.treasury.gov.au/documents/1936/PDF/103_email_agreement_with_BHP_design_MRRT.pdf (accessed 20 June 2011)

22 Katherine Murphy, *The Age*, 'BHP drafted mining tax truce, documents suggest', 12 March 2011, http://www.theage.com.au/national/bhp-drafted-mining-tax-truce-documents-suggest-20110311-1brm0.html (accessed 20 June 2011)

> Dr English: On that occasion, the advice was provided to the Prime Minister by the Treasurer.
>
> Senator CORMANN: So the Prime Minister received advice from the Treasurer, not from her own department?
>
> Dr English: On that occasion, yes.[23]

2.28 The questioning continued:

> Senator CORMANN: It was clearly a pretty involved public policy issue and I am sure you would agree with that. It was a public policy issue and one of the three issues where the Prime Minister, on becoming the Prime Minister, pointed to as an issue that she would personally resolve. In that context I am well entitled to ask whether it is normal practice. I am not asking for an opinion, I am just asking whether this is the way it normally happens that a Prime Minister would make a decision signing off on something that obliges and signs up the Commonwealth government, that contracts the Commonwealth government to a whole series of commitments. Is it usual practice, is this what normally happens, that the Prime Minister would sign without getting separate advice from her department—that is, advice separate from the Treasurer's advice?
>
> Dr English: I think it is fair to say that the Prime Minister's approach to a range of issues is dictated by the circumstances of the issue.[24]

2.29 In a joint media release, the Prime Minister, Deputy Prime Minster and Treasurer, as well as the Minister for Resources and Energy and the announced that the new tax agreements was:

> ...the result of intense consultation and negotiation with the resources industry.[25]

2.30 The government had refused repeated requests from the Senate and the committee for a signed copy of the MRRT Heads of Agreement. So as part of this inquiry, the committee requested the disclosure of the signed Heads of Agreement by the three companies involved in the exclusive and secret negotiations:

> CHAIR—…Would you have any objection to providing a signed copy of the agreement?

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23 Senator Mathias Cormann and Mr Dominic English, First Assistant Secretary, Economic Division, Department of the Prime Minister and Cabinet, *Estimates Transcript of Evidence*, 23 May 2011, p. 71.

24 Senator Mathias Cormann and Mr Dominic English, First Assistant Secretary, Economic Division, Department of the Prime Minister and Cabinet, *Estimates Transcript of Evidence*, 23 May 2011, p. 73.

25 Joint Media Release, The Hon Julia Gillard MP Prime Minister, The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and The Hon Martin Ferguson MP Minster for Resources and Energy, *Breakthrough agreement with industry on improvements to resources taxation*, Media Release No. 55, 2 July 2010.

Mr Bond—The short answer is yes. We wish to respect expressed desire of the other signatories to not release it. We again note that with the exception of the signatures, the document in its entirety exists in the hands of the Senate estimates committee.

CHAIR—When you say you want to respect the wishes of the other signatories, you are talking about government ministers. That is correct, is it?

Mr Bond—Yes.

CHAIR—So BHP Billiton as such does not have an objection to the signed copy of the agreement being released?

Mr Bond—We do not.

CHAIR—Who has expressed to you on behalf of the other signatories for the government that they do not want the signed copy released?

Mr Delaney—The Prime Minister's office.

CHAIR—The Prime Minister's office has told you that they do not want to—

Mr Delaney—They believe it is appropriate not to release the heads of agreement with the signatures on it.

CHAIR—Have they explained why?

Mr Delaney—No, they just believe it is not appropriate to do so.[26]

2.31 A signed copy was provided to the committee the same afternoon the above exchange took place, but the committee is still waiting for information about commodity price and production volume assumptions used to assess the revenue from this tax, for an official breakdown of where the mining tax revenue is expected to come from on a state by state basis and about the projected cost of related budget measures to 2020/21 to complement the projected revenue estimates over the same period.

Replacing the RSPT — Introduction of the MRRT and expanded PRRT

2.32 On 2 July 2010, the Gillard Government announced that agreement on amendments to the RSPT had been reached with 'the' resources industry[27] and that that agreement would ensure certainty for the Australian economy while at the same time:

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26 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Gerard Bond, Group Head of Human Resources, BHP Billiton, *Committee Hansard*, 8 December 2010, p. 10.

27 Joint Media Release, The Hon Julia Gillard MP Prime Minister, The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and The Hon Martin Ferguson MP Minster for Resources and Energy, *Breakthrough agreement with industry on improvements to resources taxation*, Media Release No. 55, 2 July 2010.

> ...keeping faith with [the Government's] central goal from day one: to deliver a better return for the Australian people for the resources they own and which can only be dug up once.[28]

2.33 This announcement came after the signing of the Heads of Agreement between the government, BHP Billiton, Rio Tinto and Xstrata on 1 July 2010. The government had consulted with only three mining companies. To put that into context, the Australian mining industry is said to comprise around 2500 firms with about 320 directly impacted by the new tax on mining proposed by the government. Every other competitor to the big three mining companies was excluded from the consultation/negotiation process. The result being a proposed tax designed in a way which will make it harder for those excluded to compete with those that had been given the exclusive privilege to help design the new mining tax.

2.34 Indeed the Heads of Agreement was the result of a highly exclusive negotiating framework, which left a substantial majority of the industry and other stakeholders out in the cold without any capacity to influence the development of a tax that would affect not just their businesses but the broader Australian and individual State economies.

2.35 The negotiations were so exclusive that not even the states and territories were included in any of the negotiations despite the significant implications for them. Particularly, given the promise to credit all state and territory royalties against the resources tax liability and the government's ill-informed expectation that state and territory governments would just agree not to pursue any further increases in royalties as a result of the mining tax deal negotiated without them. The government never even tried to act on the Henry Tax Review recommendation that 'the Australian and State governments should negotiate an appropriate allocation of the revenues and risks from the resource rent tax'.[29]

2.36 The Heads of Agreement provided that the latest proposal for a new tax on mining would take the form of a MRRT which would apply only to iron ore and coal and the onshore extension of the petroleum resource rent tax and to the North West Shelf. A copy of the Heads of Agreement can be found in Appendix 4. The detail of the MRRT and expanded PRRT will be discussed in greater depth in Chapter 4.

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28 Joint Media Release, The Hon Julia Gillard MP Prime Minister, The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and The Hon Martin Ferguson MP Minster for Resources and Energy, *Breakthrough agreement with industry on improvements to resources taxation*, Media Release No. 55, 2 July 2010.

29 *Australia's Future Tax System Review – Report to the Treasurer, December 2010*, Recommendation 48.

2.37 Table 2.2 below provides a further snapshot on the evolution of the Resources Rent Tax, from the RSPT and to the MRRT:

Table 2.2: A comparison of the Resources Super Profits Tax and the Mineral Resources Rent Tax[30]

Taxation feature	**Resource Super Profits Tax**	**Mineral Resources Rent Tax**
Rate	40%	30%. [effective rate of 22.5%] An extraction allowance of 25% of the otherwise taxable profits will be deductible to recognise the profit attributable to the extraction process – this is to only tax the resource profit. Operators with MRRT assessable profits below $50 million per annum are excluded from the MRRT.
Application	Applied to the extraction of all non-renewable resources in Australia.	To the mining of coal and iron ore within Australia. (The application of PRRT extended to oil and gas projects onshore (on top of state and territory royalties) from offshore (where no state and territory royalties apply in Commonwealth waters) including the North West Shelf. (Under existing arrangements, royalties apply to the North West Shelf and are shared between the Commonwealth and the WA Government. It remains unclear how the extension of the PRRT to the North West Shelf will affect this arrangement).
Transferability	Transfer to other projects or carried forward.	MRRT losses would be transferable to offset MRRT profits the taxpayer has on other iron ore and coal operations.[31] (Losses referred to here are those generated by having expenses larger than your revenues. Transferability does not apply in respect of credits arising from royalties.)[32] Note: Although taxpayers will be able to transfer tax losses generated from expenses that exceed revenues to other iron ore and coal projects in Australia, transferability does not

30 Sources: Australia's Future Tax System, *Final Report*, December 2009, (recommendations 45 – 50); KPMG, *Reform in Focus: Implications of tax reforms for Australian business*, 15 July 2010 (10TiF-037) *Changes to resources taxation and company tax rate*; Clayton Utz 2010, *Minerals Resource Rent Tax replaces RSPT*.

31 *Mineral Resource Rent Tax Heads of Agreement*, p. 1.

32 Mr David Parker, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 16.

		apply in respect of excess credits that arise from royalty payments.[33] In these circumstances, excess credits from the payment of state and territory royalties are uplifted and carried forward to be applied to a project's future MRRT liabilities.[34]
Deductibility	An allowable deduction for income tax purposes.	An allowable deduction for income tax purposes.
Royalties	States and territories keep existing regimes. Remain payable with a rebate. Unused rebate can be refunded or transferred.	Remain payable. All State and Territory Royalties are creditable against any resources tax liability. Unused credits can be carried forward and uplifted but cannot be refunded or transferred.
Company taxation rate	2013-14: 29% 2014-15: 28%	2013-14: 29% Small companies would have tax rate reduced to 29% from 2012-13.
Superannuation Guarantee	9% to 12% by 2019-20	9% to 12% by 2019-20
Regional Infrastructure Fund	Established a $6 billion Regional Infrastructure Fund.	Allocated $6 billion to a Regional Infrastructure Fund over ten years.
Scope	2500 companies affected.	Approximately 320 mining companies affected.

2.38 The RSPT and its replacement, the MRRT/expanded PRRT, are an intrusion by the Commonwealth into the own-source revenue arrangements of the states and territories. Under our Constitution the royalty arrangements in relation to minerals and resources continue to be their right and responsibility. The new MRRT is in fact a 'top-up tax' on top of the existing royalties, where the Henry Tax Review had recommended a 'replacement tax'. The MRRT is also narrower than the Henry Resource Rent Tax and more complex and less fair than the status quo, specifically to smaller mining companies. These matters and their implications are explored in Chapters 4 and 5.

The MRRT Implementation Committee - Policy Transition Group

2.39 At the time of announcing the MRRT and expanded PRRT the government established another body, a Policy Transition Group (PTG), to implement the new arrangements.[35] That group, led by Don Argus AC and Resources Minister Martin

33 Mr David Parker, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 16.

34 *Mineral Resource Rent Tax Heads of Agreement*, p. 1.

35 Joint Media Release, The Hon Julia Gillard MP Prime Minister, The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and The Hon Martin Ferguson MP Minster for Resources and Energy, *Breakthrough agreement with industry on improvements to resources taxation*, Media Release No. 55, 2 July 2010.

Ferguson, was supposed to consult with industry, government departments and stakeholders and advise the government on the technical design and implementation of the new MRRT and PRRT arrangements.[36] Mr Argus resigned as Chairman of BHP Billiton on 30 March 2010 after a decade with the company.[37]

2.40 Its terms of reference however were considered by many stakeholders to be far too restricted:

> CHAIR—...The terms of reference are not really that broad either, are they? Is it just a matter of time or a matter of focus as well?
>
> Mr Nicolaou—That issue was certainly raised in our submission to the Policy Transition Group. We were concerned not only that the time was limited, in that there was one month to report, but also that the scope of the terms of reference was quite limiting...[38]
>
> CHAIR—You have made some comments about the work with the Policy Transition Group. Are you of the view that your concerns are able to be properly considered and taken on board by the Policy Transition Group?
>
> Mr Bennison—We hope so. One of the concerns that has been uppermost in our mind over recent months has been the lack of transparency in this whole process... that is a serious concern to us. We can only work within the process at the moment...[39]
>
> CHAIR—But those terms of reference for the Policy Transition Group are pretty restrictive, aren't they? There is one condition in there which says that any recommendations have to be revenue neutral... Do you think that there is enough scope for the Policy Transition Group to recommend the sorts of changes that you need?
>
> Mr Bennison—...no, I do not think there is...[40]

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36 Joint Media Release, The Hon Julia Gillard MP Prime Minister, The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and The Hon Martin Ferguson MP Minster for Resources and Energy, *Breakthrough agreement with industry on improvements to resources taxation*, Media Release No. 55, 2 July 2010.

37 Media release, *BHP Billiton – Chairman Succession Date*, http://www.bhpbilliton.com/bb/investorsMedia/news/2010/chairmanSuccessionDate.jsp (accessed 23 May 2011)

38 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr John Nicolaou, Chief Officer, Membership and Advocacy, Chamber of Commerce and Industry of Western Australia, *Committee Hansard*, Monday 8 November 2010, p. 79.

39 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Simon Bennison, Chief Executive Officer, Association of Mining and Exploration Companies, *Committee Hansard*, Monday 8 November 2010, p. 6.

40 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Simon Bennison Chief Executive Officer, Association of Mining and Exploration Companies, *Committee Hansard*, 8 November 2010, pp. 6–7.

2.41 In December 2010 the PTG presented its report, together with 98 recommendations,[41] to the government. The government responded on 24 March 2011 outlining that they accepted all 98 recommendations of the PTG:

> ...This includes the 94 recommendations relating to Australia's new resource taxation arrangements, which will inform the design of draft legislation to be released for consultation in the first half of this year. The other 4 recommendations relate to promoting exploration.[42]

2.42 To demonstrate the narrowness of the PTG process, the government directed the Group not to make recommendations that the proposed MRRT and PRRT would have no net impact on the Budget over the forward estimates.[43]

Committee comment

2.43 It is important to consider where this whole process started. The Henry Tax Review was labelled by the government as the most comprehensive review of Australia's tax system since World War II. It was supposed to lead to a simpler, fairer more efficient and effective tax system. There is no doubt that the Henry Tax Review panel delivered a detailed and comprehensive report, which identified many possible areas for reform. However, in the committee's opinion the government's incompetent handling of the tax reform process from the moment the report was delivered to it, has created massive and unnecessary uncertainty for one of Australia's most important industries. Australia has wasted valuable time which should have been used to further the cause of genuine and strategic tax reform.

2.44 What we have ended up with is not a simpler, fairer and more efficient tax system. The only initiative adopted by the government out of the Henry Tax Review is a multi-billion dollar new ad hoc tax imposed on a single industry, a tax which is manifestly more complex and the committee believes less fair than the status quo.

2.45 The main policy objective advanced by the Henry Tax Review for a profit based resource rent tax – to remove distortions of investment and production decisions caused by royalties on production – is not achieved by the Gillard Government version of the mining tax. In fact, later in this report it will become apparent that all of the distortions from royalties on production – to the extent they exist – will remain, while new and additional distortions are created by the MRRT itself.

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41 The Policy Transition Group's recommendations in relation to relevant rent tax arrangements are set out in Appendix 5.

42 The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and The Hon Martin Ferguson MP, Minister for Resources and Energy, *Government accepts resource tax recommendations*, Joint Media Release, No. 24, 24 March 2011.

43 The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and The Hon Martin Ferguson AM MP, Minister for Resources and Energy, *Government accepts resource tax recommendations*, Joint Media Release, No. 24, 24 March 2011.

2.46 In the Heads of Agreement entered into with BHP Billiton, Rio Tinto and Xstrata the government committed the Commonwealth to crediting 'all state and territory royalties' against any mining tax liability. The committee is greatly concerned that the government never once sought to engage with state and territory governments about their intentions in relation to their royalty arrangements before signing that agreement.

2.47 The signatures on the mining tax deal are those of the Prime Minister, the Treasurer and the Resources Minister on behalf of the government and the Chief Executive Officers of the three biggest mining companies. Not a single state Premier or territory Chief Minister or Treasurer is part of the agreement entered into by the government.

2.48 In the circumstances it is obvious to the committee that as a direct consequence of the promise to credit all state and territory royalties, the Commonwealth budget would be exposed to decisions about increases in royalties.

2.49 The committee finds it very difficult to understand why the government did not seek to actively engage with state and territory governments on this before entering into the agreement. That is if this whole process was indeed about genuine reform of resource taxation and royalty arrangements as had been suggested by the Henry Tax Review.

2.50 It is the committee's view that this whole process was never about genuine tax reform. It was about a fiscally challenged government in desperate need for some more cash to help create the illusion of an early surplus in the lead-up to a difficult election.

2.51 Because the government was in a rush it did not have the time to think things through properly and to engage with all the stakeholders that ought to have been engaged in the process.

2.52 Declaring a tax war against any state which ends up putting the Commonwealth Budget under pressure by exercising its rights and responsibilities under the Constitution to increase royalties is not an appropriate way to fix the problem the government has created for itself.

2.53 Regardless of the changes the Gillard Government made to the mining tax, under massive political pressure and in the shadow of a difficult election, this tax on the mining industry remains a threat to our economy and jobs, especially in Western Australia and Queensland.

2.54 The MRRT was negotiated by the government through a highly improper process – exclusively and in private with the three biggest multi-national, multi-commodity, multi-project companies.

2.55 It is the committee's strong opinion that this process should not be allowed to stand as a successful precedent for tax policy design. The Parliament should reject the deeply flawed tax which came out of this highly improper process.

2.56 The Gillard Government announced that they were throwing open their door to the mining industry. Yet, the 'breakthrough' agreement was negotiated with just three miners. The deeply flawed consultation process of developing these tax changes will be discussed in more detail in Chapter 3.

2.57 The central goal of the Henry Tax Review was to make the tax system simpler and fairer for all taxpayers. The international competitiveness of the Australian economy was to be protected. In the committee's view the government has failed to deliver the intended outcomes. The MRRT and expanded PRRT came out of a flawed process that produced a complex tax which is less fair and damaging to our international competitiveness. Chapter 4 explores these issues further.

2.58 The committee is of the view that by announcing the RSPT and its successors the MRRT and expanded PRRT as a central plank of the government's fiscal strategy while linking revenue from these taxes to the future cost of related budget measures, the government has exposed the Budget to a volatile and downward trending revenue base. This revenue base has effectively been hypothecated and tied to related costs to the budget which will continue to increase over time – well beyond the projected revenue from the mining tax over the next decade. Over time, this will place further pressure on the budget by worsening the current structural deficit. This matter is discussed further in Chapter 5.

2.59 The committee is of the view that the MRRT and the PRRT go to the heart of the financial relationship between the Commonwealth and the states and territories. The current government promised a new era of cooperative federalism in the past. Not only is there no evidence of cooperative federalism, the Commonwealth has treated the states and territories with absolute contempt when it comes to the implications of the proposed national mining tax on their own-source revenue base. The issues that this raises are explored in Chapter 6 of this report. That chapter also highlights the significant problems in effectively linking state and territory royalties to the Commonwealth Budget still to this day without any constructive engagement about royalty arrangements into the future.

2.60 The committee is of the view that the Parliament should refuse to deal with any mining tax legislation until the government has tabled an agreement with all state and territory governments resolving the interaction between the proposed mining tax, state and territory royalties and GST sharing arrangements.

The committee takes the view that if the Henry Tax Review report had been released for public consultation before the announcement of the RSPT, it could have led to an informed debate about the future of tax reform and could have been an important document in shaping the agenda for the coming tax summit. Chapter 7 of the report assesses what would have been a better process and what should be the way forward.