The Senate

Select Committee on the Scrutiny of New Taxes

The Mining Tax: A bad tax out of a flawed process

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TABLE OF CONTENTS

Membership of Committee .... **iii**

Executive Summary .... **ix**

Summary of Recommendations .... **xv**

Chapter 1 .... **1**

Inquiry into a national mining tax **1**

Terms of reference 1

Structure of the report 2

Chapter 2 .... **5**

An overview of the development of recent Resource Rent Tax proposals **5**

Introduction 5

The Government's Response to the Henry Tax Review 8

Replacing the RSPT — Introduction of the MRRT and expanded PRRT 15

The MRRT Implementation Committee - Policy Transition Group 18

Committee comment 20

Chapter 3 .... **23**

A taxing time: the development of the Resources Super Profits Tax, the Mineral Resources Rent Tax and expanded Petroleum Resources Rent Tax .. **23**

Introduction 23

The government's initial consultation process and response for the RSPT 26

The states and the RSPT 27

Secret and exclusive: the MRRT and expanded PRRT development process 30

The Government's failure to implement best-practice regulation principles 34

The Treasury and the development of the MRRT and expanded PRRT 36

The Implementation Committee – renamed 'Policy Transition Group' 40

The Resource Tax Implementation Group 42

General comments on the policy development process 43

Transparency 44

Senate Committees, the Executive and Departments 49

Committee comment 54

Chapter 4...59

The Mineral Resources Rent Tax and expanded onshore Petroleum Resources Rent Tax 59

Introduction 59

The MRRT – Increasing distortions 59

The MRRT - A narrowly based tax, but for how long? 70

The MRRT - Uncertainty and compliance burdens 74

The 'big three mining' companies 77

The Treasury 79

The Western Australian Treasury 82

MRRT – Less fair, royalty credits which are non-refundable, non-transferable 82

MRRT – More complex and administratively burdensome, the $50 million profit threshold 86

The Petroleum Resource Rent Tax 89

Committee comment 92

Chapter 5...95

Broader economic consequences of the flawed Mineral Resources Rent Tax and the expanded Petroleum Resources Rent Tax 95

Introduction 95

Competitive advantage for the big three miners 95

Sovereign risk 99

A flawed foundation – pure resource rents do not exist....................................102

Revenue, spending and structural deficit under the MRRT and PRRT 104

Revenue raised from the MRRT...111

Costs of measures associated with the MRRT and expanded PRRT 111

The structural deficit...114

Consequences for the broader economy 118

Chapter 6 .... **125**

The taxation of non-renewable resources and implications for the federation **125**

Introduction 125

The mining industry in Australia 125

The mining industry and royalties 126

The importance of royalty revenue 129

Mining, royalties and the federation 134

Gillard Government version of the mining tax: A tax on Western Australia ... 135

Horizontal fiscal equalisation 137

Reforming the Commonwealth Grants Commission framework 142

The Commonwealth declares a tax war against the resource states 143

The further erosion of the credibility of the Commonwealth Grants process 150

Constitutional issues 155

Committee comment 161

Chapter 7 .... **165**

Australia needs genuine tax reform not lazy tax grabs **165**

A lack of strategic, coordinated and coherent framework for tax reform 165

A framework to get taxation reform right 167

Committee comment: Another missed opportunity 168

APPENDIX 1 .... **177**

Submissions Received **177**

Additional Information Received **178**

Tabled Documents 179

APPENDIX 2 .... **181**

Public Hearings and Witnesses **181**

APPENDIX 3 185
Terms of Reference Australia's future tax system 185
Objectives and scope 185
Composition and consultation 186
Structure and timing 187
APPENDIX 4 189
Mineral Resource Rent Tax Heads of Agreement 189
APPENDIX 5 191
Policy Transition Group List of Recommendations 191
MRRT Recommendations 191
PRRT Recommendations 204

Executive Summary

Introduction

For a substantial part of Australia's history the mining industry has been a source of national prosperity and national political importance. The Eureka Rebellion of 1854 was a revolt by Victorian miners against the heavy hand of taxation and regulation by colonial authorities. It also contributed to a growing sense of nationalism. To this day, the Eureka flag remains a potent political symbol.

In 2010, the mining industry was again forced to resist the heavy hand of government. This time a central government would ignite resistance to a poorly developed and poorly designed tax which would have dire consequences for the mining industry. Unlike the Eureka rebellion, the events of 2010 would also be about the rights of states and would highlight a growing schism between resource rich states and a distant central government in Canberra.

This report by the Senate Select Committee on the Scrutiny of New Taxes is about the various mining taxes – the Resource Super Profits Tax, the Minerals Resource Rent Tax and the expanded Petroleum Resource Rent Tax – developed by the Labor Government since 2010.

Poor process

After coming to office in 2007, the former Prime Minister, Kevin Rudd, and the Treasurer, Wayne Swan, commissioned a 'root and branch' inquiry into the nation's taxation arrangements – Australia's Future Tax System Review also known as the Henry Tax Review. The Government's response to the Review was to announce a Resources Super Profits Tax (RSPT). Without any meaningful consultation on the proposed RSPT the mining industry, the states and territories and all other stakeholders were taken by surprise.

Following the announcement of the RSPT, the mining industry mobilised a concerted campaign to have the RSPT abolished. The anti-RSPT campaign contributed to the removal of Prime Minister Rudd and the installation of his successor Julia Gillard. The new Prime Minister undertook to negotiate with the mining industry over the RSPT.

However, instead of negotiating with the mining industry, the new Prime Minister and her Treasurer, and now new Deputy Prime Minister, negotiated a new mining tax deal in secret and exclusively with the three biggest mining companies – BHP Billiton, Rio Tinto and Xstrata – in the shadow of what they knew would be a difficult 2010 general election. The secret and exclusive negotiations with the multi-national, multi-commodity and multi-project majors excluded around 320 of their competitors and every state and territory government from that process. The result was the Mineral Resources Rent Tax (MRRT) and expanded Petroleum Resources Rent Tax (PRRT).

The proposed MRRT and expanded PRRT are supposed to start on 1 July 2012. Revenue from the proposed national mining tax has been in the Commonwealth Budget since 2010-11. The revenue from those taxes – now the MRRT and expanded PRRT- which has been assessed by Treasury as reducing over time has been earmarked for a number of related measures, the cost of which will increase over time.

The key assumptions underpinning these taxes remain secret. In contrast to the secret approach of the Commonwealth, the state budgets of Western Australia and Queensland provide details of assumptions underpinning their mining royalties and therefore enabling proper scrutiny of their revenue estimates.

The Government has also refused to publicly release its cost projections for the various measures associated with the national mining tax proposal for the period for which MRRT revenue projections have ultimately been made available (ie to 2020-21). Information about the cost of those various measures to 2020-21 is necessary to properly scrutinise the fiscal impact of the whole national mining tax package. In the absence of relevant information from the government, the committee has made its assessments included in this report based on the best available information and with the assistance of economic experts in the Parliamentary Library.

Substantial secrecy has surrounded the development of the RSPT, the MRRT and the expanded PRRT. The Senate has been denied information only to find it released much later under Freedom of Information. The lack of openness and transparency has impeded the development of these proposed new taxes, and left many wondering what assumptions underpinned these important policy proposals.

The government's failed taxation reform efforts are the direct result of the government's flawed response to the Henry Tax Review. The government failed to consult appropriately with a wide range of stakeholders (including state and territory governments), the government underestimated the complexities of running a resource rent tax and royalty system in parallel, the government sidelined Treasury officials during the negotiations with BHP Billiton, Rio Tinto and Xstrata, the government refused to release key assumptions, the government demonstrated a lack of good faith by presenting much of the details of the tax as a 'fait accompli' and the government's modifications to create the MRRT and expanded PRRT was "policy by deal" rather than policy developed through extensive consultation and detailed consideration. In doing so, the government completely defied its own best practice regulation guidelines with predictable results.

A dagger at the heart of Australia's prosperity

The poorly designed tax has many short comings which are elaborated upon in this report, including that it:

- introduces another new tax on an important industry 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.

In short, the MRRT and expanded PRRT would impose more economic distortions than the existing royalty arrangements. The MRRT is imposed on a narrow base which penalises some resource sectors (iron ore and coal). Moreover, these new taxes would impose substantial compliance costs even on a sector which is highly unlikely to have a large liability (such as the onshore gas and petroleum sector). Overall, the government's response to the Henry Tax Review has exposed the federal budget to a higher degree of risk. The government has proposed various associated measures which will become increasingly costly over time to be funded by a tax which could be dramatically impacted at any time by increases in royalties by state governments. These deficiencies completely refute the government's argument that their proposed changes create a more efficient tax system.

To ensure that the big companies of tomorrow can emerge and grow into the BHP Billiton's and Rio Tinto's of the future, we need to get the policy settings right today. The MRRT favours today's big majors over the small and mid-tier industry players aspiring and having the opportunity to be among the big majors of tomorrow. The MRRT is not competitively neutral. New taxes introduced by government should be. Given the importance of the 'minors' in the industry this is another longer term challenge policy makers must now confront.

Australia is enjoying its best terms of trade in 140 years and the government should not take the continued strength of the mining industry for granted. The economic development of India and China continues to fuel a strong demand for Australia's resources. However, Australia will face increased competition from other minerals and energy suppliers. In these circumstances policy settings must be carefully calibrated to ensure the international competitiveness of Australia as a mining investment destination and growing employment is preserved. This proposed national mining tax is a dagger at the heart of Australia's continued prosperity which should be avoided.

Dire fiscal consequences and a strain on federal–state financial relations

While the original concept of a Resource Rent Tax contained in the Henry Tax Review recommended negotiations with the states and territories, the Commonwealth conducted its negotiations with the 'big three' without them. Under Australia's constitutional arrangements, royalties are the responsibility of the states and territories. Ignoring this reality, the Commonwealth agreed with the big three miners to credit all state and territory royalties apparently completely oblivious of the flow-on consequences for the Commonwealth Budget.

The combination of a highly volatile revenue from the MRRT expected to reduce over time, the increasing cost of associated measures over time, as well as state and territory royalties being credited by the Commonwealth, create a fiscally irresponsible combination. As the best terms of trade in 140 years ease and the projected cost of related measures increases, a structural deficit will put more pressure on the Commonwealth Budget.

At the time the government signed the deal with the big three miners, Treasury assessed that the MRRT would raise around $38.5 billion. About 65 percent of that revenue or $25 billion is expected to come from iron ore production. With almost all the iron ore production taking place in Western Australia, the MRRT is a massive and disproportionate national tax impost on one state economy. Along with Western Australia, Queensland and New South Wales would bear the brunt of this tax.

The RSPT, the MRRT and expanded PRRT are a further intrusion of the Commonwealth into the revenue sphere of the states and territories. The Government of Western Australia raised its royalties in its 2011-12 Budget by phasing out royalty concessions on iron ore fines, as did Tasmania. The Gillard Government had known for some time about the Western Australian government's intentions to phase out royalty concessions on iron ore fines. Importantly, the states of New South Wales and Queensland have reserved their right to also raise their royalties. In the absence of a negotiated agreement involving the states and territories, the Commonwealth will be forced to cover these royalty rate rises. Already this amounts to about $2 billion over the current forward estimates and that cost could well rise into the future.

Businesses and the Western Australian Government have flagged the possibility of a constitutional challenge to the proposed MRRT and expanded PRRT.

Way forward

The Government's proposed new national mining tax arrangements are more complex, less efficient and less fair than the status quo. The process for the development of the MRRT and expanded PRRT was inappropriately secretive and exclusive.

In the Committee's view the design of the MRRT and expanded PRRT which came out of that process is irretrievably broken. Any attempt to 'fix' the defects in these taxes would sucker a government into a series of quid-pro-quos with affected companies, which could never be the foundation of enduring taxation reform. Instead,

the government should scrap its failed attempt to respond to the Henry tax review and start again.

Genuine tax reform is best delivered through an open, transparent and inclusive process, not by negotiation behind closed doors with a chosen few given the privileged opportunity to pursue their particular interests.

Taxation reform must be an ongoing process. It should not be targeted at one industry in isolation as is the case with the MRRT and expanded PRRT. Australia needs genuine taxation reform not lazy tax grabs. Australia needs taxation reform which is focused on delivering lower, simpler and fairer taxes. Australia needs tax reform aimed at improving our productivity and international competitiveness, to encourage increased workforce participation, enterprise and to attract investment. To achieve all that, more needs to be done, in particular on the spending side of the budget. Future taxation reforms must also focus on making the system more user friendly, efficient and on reducing red tape for households and business instead of increasing it.

Finally, any genuine tax reform must also be focused on and address the implications for federal-state financial relations.

The committee recommends that the Government scrap its proposals for an MRRT and expanded PRRT. The committee recommends that the uncoordinated, incoherent and ad hoc taxation processes currently underway be replaced by one genuine tax reform process focused on delivering lower, simpler and fairer taxes, through an open, transparent and inclusive process.

This report

Chapter 2 sets out the process of the proposed tax's development. Chapter 2 identifies the main themes that will be examined in the remaining chapters of the report.

Chapter 3 examines the design process of the proposed tax in more detail. It illustrates the deeply flawed policy development processes behind the RSPT, the MRRT and expanded PRRT. It also considers the lack of transparency surrounding the development of these new taxes.

Chapter 4 examines the design of the proposed MRRT and expanded PRRT. Chapter 4 will explore the impact of the proposed taxes and inquire into the concerns that have been raised by stakeholders.

Chapter 5 investigates the broader economic and fiscal policy issues raised by the mining tax, specifically the structural deficit associated with the fiscally irresponsible combination of declining revenue streams and increasing costs of associated budget measures over the medium to long term.

Chapter 6 examines the role of the mining sector in the Australian economy, how the mining tax will impact on relevant states and territories and the implications for federal-state financial relations.

Chapter 7 focuses on the need for genuine tax reform instead of lazy tax grabs and proposes a more appropriate framework for tax policy development.

Recommendations

The recommendations of this report are set out on the following page.

Summary of Recommendations

Recommendation 1

3.113 The committee recommends that the Parliament not support the deeply flawed and poorly designed MRRT and expanded PRRT.

3.114 Should the Parliament be inclined to consider the government's proposed mining tax contrary to this principal recommendation, the committee makes the following further recommendations:

Recommendation 2

3.115 The committee recommends that Parliament insist that government proposals to make major structural changes to Australia's tax system be based on an open, transparent and inclusive policy development process before final policy decisions are made.

3.116 The committee also recommends that the Parliament refuse to consider any changes to resource taxation which have implications for state and territory royalty arrangements until the government can demonstrate that it has actively engaged and reached agreement with state and territory governments.

Recommendation 3

3.117 The committee recommends that in line with the government's stated commitment to openness and transparency the Parliament require the public release of all mining tax related revenue assumptions, including commodity price and production volume assumptions.

3.118 To enable proper scrutiny of the government's mining tax revenue estimates, the committee recommends that the Parliament insist on release of that information before it agrees to consider any mining tax related legislation.

Recommendation 4

3.119 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 international competitiveness**
- **the Commonwealth's budget position**
- **State and Territory revenues**
- **cost of living; and**
- **the Australian Economy as a whole.**

Recommendation 5

3.120 The committee recommends that the Parliament insist on the government restoring confidence in good regulatory processes by:

- **formally recommitting to the best-practice regulation guidelines developed by its Office of Best Practice Regulation;**
- **confirming that proposals for new taxes require the development of Regulatory Impact Statements consistent with the requirements of the best-practice regulation handbook**

3.121 The committee recommends that before considering any mining tax related legislation the Parliament insist on a report from the Office of Best Practice Regulation about the extent to which the government's policy development processes for the RSPT, MRRT and expanded PRRT were consistent with its own best-practice regulation guidelines.

3.122 The committee recommends that the Office of Best Practice Regulation be required to make recommendations to improve the government's compliance with these principles.

Recommendation 6

4.113 The committee again recommends that because the government's proposed MRRT and expanded PRRT would impose more economic distortions than existing royalty regimes, the Parliament not support any plans by government to pass legislation to give effect to these proposed new taxes.

Recommendation 7

5.89 The committee recommends that, if contrary to its principal recommendation the Parliament is of a mind to pass these flawed resource rent tax arrangements, the Parliament amend the legislation to ensure revenues raised, which are subject to high volatility and likely to reduce over time, are used to increase the net financial worth of the Australian government either through the payback of debt or investment in assets through the Future Fund.

Recommendation 8

6.143 The committee recommends that the Parliament insist on the government tabling an agreement with the states and territories about the interaction between the proposed MRRT/expanded PRRT, royalties, GST sharing arrangements and any other related federal-state financial relations issues before considering any mining tax related legislation.

Recommendation 9

7.25 The committee recommends that the current uncoordinated, incoherent and ad hoc taxation processes currently underway be replaced by one genuine tax reform process focused on delivering lower, simpler and fairer taxes, through an open, transparent and inclusive process.

Chapter 1

Inquiry into a national mining tax

Terms of reference

1.1 On Thursday, 30 September 2010 the Senate established the Select Committee on the Scrutiny of New Taxes to inquire into a broad range of matters relating to taxation:

(a) New taxes proposed for Australia, including:

(i) the minerals resource rent tax and expanded petroleum resource rent tax,

(ii) a carbon tax, or any other mechanism to put a price on carbon, and

(ii) any other new taxes proposed by Government, including significant changes to existing tax arrangements;

(a) the short and long term impact of those new taxes on the economy, industry, trade, jobs, investment, the cost of living, electricity prices and the Federation;

(b) estimated revenue from those new taxes and any related spending commitments;

(c) the likely effectiveness of these taxes and related policies in achieving their stated policy objectives;

(d) any administrative implementation issues at a Commonwealth, state and territory level;

(e) an international comparison of relevant taxation arrangements;

(f) alternatives to any proposed new taxes, including direct action alternatives; and

(g) any other related matter.[1]

1.2 Given the extensive scope of the terms of reference the committee resolved to report to the Senate on a subject by subject basis, as each matter referred had been inquired into.

1.3 This report sets out the committee's findings of its inquiry into the proposed national mining taxes. This inquiry involved investigation of the proposed minerals resource rent tax and the expanded petroleum resource rent tax.

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1 *Journals of the Senate*, 2010, pp. 119-120.

Conduct of the inquiry to date

1.4 Following its establishment and the resolution to inquire into the terms of reference on a subject by subject basis, the committee advertised its inquiry into a national mining tax in the national press *(The Australian)* and invited written submissions by 29 October 2010. The closing date for submissions was later extended to 30 April 2011. Details of the inquiry were published on the committee's website.[2] The committee also wrote to a large number of stakeholders inviting submissions.

1.5 The committee received 33 submissions. A list of the submissions received can be found in Appendix 1.

1.6 Seven public hearings were held in Perth, Melbourne, Canberra and Sydney throughout November and December of 2010, and February and March of 2011. The witnesses who appeared before the committee at its hearings are listed in Appendix 2. The committee is very disappointed that the Chair and members of the government appointed Policy Transition Group refused to participate in the inquiry process.

Acknowledgement

1.7 The committee extends its sincere thanks to all parties who contributed to and participated in the inquiry process by making submissions and/or appearing before it.

Structure of the report

1.8 This report into a national mining tax is comprised of 7 chapters.

- Chapter 2 sets out the process of the proposed rent taxes. This Chapter identifies the main themes that will be examined in the remaining chapters of the report.
- Chapter 3 examines the design process of the proposed tax. It outlines the flawed policy development processes behind the Resource Super Profits Tax (RSPT), the Mineral Resource Rent Tax (MRRT) and the expanded Petroleum Resource Rent Tax (PRRT). In particular it focuses on the lack of openness, transparency and inclusiveness surrounding the development of those new taxes.
- Chapter 4 examines the proposed MRRT and expanded PRRT in more detail. This Chapter explores the impact of those proposed taxes and inquires into the concerns that have been raised by stakeholders.
- Chapter 5 investigates some broader economic and fiscal policy issues raised by the mining tax, including the worsening structural deficit, caused by a combination of highly volatile and declining revenue from the national mining tax, and the increasing cost of related budget measures.

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2 http://www.aph.gov.au/Senate/committee/scrutinynewtaxes_ctte/index.htm

- Chapter 6 examines the role of the mining sector in the Australian economy, how the mining tax will affect the economies of each state and how the proposed proceeds will be spent. The chapter also considers these issues in the context of Commonwealth-state financial relations.
- Chapter 7 focuses on the need for genuine tax reform instead of a lazy grab for cash by a government addicted to more and more spending. This chapter is also focussed on objectives and process improvements for tax reform in the future.

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 **replaced** 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.

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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

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,
>
> 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.

Chapter 3

A taxing time: the development of the Resources Super Profits Tax, the Mineral Resources Rent Tax and expanded Petroleum Resources Rent Tax

Introduction

3.1 This Chapter provides an assessment of how the deeply flawed policy development processes for the government's RSPT and its successors, the proposed MRRT and expanded PPRT, contributed to the development of a bad tax.

3.2 The policy development process for the MRRT and expanded PRRT was characterised by exclusive and secretive negotiations by the government with a small, select group of large multi-national, multi-commodity and multi-project mining companies. All the competitors of the big three miners were excluded from the process. The government also excluded the states and territories from the 'mining tax design process' despite the serious encroachment into the own-source revenue sphere of state and territory governments. The exclusion of state and territory governments was in direct breach of the explicit recommendations made by the Henry Tax Review, which had advised the government to negotiate the implications of a resources rent tax with state and territory governments.[1]

3.3 Not only was the mining industry (with the exception of the big three), excluded from the mining tax negotiations, they were also refused access by the Gillard Government to key information about the workings and implications of the proposed MRRT and expanded PRRT. To this day the government has refused to make public the mining tax revenue assumptions it has used. Given both the Western Australia and Queensland government publish that same information in their budget papers, that ongoing lack of transparency appears unacceptable. Particularly in the context of a requirement imposed by the government that any changes which may flow from subsequent processes either through the Policy Transition Group or in the context of the current 'draft exposure draft legislation' have to be revenue neutral.

3.4 Repeated calls by mining industry peak bodies like the Association of Mining and Exploration Companies and business groups for a more inclusive consultative process were ignored:

> Industry is extremely disappointed that the first opportunity it will have to formally comment on the MRRT is over a period of just one month. The

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1 Recommendation 48 of the Henry Tax Review explicitly stated: 'The Australian and State governments should negotiate an appropriate allocation of the revenues and risks from the resource rent tax'. Source: *Australia's Future Tax System – Report to the Treasurer*, December 2009, Part One, Recommendation 48, p. 89.

> Government has also ignored industry concerns by directing the PTG to consult solely on MRRT design and implementation rather than on the merits of the tax itself. There has been little debate on the merits of rent taxes and their suitability to mining.[2]
>
> ...the PTG's consultation timetable and the reporting timeframe back to government will provide to be quite challenging and therefore will present some risks to the thoroughness of the policy development process... the [Institute of Chartered Accountants in Australia] urges the PTG to consider carefully whether an extended reporting timeframe back to government is necessary in light of the circumstances, and if so, to alert the government and external stakeholders to this as soon as possible. Clearly, it is in the national interest to ensure we all get this new regime right, first time around.[3]

3.5 To this day state and territory governments continue to be ignored by the Gillard Government when requesting information about the interaction between the proposed MRRT, State and Territory royalties and GST sharing arrangements. Repeated correspondence from the Western Australian Government for example over a period of a whole year remained unanswered:

> Senator CORMANN: …in the statement that Mr Ray has just made, you listed a series of pieces of correspondence from the state governments to the Commonwealth, but you haven't listed any responses from the Commonwealth to the state governments in response to those letters.
>
> Mr Ray: There are none on our files. I say that carefully because one of the pieces of correspondence that is on our files is a letter to the Prime Minister. We do not know whether the Prime Minister replied to that letter.
>
> Senator CORMANN: Sure, but successive correspondence from the state government at a Treasury level—that is, from WA Treasurer Buswell on 18 March [2010], from the Under Treasurer on 11 May [2010], from the Under Treasurer again on 16 November [2010]. Treasury or the federal government has not responded to one of those letters—
>
> Mr Ray: Correct.
>
> Senator CORMANN: which raise serious concerns about the impact of the mining tax on royalty arrangements and the interaction with GST sharing arrangements. You said 'correct' before.
>
> Mr Ray: It is correct that there is no reply to those pieces of correspondence. That is correct.[4]

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2 Chamber of Commerce and Industry Western Australia, *Submission to the Policy Transition Group*, October 2010, p. 5.

3 Institute of Chartered Accountants in Australia, *Submission to the Policy Transition Group*, 28 October 2010, p. 4.

4 Senator Mathias Cormann and Mr Nigel Ray, Executive Director, Department of the Treasury, *Estimates transcript of evidence*, 1 June 2011, p. 9.

3.6 The discussion continued:

> Senator CORMANN:... .There are five letters from the state government in Western Australia—18 March, 11 May, 16 November, the letter from the Treasurer on 18 May 2011 and there was a submission to the PTG. Not one of them has been responded to by the Commonwealth government. Yet the Queensland Treasurer wrote a letter on 9 February, which was received on the 11th, and within less than a week he gets a response from the Commonwealth. Why, with respect to the letters that were addressed to Treasury by the Under Treasurer from WA, did Treasury not once respond to any of those letters where the state government of Western Australia raised serious concerns about the implications of the mining tax for royalty arrangements and the introduction of GST sharing arrangements? Why is there not one single response to one of those letters?
>
> Mr Ray: Because, Senator, we did not think we were in a position to reply.
>
> Senator CORMANN: Because you did not think you were in a position to reply? Why is that?
>
> Mr Ray: Because those letters were seeking assurances that we could not give.
>
> Senator CORMANN: It was actually not seeking assurances; it was seeking confirmation of assurances that, according to the state government, had been given before.[5]

3.7 The committee is disappointed that in pressing ahead first with the RSPT and then the MRRT and expanded PRRT the Rudd/Gillard Governments both missed the opportunity to pursue genuine tax reform through an open, transparent and inclusive process.

3.8 Both the consultation processes around the RSPT (where it was non-existent), as well as for the MRRT and expanded PRRT were deeply flawed. This inevitably led to a deeply flawed mining tax design. Where the government had promised a simpler, fairer tax system as a result of the Henry Tax Review the new proposed mining tax arrangements would be more complex and less fair. The tax designed by the government with the big three miners is not competitively neutral and does not adequately take the implications for State and Territory governments own-source revenue into account.

3.9 The final MRRT/expanded PRRT design is far removed from the original policy intentions promoted by the Henry Tax Review when recommending its resource rent tax proposal. The key objective promoted by the Henry Tax Review was to remove the supposed distortions from royalties on production for investment and production decisions. Under the Gillard Government's version of the resources rent tax all iron ore and coal projects would continue to pay royalties. Only those projects

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5 Senator Mathias Cormann and Mr Nigel Ray, Executive Director, Department of the Treasury, *Estimates Transcript of Evidence*, 1 June 2011, p. 40.

that are liable to pay more MRRT than royalties paid would ultimately get a full refund. Those projects not subject to the MRRT/expanded PRRT (which presumably are those exposed to 'distortions in investment and production decisions' talked about by the Henry Tax Review) will not have those royalties refunded. Those projects in the so-called 'decline phase' will never get a royalty refund. Yet all those projects would now have to go through the additional compliance and administrative burdens of having to prove that they remain outside the scope of the MRRT/expanded PRRT.

3.10 The government's failed taxation reform efforts resulted directly from the government's flawed response to the Henry tax review. In effect, failure was "baked in the cake". The government failed to consult appropriately with a wide range of stakeholders (including state and territory governments), the government underestimated the complexities of running a resource rent tax and royalty system in parallel, the government sidelined Treasury officials during the negotiations with BHP Billiton, Rio Tinto and Xstrata, the government refused to release key assumptions, the government demonstrated a lack of good faith by presenting much of the details of the tax as a "fait accompli" and the government's modifications to create the MRRT and expanded PRRT was "policy by deal" rather than policy developed through extensive consultation and detailed consideration. In doing so, the government completely defied its own best practice regulation guidelines with predictable results.

3.11 This chapter charts the flawed taxation development process before chapters 4 and 5 consider the impact of these poorly designed taxes on investment and jobs in the mining industry and on states like Western Australia, Queensland and New South Wales where most of the MRRT/expanded PRRT revenue will come from.

The government's initial consultation process and response for the RSPT

3.12 The Henry Tax Review was to investigate options to reduce complexity and compliance costs and deliver recommendations to improve the tax system. In relation to resource taxation (recommendations 45 to 50) the Henry Tax Review panel recommended that the current resource charging arrangements be 'replaced' by a uniform resource rent tax imposed and administered by the Australian Government[6] and that the Commonwealth negotiate with the state and territory governments an appropriate allocation of the revenues and risks from the resource rent tax.[7]

3.13 The Henry Tax Review concluded that:

> Australia has too many taxes and too many complicated ways of delivering multiple policy objectives through the tax system. The capacity of the legislative and operating platforms of these systems, and their human users, to deal with the resulting complexity has been overreached. To a large

6 *Australia's Future Tax System – Report to the Treasurer*, December 2009, Part One, Recommendation 45, p. 89.

7 *Australia's Future Tax System – Report to the Treasurer*, December 2009, Part One, Recommendation 48, p. 89.

> extent this is a reflection of a compartmentalised and incremental approach to tax policy that has been weighted toward achieving finely calibrated equity and efficiency outcomes at the expense of simplicity. Around 90 per cent of Australian tax revenue is raised through only 10 out of some 125 different taxes that are currently levied on businesses and individuals.[8]

3.14 The government's response to the Henry Tax Review released on 2 May 2010 ignored that finding. It proposed another new tax (number 126) – the RSPT[9] – without replacing any of the other 125 taxes (or royalties). The government's proposed MRRT and expanded PRRT proposes two new taxes (126 and 127) without replacing any other tax (or royalty).[10] The 'compartmentalised and incremental approach to tax policy' criticised by the Henry Tax Review is clearly continuing.

3.15 Instead of releasing the Henry Tax Review Report and its recommendations for public consideration and debate, the government announced its response, including the proposal for a new national tax on mining at the same time as making the report publicly available for the first time.

3.16 The RSPT was designed by the government in secret and announced without any prior proper consultation either with business stakeholders or with state and territory governments. Although the RSPT was based on the model recommended in the Henry Tax Review it is substantially different in important parts. After having promoted the merits of the RSPT aggressively the government abandoned it less than two months after having first proposed it.

The states and the RSPT

3.17 The interaction between the various national mining tax proposals and state and territory royalties has previously been subject to detailed consideration, especially in the Senate Select Committee on Fuel and Energy Committee Report: *The mining tax: Still bad for the economy – still bad for jobs*. Below is a relevant extract covering the key points about the way in which the Commonwealth approached the implications of the proposed new tax for state and territory royalty arrangements.

3.18 The Senate Select Committee on Fuel and Energy inquired into the level of consultation which took place during the development of the RSPT and the MRRT and expanded MRRT. The Department of the Treasury confirmed during that inquiry that the original resource rent tax proposal by the Henry Tax Review was designed to 'replace' state royalties, which neither the RSPT nor the MRRT/expanded PRRT does:

> Dr Henry...when the royalties are removed and replaced with an RSPT one would expect not a reduction in investment but actually an increase in

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8 *Australia's future tax system – Report to the Treasurer*, December 2009, p11.

9 The Hon. Kevin Rudd MP, Prime Minister, the Hon. Wayne Swan MP, Treasurer, *Stronger, fairer, Simpler: A tax plan for our future*, Media Release, 2 May 2010.

10 *Mineral Resource Rent Tax Heads of Agreement*

> investment and an increase in mining activity in Australia. That is why all the modelling shows that by removing royalties and introducing this profits based tax, mining investment would be expected to increase, not to fall.[11]

3.17 While the Senate Select Committee on Fuel and Energy inquired into the matter of state and territory royalties being replaced, this committee also considered the matter:

> CHAIR—Dr Henry, I had a close look through your review document again. Chapter 6, 'Land and resource taxes', under 6.1, 'Charging for non-renewable resources', talks about how current charging arrangements distort investment and production decisions, thereby lowering the community's return from its resource—hence your recommendation. It is fair to say that your recommendation was for the national resource rent tax to replace state royalties completely. That is right, isn't it?
>
> Dr Henry—Yes, that is correct.
>
> CHAIR—And under the RSPT the distorting effects of royalties were effectively removed because they were completely refunded—is that right?
>
> Dr Henry—That is correct.
>
> CHAIR—But under the MRRT they are not, are they?
>
> Dr Henry—No, clearly they are not.
>
> CHAIR—So the distorting elements of state royalties, to the extent that they exist, have not been removed, have they?
>
> Dr Henry—To the extent that there is not a full credit provided for those royalties under the MRRT, the royalties would be impacting on investment decisions.
>
> CHAIR—Would be impacting on investment decisions?
>
> Dr Henry—I would expect so, yes.
>
> CHAIR—And, potentially, production decisions too, wouldn't they?
>
> Dr Henry—Indeed.
>
> CHAIR—Smaller projects that are not yet subject to the MRRT would continue to pay royalties?
>
> Dr Henry—That is correct.[12]

3.19 The Western Australian Government, sought assurances from the federal government concerning the interaction between the proposed resource rent taxes with

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11 Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 27 May 2010, p. 16.

12 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes, Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p.9

both the state and territory royalties and GST sharing arrangements. Their inquiries however, remain unanswered.

> Senator CORMANN: ...Treasury tabled this morning a whole series of letters. There are five letters from the state government in Western Australia—18 March, 11 May, 16 November, the letter from the Treasurer on 18 May 2011 and there was a submission to the PTG. Not one of them has been responded to by the Commonwealth government …. Why, with respect to the letters that were addressed to Treasury by the Under Treasurer from WA, did Treasury not once respond to any of those letters where the state government of Western Australia raised serious concerns about the implications of the mining tax for royalty arrangements and the implications for GST sharing arrangements? Why is there not one single response to one of those letters?
>
> Mr Ray: Because, Senator, we did not think we were in a position to reply.
>
> Senator CORMANN: Because you did not think you were in a position to reply? Why is that?
>
> Mr Ray: Because those letters were seeking assurances that we could not give.
>
> Senator CORMANN: It was actually not seeking assurances; it was seeking confirmation of assurances that, according to the state government, had been given before.[13]

3.20 The Senate Select Committee on Fuel and Energy noted that the Secretary to the Treasury, Dr Henry, had made it quite clear that the RSPT was designed to replace state royalties, if not immediately, 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.

3.21 The Senate Select Committee on Fuel and Energy, and later inquiries through this committee as well as through Senate Estimates heard repeated concerns from the Western Australian Department of Treasury and others about the lack of consultation on the RSPT or its successor the MRRT/expanded PRRT, including in relation to the possible future abolition of state royalties:

> CHAIR—Did the Australian Treasury contact you before the release of the super profits 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.

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13 Senator Mathias Cormann and Mr Nigel Ray, Executive Director, Department of the Treasury, *Estimates transcript of evidence*, 1 June 2011, p. 40.

> CHAIR—The original proposal was for the resource super profits 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.[14]

3.22 The recommendations of the Henry Tax Review to replace state and territory royalties with a resource rent tax and consult with the states and territories have been consistently ignored as have requests from state governments seeking assurances about how the proposed taxes will affect their own source revenue.

3.23 The Senate Select Committee on Fuel and Energy heard evidence from the Western Australian Department of Treasury and Finance 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.[15]

Secret and exclusive: the MRRT and expanded PRRT development process

3.24 Following considerable opposition to the RSPT, the newly appointed Prime Minister Julia Gillard announced there would be changes to the tax after the government had negotiated a deal – exclusively and in secret – with three of the mining industry's biggest players.

3.25 On 2 July 2010, the Prime Minister announced that the government would remove its proposed resource rent tax from all mineral resources other than iron ore, coal, oil and gas. The RSPT was replaced by the MRRT which would apply to profits on iron ore and coal production. The Prime Minister also announced the extension of the current PRRT to all Australian onshore and offshore oil and gas projects, including the North West Shelf gas project.

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

15 Senate Select Committee on Fuel and Energy, *The mining tax: Still bad for the economy – still bad for jobs*, Second interim report, July 2010, pp. 28 – 33.

3.26 The Prime Minister asserted that the agreement was 'the result of intense consultation and negotiation' and that these changes recognised the views of 'the' mining industry in relation to the treatment of new investments.[16]

3.27 In this phase of the process the government consulted with BHP Billiton, Rio Tinto and Xstrata. It did not include any of the other mining companies impacted by the proposed new tax, nor any industry representative bodies, or any of the states and territories in the process. Given the importance of mining-based revenue for states like Western Australia, Queensland, New South Wales and the Northern Territory in particular it seems extraordinary that the government did not at least offer the same access to contribute to the ultimate design of the tax to those states and territories as it did to the three biggest mining companies.

3.28 The completely inadequate nature of the consultation process in developing the MRRT and expanded PRRT was raised during submissions to the inquiry and at public hearings.

Nature and extent of industry consultation

3.29 Although the government has consistently contended that they did undertake consultation with 'the' mining industry, the facts are that 99 per cent of the mining industry was excluded from the process. Around 320 mining companies will be impacted by the MRRT and only three were given the opportunity to contribute to the revised design of the mining tax.

3.30 It is notable that even the three big miners themselves urged the government to consult more widely:

> CHAIR—...I understand that BHP Billiton acted, as you must, in the best interests of your shareholders. But there is of course a different test for governments, which is to act in the public interest. The government sat down with essentially three taxpayers and designed a tax with broader application beyond those three taxpayers, behind closed doors, with all other stakeholders and the public at large excluded. It was not a very open and transparent process, was it?
>
> Mr Bond—The conversations that we participated in were at the invitation of government. As taxpayers and industry participants, if invited to participate in those conversations, we naturally went. Prior to entering those discussions, during those discussions and after those discussions, we did

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16 The Hon Julia Gillard MP, Prime Minister, the Hon. Wayne Swan MP, Deputy Prime Minister and Treasurer and the Hon Martin Ferguson AM MP, Minister for Resources and Energy, *Breakthrough agreement with industry on improvements to resources taxation*, Media Release, 2 July 20101, pp.1, 3.

urge the government to engage more broadly with other affected industry participants.[17]

3.31 Miners and stakeholders excluded by the government from the consultation process such as the Association of Mineral Exploration Companies, expressed clear frustration with the government's lack of consultation:

> Going to the Henry tax review and tax reform in general, we have been very disappointed with both the outcome of that review and the government's approach to tax reform...the lack of consultation with industry has been a very serious concern for us. We think there are still some very serious flaws in the proposed MRRT.[18]
>
> We are very disappointed in the lack of consultation that has occurred leading into the introduction of the MRRT in July. That probably sticks in our throat as much as anything else in the context of a lack of involvement by the government with industry and essentially doing a deal with three large multinationals at the expense of not only our membership but others as well.[19]

3.32 Witnesses before the committee's inquiry were generally critical of the government's approach to negotiating the proposed tax with the mining industry's three largest miners exclusively and in secret:

> CHAIR—Let me ask you a more general question then. Do you think it is appropriate for a government to negotiate the design of a tax with three taxpayers with a particular perspective and exclude everybody else that has a separate interest in the same industry?
>
> Dr Manning—No.
>
> Mr Armstrong—No. I would concur. You need to have consultation and look at all the implications of what you are doing with all the players. I would say that is a general policy.
>
> CHAIR—Should there have been a discussion paper and consultation giving everybody an opportunity to—
>
> Mr Armstrong—Yes. It would be ideal, I would think, to canvass opinions.
>
> ...

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17 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Gerard Bond, Head of Group Human Resources, BHP Billiton, *Committee Hansard*, 8 December 2010, p. 6.

18 Mr Simon Bennison, Chief Executive Officer, Association of Mineral and Exploration Companies, *Committee Hansard*, Monday 8 November 2010, p. 2.

19 Mr Simon Bennison, Chief Executive Officer, Association of Mineral and Exploration Companies, *Committee Hansard*, Monday 8 November 2010, p. 3.

> Mr Armstrong—One of the fears about the political process is that it has become too 'insider'.[20]

3.33 There were concerns that the Heads of Agreement with the three miners chosen to participate in the government's exclusive negotiations would have detrimental effects on those excluded from that process. In terms of a specific example:

> CHAIR—Obviously you are understandably aggrieved that the government negotiated in secret with some of your competitors. You have mentioned the issue of infrastructure. Can you give us the areas where the design of the new MRRT favours your competitors compared to the business structure or business model that you have in place?
>
> ...
>
> Mr Pearce—The design of the tax is biased in favour of BHP and Rio in particular—given that they are our major competitors in the iron ore industry in a number of ways—in terms of both design and the combination of elements of the design. The main points are around the application of the mining rights value versus the principles involved in historical cost; the low value they appear to be arguing should be placed on infrastructure, where they are likening it to a railroad in central Melbourne as opposed to high-risk infrastructure linking a port to a mine; the way 'projects' looks as if it is being defined through the consultative panel; and the transferability rules. It is the combination of those particular factors that tends to favour companies with established mines and infrastructure and clusters of mines that help to de-risk that infrastructure in remote locations. The definitional aspects of 'projects' seem to be biased towards BHP and Rio. There is the issue of possible treatment of black-hole expenditure, which is particularly relevant for companies that are trying to develop but may not meet the definition of a project at this point in time... There is also the cost of compliance. The cost of compliance for this thing, per tonne, for the smaller players is going to be horrendous compared to the per-tonne cost of compliance for the larger companies.[21]

3.34 Even though they had received exclusive preferential treatment by the government, BHP Billiton and Rio Tinto remained concerned about the government's approach to industry consultation:

> CHAIR—...BHP Billiton was very critical of the lack of proper process...with no consultation or testing of the design features, of the original resource super profits tax, so-called. Do you think the process

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20 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Graham Armstrong, Senior Associate, Dr Ian Manning, Deputy Executive Director, National Institute of Economic and Industry Research, *Committee Hansard*, 19 November 2010, pp. 23 – 24.

21 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Stephen Pearce, Chief Financial Office, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 22.

which led to the development of the MRRT and the expanded PRRT was a good public policy development process?

Mr Bond—I think it is fair to say that the whole experience and the formulation of the tax would not go down as world's best practice on policy development. The only comment we would make is that the MRRT that resulted from the discussions we had and the government's thinking based on the feedback it got is a better tax than the RSPT.[22]

CHAIR—...Do you think the process which led to the development of the minerals resource rent tax was a good public policy development process?

Mr O'Neill—I am happy to say that it was not ideal. We view the entire process, if you like, from the report of the Henry review in late 2009 through to the announcement of the MRRT, as being effectively part of an overall process that was entered into. It is no secret that we do not regard much of that as being an ideal public policy process.

CHAIR—What would have been an ideal public policy development process?

Mr O'Neill—I think Mr Bond from BHP in evidence just given reflected on the process that was undertaken in relation to the petroleum resource rent tax in the 80s where you had a long period of policy being flagged, a long period of public consultation. You had numerous discussion papers and, presumably, hundreds if not thousands of meetings leading to that particular reform. That is a reasonable yardstick I think of the sort of public policy process that we would have preferred had led to where we are today.[23]

The Government's failure to implement best-practice regulation principles

3.35 The government's failure to consult widely with affected stakeholders was a direct breach of their own best-practice regulation guidelines. The Office of Best Practice Regulation released updated best-practice regulation guidelines in June 2010. These guidelines outline how government should develop Regulatory Impact Statements (RIS) to help them evaluate all of the potential options for tackling a particular policy issue.

3.36 Although these guidelines apply to the development of a broad range of regulations, it is clear that they are meant to apply to new taxes as well.

Do the RIS requirements apply to changes in taxation?

Yes – a RIS is required for all regulatory decisions, including changes in taxation, likely to have any impact (whether positive or negative) on

22 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Gerard Bond, Head of Group Human Resources, BHP Billiton, *Committee Hansard*, 8 December 2010, p. 6.

23 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Mark O'Neill, Chief Adviser Taxation, Rio Tinto, *Committee Hansard*, 8 December 2010, p. 38.

> business or the not-for-profit sector unless the impact is of a minor or machinery nature or, in the case of taxation, purely revenue in nature. [24]

3.37 The best-practice guidelines contain an appendix on best practice consultation principles. These guidelines state that:

> RISs are required to demonstrate that consultation commensurate with the magnitude of the problem and the size of the potential impact of the proposal has been undertaken.[25]

3.38 The Guidelines stress that consultation should be a continuous process which is undertaken at all stages of the policy development process:

> Meaningful consultation with key stakeholders should be continuous and should start as early as possible. Consultation should continue through all stages of the regulatory cycle, including when detailed design features are being finalised. This will assist in identifying and understanding potential problems and in designing and implementing better regulation.[26]

3.39 The Guidelines further stress the importance of consultation with other governments:

> Relevant state, territory and local governments, and Australian Government agencies, should be consulted to ensure that regulatory policies across jurisdictions are consistent and complementary. In order to produce efficient regulation, it is necessary to avoid or minimise duplicating legislative requirements across agencies and government at all levels. This is particularly important where the regulatory processes arise from negotiations between different levels of government and/or involve overlapping responsibilities.[27]

3.40 Given that the government failed to undertake any consultation before the announcement of the RSPT, it is clear that the government failed to comply with these principles. The exclusive and secretive negotiation between the government and the three largest mining companies before announcing the MRRT and expanded PRRT is also a clear breach of these guidelines, as the government failed to involve all stakeholders, including state and territory governments.

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24 Australian Government, 2010, *Best Practice Regulation Handbook*, p.26, http://www.finance.gov.au/obpr/proposal/handbook/docs/Best-Practice-Regulation-Handbook.pdf (access on 20 June 2011)

25 Australian Government, 2010, *Best Practice Regulation Handbook*, p.51, http://www.finance.gov.au/obpr/proposal/handbook/docs/Best-Practice-Regulation-Handbook.pdf (access on 20 June 2011)

26 Australian Government, 2010, *Best Practice Regulation Handbook*, p.51, http://www.finance.gov.au/obpr/proposal/handbook/docs/Best-Practice-Regulation-Handbook.pdf (access on 20 June 2011)

27 Australian Government, 2010, *Best Practice Regulation Handbook*, p.52, http://www.finance.gov.au/obpr/proposal/handbook/docs/Best-Practice-Regulation-Handbook.pdf (access on 20 June 2011)

The Treasury and the development of the MRRT and expanded PRRT

3.41 The negotiations between the government, BHP Billiton, Rio Tinto and Xstrata were the mechanism by which the new MRRT and expanded PRRT were developed. As outlined above, a cross-section of industry players expressed concern about the lack of broader stakeholder involvement.

3.42 The role of the Treasury as an adviser to the government during these negotiations has also arisen during this inquiry.

> CHAIR—Who was in the room during the discussions?
>
> ...
>
> Mr Bond—During the discussions there was the Deputy Prime Minister and Treasurer, Mr Swan; the resources and energy minister, Mr Ferguson; their chiefs of staff, Mr Barrett and Ms Winters; and a senior advisor to the Prime Minister, Mr Bentley.
>
> CHAIR—Were there any Treasury officials in the room at any stage of the process? Any public servants?
>
> Mr Bond—Not in those particular discussions, but through the period of time we did meet with Treasury, as I articulated in the opening address.
>
> CHAIR—Sure. But in the discussions you had with the Deputy Prime Minister and the Minister for Resources and Energy, there were no public servants present?
>
> Mr Bond—Not in those ones, no.
>
> CHAIR—... So it was essentially the ministers and their private staff. At the end of the process, before the announcement that you signed the deal [HoA], who was involved at that time? You signed the heads of agreement.... At the end of the process when you signed the heads of agreement, who was involved then?
>
> Mr Bond—The secretaries were obviously involved in the signing of the document and the signatories. Is that the question you are asking?
>
> CHAIR—Who was in the room when you signed the deal?
>
> Mr Bond—The same people. There was no difference.
>
> CHAIR—The Prime Minister was not in the original—
>
> Mr Bond—The Prime Minister was not in the room, no.
>
> CHAIR—But she was in the room to sign the heads of agreement?
>
> Mr Bond—She signed the document, yes.
>
> CHAIR—So was she in the room when that happened? She signed it at another location?
>
> Mr Bond—It was in the same office. I think it was next door.
>
> CHAIR—But she was not actually in the room with you?
>
> Mr Bond—Correct.

> CHAIR—So the three people that signed the heads of agreement for the government were the Prime Minister, the Deputy Prime Minister and the Minister for Resources and Energy?
>
> Mr Bond—Yes.[28]

3.43 The Department of the Treasury had no direct involvement in negotiations between government ministers and those big three mining companies. The following exchange between the chair and Dr Ken Henry, then Secretary of the Treasury, outlines the limited involvement of Treasury during the negotiations between the government, BHP Billiton, Rio Tinto and Xstrata:

> CHAIR—Just going back to the level of Treasury involvement in the negotiation between the government and BHP, Rio and Xstrata, can you describe for us again in detail what level of involvement Treasury officials did have in those negotiations?
>
> Dr Henry—I cannot add much to what I said last week, which is that we were involved very heavily in the quantification of proposals and beyond that we were involved in a quality assurance or due diligence role in providing advice to government in respect of propositions that the companies were advancing.
>
> CHAIR—So you were not personally present for any of the sessions of the negotiations?
>
> Dr Henry—That is certainly true.
>
> CHAIR—Who was the most senior Treasury official directly involved in the negotiations between the government and BHP, Rio and Xstrata?
>
> Dr Henry—As I have indicated, there was no Treasury official...directly involved in the negotiations as such. There were Treasury officials who were, during that time, having discussions with senior executives of those companies about numbers and design issues.
>
> CHAIR—So those Treasury officials were waiting in the Treasurer's office and somebody would come in and out of the negotiations with BHP, Rio and—
>
> Dr Henry—No. I would have to check, but I think that most—and maybe all—of those consultations occurred during that period by phone. I think the Treasury officials, on all occasions—I would need to check—would have been in the Treasury building.
>
> CHAIR—So the way it would have worked was that the Treasurer and Minister Ferguson were having negotiations with BHP, Rio and Xstrata and then somebody would walk out, pick up the phone and talk to a Treasury official and say, 'They have just told us this. Is this right? We have just agreed to do that. What does that mean?' Is that the way it worked?

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28 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Gerard Bond, Head of Group Human Resources, BHP Billiton, *Committee Hansard*, 8 December 2010, pp. 8-9.

Dr Henry—That is a relatively accurate characterisation of it.[29]

3.44 The Government's principal economic advisor, the Department of the Treasury, the Prime Minister's own Department, as well as all the states and territories and around 2500 mining companies were sidelined from the process which led to the design of the MRRT and expanded PRRT. It was a secret, non-transparent and exclusive process involving two Ministers, the Prime Minister and three companies:

> 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.
>
> 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.[30]

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

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29 Senator Mathias Cormann, Chair, Senate Select Committee on Fuel and Energy, and Dr Ken Henry, Secretary, Department of the Treasury, Fuel and Energy *Committee Hansard*, 13 July 2010, pp. 52–53.

30 Senator Mathias Cormann and Mr Dominic English, First Assistant Secretary, Economic Division, Department of the Prime Minister and Cabinet, Hansard, *Estimates transcript of evidence*, 23 May 201, p. 71.

3.46 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 along with the Minister for Resources' then Chief of Staff, Tracey Winters. The next day, on 1 July, Mr Barrett emailed David Parker who was at the time the Treasury Executive Director for the Revenue Group along with another senior Treasury officer and 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[31]

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

> Gerard,
>
> Final, clean version for your signature. Please let me know if any issues at your end.
>
> Regards,
>
> Chris[32]

3.48 It seems highly unusual and inappropriate that one taxpayer, BHP Billiton, was given the extraordinary opportunity to draft this mining tax peace deal after a process from which all its competitors (other than Rio Tinto and Xstrata) had been excluded by the government. To top it all off the immediate past chairman of that same taxpayer who drafted the deal was then appointed by the government as the co-chair of the new mining tax implementation committee soon re-named the 'Policy Transition Group'.

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31 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)

32 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)

The Implementation Committee – renamed 'Policy Transition Group'

3.49 The Heads of Agreement on the MRRT and expanded PRRT announced on 2 July 2010 provided for an Implementation Committee which was to be:

> **Implementation Committee**
>
> A mutually acceptable Committee comprising credible, respected industry leaders will oversee the development of more detailed technical design to ensure the agreed design principles become effective legislation. This will have the objective of ensuring the agreed principles are effected in line with their intent in a commercial, practical manner.[33]

3.50 The government renamed the 'Implementation Committee' the 'Policy Transition Group' (PTG) and announced immediate past Chairman of BHP Billiton Don Argus and Resources Minister Martin Ferguson as its co-chairs.

3.51 Mr Argus had stepped down as Chairman of BHP Billiton about three months before the mining tax deal was signed. By that time he had been at the company in that role for around a decade.

3.52 The PTG was given the task to 'consult' with industry. However its task was severely constrained by both the brief it was given through the Heads of Agreement and by the government in subsequent announcements.

3.53 In its terms of reference the Policy Transition Group was directed by government to:

> ...advise the Australian Government in the development of the technical design of the [MRRT] and transition of existing petroleum projects to the [PRRT] regime as announced by the Government on 2 July 2010.[34]

3.54 In providing this advice, the PTG was directed to:

> ...ensure the new tax arrangements are implemented as efficiently and consistent with the design principles as possible... [and] be consistent with the Government's fiscal strategy as stated in the 2010-11 Budget.[35]

3.55 It is notable that in directing the PTG to ensure that their advice was consistent with the government's 2010-11 budget commitments, the government mandated that:

> Any policy deviation from the Government's announcement of 2 July 2010 is to be fully offset within the recommendations in terms of impacts on revenue or costs.[36]

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33 *Mineral Resources Rent Tax Heads of Agreement*, p.2.

34 Policy Transition Group, *Terms of Reference*, p. 1.

35 Policy Transition Group, *Terms of Reference*, p. 1.

36 Policy Transition Group, *Terms of Reference*, pp 1-2.

3.56 Given that the terms of reference of the PTG were limited to working out the practicalities of implementing the fundamental design features of the tax rather than examining the suitability of those design features it is little wonder that stakeholders expressed frustration and concern that the PTG process was inadequate:

> 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. And I do not think the burden or the onus should have been put on the PTG to actually come out with revenue neutrality...that is something that should be tasked to the Treasury...it seems an unrealistic expectation...[37]
>
> CHAIR—...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.[38]

3.57 Given the government has refused to release its mining tax revenue assumptions it is pretty hard to see how contributors to the PTG process could be expected to make 'revenue neutral' recommendations.

3.58 The PTG provided two reports to the government on 21 December 2010, the first making 94 recommendations regarding the technical design of the MRRT and the expanded PRRT. The second report made four recommendations on mineral and petroleum exploration.

3.59 In compiling its reports to government, the PTG considered feedback from industry and other stakeholders provided during consultations across Australia as well as through 88 written submissions.[39] On 24 March 2011 the government announced it had accepted all 94 recommendations of the PTG. The exposure draft of the legislation has only recently been released for public consultation.[40]

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37 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.

38 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, p. 6.

39 http://www.futuretax.gov.au/pages/resourcetax_PTG_conslt.aspx (accessed, 20 April 2011)

40 http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2070

3.60 Despite assurances that consultation had occurred, the majority of witnesses who gave evidence to the committee were highly critical of the PTG's approach. They maintained that the government's consultation process had been completely inadequate. The establishment of the PTG to implement a mining tax deal negotiated exclusively and in secret with the three biggest mining companies did nothing to allay their concerns.

3.61 Concerns remained about the overall policy development approach. The Chief Executive Officer, Mr Andrew said:

> The consultation process which has been carried forward for the mining industry—particularly iron ore and coal, which this tax discriminates against—is no more than the sham of the original Treasury discussions. There was no change at all in terms of reference, there was no change in how much money the tax would raise and there was no change in what was allowed to be discussed.[41]

3.62 The committee approached the Co-Chairman of the PTG, Mr Don Argus, to participate in this Inquiry to provide his perspective and expertise. The first approach was made by email on 31 December 2010 and other further attempts followed on 2 February 2011 and 8 March 2011. On 19 May, 2011 a further invitation was extended for Mr Argus to attend and on 25 May 2011 Mr Argus again declined to appear. The committee is very disappointed that Mr Argus did not see fit to assist the committee with its inquiries. The committee had a series of questions for Mr Argus which remain unresolved. Given his important role in assisting the government with the implementation of its revised mining tax proposals and his association with one of the three companies involved in the mining tax negotiation until shortly before the mining tax deal was concluded, his evidence on these matters was – in the committee's view – in the public interest. In these circumstances the committee considers it to be very unfortunate and regrets that Mr Argus has declined these opportunities to assist the committee with its inquiries and to help it in the preparation of this report.

The Resource Tax Implementation Group

3.63 On 24 March 2011 the government announced the establishment of the Resource Tax Implementation Group (RTIG) to support the legislative design process.

3.64 The purpose of the RTIG is to enable ongoing industry engagement and respond to the PTG’s recommendation that an implementation group should support the legislative design process.

3.65 The RTIG, comprising representatives of industry and the tax profession as well as government officials, is supposed to ensure close consultation with the

41 Mr Andrew Forrest, Chief Executive Officer, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 19.

resource sector during drafting of the legislation and as legislation is prepared for introduction into the Commonwealth Parliament.

3.66 The committee will follow the work of the RTIG with interest.

General comments on the policy development process

3.67 The chronology and outline of submissions and evidence from hearings as presented above should also be considered in the context of a participant not directly involved in the consultation process itself.

3.68 Professor Ross Garnaut, a pre-eminent economic advisor to this government, was particularly critical of the government's approach to the development of the government's mining tax proposals:

> It is best I be straightforward. I would think that the best process—world's best practice, to which I refer there—would have been for the Henry review recommendations to have been made public and for there to have been a thorough public discussion with everyone with an interest—from a public interest point of view or a business or private interest point of view—putting views on that. I think we would have had a better discussion if it had been done in that way. Obviously, that was not done the first time and it was not done the second time.[42]

3.69 Professor Garnaut suggested that the preferred approach for the development of a complicated public policy, such as a mining tax, should involve 'widespread' public discussion:

> CHAIR—We are now in a position where we are trying to assess the merits or otherwise. We have got the policy transition group process going with very narrow terms of reference and prescriptions that it has to be revenue neutral and it has got to respect the main features of the tax. Do you think that the policy transition group process is adequate to ensure that there is a proper discussion of the merits of specific features of the tax, so it gives enough flexibility for the government to properly take on board the public interest as well as the various stakeholder interests?
>
> Prof. Garnaut—My views on policy process are well enough known for it to be no surprise for me to say that I think that a complicated public policy issue like this will be handled better if there is widespread public discussion of it. But that process that is going on now involving some consultation will not be the whole of the process. The process that you are going through is part of the process. What I would hope is that through all of the various ways in which this will be discussed we can get all of the important interests, especially public interests, properly represented in the discussion. But if all there was for us was the process as described, that would not be enough...
>
> CHAIR—So the policy transition group process on its own is not enough?

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42 Professor Ross Garnaut, *Committee Hansard*, 19 November 2010, p. 27.

> Prof. Garnaut—No, I think that the processes of this committee and of parliamentary discussion and the public discussion that could go on around whatever comes out of the transitional process are all important to good policymaking.[43]

3.70 Professor Garnaut identified the importance of hearing from a broadly representative public voice in the development of the proposed tax.

> CHAIR—...this time, of course, the government has negotiated the design of the tax with three individual companies who have got a particular business model—and these are the BHPs, Rios and Xstrata's—and they have excluded the FMGs and the iron ore ones and all of the other companies who in fact had a different business model. Can you see why those companies that were excluded from that tax design process feel aggrieved and why they think that BHP, Rio and Xstrata were given a competitive advantage?
>
> Prof. Garnaut—...I think that the public interest would be well served by a wide discussion in which the interests of particular companies are legitimate, so we can hear their voices but we need a wider public voice. And there is a very big public interest in this question; it is not just that of BHP and Fortescue and the other mining companies. So I hope that we will get enough public discussion.[44]

Transparency

3.71 Previously in this chapter, the focus was on the consultation process. In this part of the chapter the focus is on the lack of the transparency that restricted proper scrutiny of the RSPT, MRRT and expanded PRRT. That lack of transparency remains as an ongoing issue.

3.72 Based on the hearings and submissions, it is clear that the government's processes lacked openness and transparency. Rather than using the Henry Tax Review as a starting point to 'support an informed debate about future tax and transfer policy,'[45] debate has not and did not take place. In particular, there was no negotiation with State and Territory governments around the interaction between the proposed new national mining tax and state and territory royalty arrangements:

> CHAIR—You suggested in your review that the allocation of revenue and risks from the new tax should be—and I emphasise—negotiated between the Australian and state governments. That did not happen before the announcement, did it?

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43 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Ross Garnaut, *Committee Hansard*, 19 November 2010, pp. 27–28.

44 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Ross Garnaut, *Committee Hansard*, 19 November 2010, pp. 27–28.

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

> Dr Henry—There was no negotiation as such, no.
>
> CHAIR—What is the status of discussions with states and territories on royalty arrangements and interaction between the MRRT and royalties now? Is there negotiation around that with state and territory governments? Have they impacted on it?
>
> Dr Henry—I am not aware of any negotiations as such on those matters. That is not to say that there have not been discussions, but I am not aware of any.[46]

3.73 The committee is of the view that no genuine reform of resource taxation and royalty arrangements can take place without active engagement and ultimately agreement with state and territory governments.

3.74 Evidence received by the committee throughout the inquiry also identified that the lack of transparency around revenue estimates and key assumptions compounded concerns that stakeholders already had with the process:

> We are concerned about the lack of transparency over the revenue estimates and the key assumptions behind those estimates. We believe that the tax is centred on the revenue that would be raised rather than on a genuine commitment to tax reform, and we believe that such an approach is flawed in nature and really does represent a missed opportunity to undertake more wide-ranging and fundamental tax reform to Australia's tax system.[47]

3.75 Professor Garnaut agreed that from an openness and transparency perspective, given the importance of this issue, 'we would all benefit from wide discussion of effects on the budget and the economy, and I hope we will still get some of that'.[48]

3.76 The government's refusal to make available key modelling and forecasting assumptions about its taxes has also hampered the ability of industry participants (other than for the three directly involved in the negotiations) to model the effect that the proposed mining tax would have on their operations.

3.77 The Senate Fuel and Energy Committee heard evidence from Mr Simon Bennison, Chief Executive Officer (CEO), Association of Mining and Exploration Companies (AMEC) about the role of AMEC in the resource sector. AMEC is a national organisation. It represents mainly the mid-tier to junior production and exploration companies across Australia. It has about 140 members in this category. It also represents a vast number of the service industries to the resource sector, particularly companies that are involved in drilling and equipment supply. AMEC has

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46 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 11.

47 Mr John Nicolaou, Chief Officer, Membership and Advocacy, Chamber of Commerce and Industry of Western Australia, *Committee Hansard*, 8 November 2010, p. 78.

48 Professor Ross Garnaut, *Committee Hansard*, 19 November 2010, pp. 28–29.

over 100 member companies that fit into this category. Effectively AMEC acts as an advocacy and policy organisation for these members.[49]

3.78 Mr Mike Young, Managing Director, BC Iron Limited who appeared as part of a panel of witnesses before the Fuel and Energy committee with AMEC noted:

> Mr Young—Can I add something about the heads of agreement as I went through it and as we were modelling this. We have had to do six iterations based on the various assumptions. My assumption, cynical as it may be, is that the companies who negotiated this MOU will have only done one model because they understand the underlying assumptions of all these points and we do not.
>
> CHAIR—So they have a competitive advantage, in effect, compared to you because they would have been part of the discussions?
>
> Mr Young—Yes, absolutely. And that is part of the consultation process that I would have expected. The first time I knew that there had been an agreement with the mining industry was over my Weet-Bix watching Sky News. When you look at how many miners there are in Australia currently mining iron ore, it is BHP, Rio, Atlas, Murchison, Mount Gibson, Cleveland- Cliffs and Grange Resources. Next year there will be BC Iron and probably Gindalbie.[50]

3.79 Mr David Flanagan, Managing Director, Atlas Iron Limited, who also appeared as part of a panel of witnesses who belong to AMEC noted:

> From a compliance point of view with the ASX, we are obliged to make material disclosures to the market, just to keep the market informed. There are a number of measures on what is 'material', and one of them is if something can impact the value of your company by more than 10 per cent. So there are some companies that have an understanding of whether this is material and some companies that do not. We feel disadvantaged by that.[51]

3.80 Mr Young further noted that:

> By not being in the room, particularly with Rio Tinto and BHP, who have clearly shown that they do not wish to share their rail infrastructure and will fight tooth and nail to avoid it, a cynic might think that the deal they have

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49 Mr Simon Bennison, Chief Executive Officer, Association of Mining and Exploration Companies, *Fuel and Energy Committee Hansard*, 13 July 2010, p. 81.

50 Senator Mathias Cormann, Chair, Senate Select Committee on Fuel and Energy, and Mr Mike Young, Managing Director, BC Iron Limited on behalf of Association of Minerals and Exploration Companies, *Fuel and Energy Committee Hansard*, 13 July 2010, p. 86.

51 Mr David Flanagan, Managing Director, Atlas Iron Limited on behalf of Association of Minerals and Exploration Companies, *Fuel and Energy Committee Hansard*, 13 July 2010, p. 90.

> negotiated for themselves would be prejudicial to any of their competitors in the Pilbara.[52]

3.81 The extent to which Treasury's assumptions were commercial-in-confidence and could not be released publicly was raised during the public hearings:

> CHAIR—Okay. You mentioned that you provided the government with information. You have already said that the original information used by government was wrong.
>
> Mr Bond—No, we said the information that we saw was vastly different to that which we had on the same item. There was a difference pertaining to critical input assumptions and we simply articulated what our view was on those same assumptions.
>
> CHAIR—When you had those discussions about your views, did you provide the government with market sensitive, commercial-in-confidence information from BHP Billiton?
>
> Mr Bond—One point of clarification: we provided it to the Treasury. And, yes, the information that we did provide was market-sensitive, confidential information.
>
> CHAIR—So you did not point them to information that was publicly available in order to inform their revised assumptions?
>
> Mr Bond—In articulating what our view was on some assumptions, we certainly directed them to public sources that would give them a basis for having the view as to the approximate reasonableness of ours. For example when it comes to prices, we were able to point them to the forward curves for commodity prices and indeed exchange rates that were closer to our assumptions than theirs were.
>
> CHAIR—Let me make this absolutely clear: the information you provided to the Treasury and/or the government was information that was otherwise publicly available but relied upon by BHP or was it very specific, very secret, commercial-in-confidence information tightly held within the senior management levels of BHP Billiton?
>
> Mr Bond—It was certainly more the latter. The public information goes to inform our assumptions.
>
> CHAIR—Was information of production volumes tightly held commercial-in-confidence data or was that publicly available data?
>
> Mr Bond—The information as it pertains to volumes was very macro level; it was not specific. It was more in the nature of year-on-year change rather than bottom-up estimates. There was a difference in that rate of change period on period.
>
> CHAIR—Much of your operation in Australia is in the Western Australian market—and I see you nod. You would be aware that the Western

52 Mr Young, BC Iron Limited, Association of Minerals and Exploration Companies, *Fuel and Energy Committee Hansard*, 13 July 2010, p. 86.

Australian government publish their commodity price and production volume assumptions in their budget papers. Do you have a problem with that?

Mr Bond—We do not have a view on it. What the government chooses to do is their decision.[53]

3.82 In addition to the views of BHP Billiton, the committee also heard from Rio Tinto on the matter:

CHAIR—Have you provided the government with confidential data and market-sensitive data on your commodity price assumptions moving forward?

Mr O'Neill—There would have been a number of discussions, which were obviously in-confidence discussions, where we may have provided a view on issues that we would regard as commercial-in-confidence. **<u>We did not hand over data that would go to our own price assumptions</u>**, but we may well have discussed issues. (emphasis added)

CHAIR—…I have difficulty in accepting that any of the companies would have provided market-sensitive information to the government. The suggestion then is that you would have provided information to the government that you did not provide to the market.

Mr O'Neill—I do not believe that we would have provided information to the government that we were required to provide to the market and haven't.

CHAIR—You say that your commodity price assumptions are market sensitive. So by giving the government access to market-sensitive information, they have information not available to others. Would you have provided the government with market-sensitive information not available to others or would you have pointed them to publicly available information?

Mr O'Neill—We may at times have done both. We would certainly have pointed them towards publicly available information. But we are talking about commodity price forecasts, volume forecasts, exchange rate forecasts several years into the future.[54]

3.83 Xstrata also made a similar representation to the committee regarding the disclosure of information to the government:

CHAIR—Revenue estimates for the mining tax have bounced around quite a bit. The original RSPT was said to be $12 billion and then there were changes in commodity prices and other assumptions to facilitate the MRRT.

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53 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Gerard Bond, Head of Group Human Resources, BPH Billiton, *Committee Hansard*, 8 December 2010, pp. 17 – 18.

54 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Mark O'Neill, Chief Adviser - Government Relations, Rio Tinto, *Committee Hansard*, 8 December 2010, p. 46.

> We were told the original tax would rise to $24 billion. Did the government get it wrong with their original assumptions?
>
> Mr Freyberg—I do not know what their original assumptions were. **We pointed them in the direction of public information.** (emphasis added) At the end of the day, I cannot comment on their projections. I do not have an insight to it. It is something that Treasury does.
>
> CHAIR—So you directed them to publicly available information. You did not provide them with market sensitive commercial in confidence information?
>
> Mr Freyberg—We pointed them to public information.[55]

3.84 The companies involved in the negotiations indicate that they pointed the government to publicly available information to inform their revised commodity price and various other assumptions. Yet the government continues to refuse to release that information. It does raise the question what the government has to hide. In particular when both the Western Australia and Queensland Governments publish all that information in their budget papers as a matter of course.

3.85 The projected revenues remain highly speculative with unknown commodity price and production volume assumptions, unknown implications of State and Territory government decisions around royalties into the future and question marks over the constitutional validity of the new tax.

3.86 This lack of transparency has limited the effectiveness of the consultation processes of the Policy Transition Group. As noted above, that Group was directed to only consider changes which would be revenue neutral. It is unclear to the committee how the Group could effectively evaluate whether a change would be revenue neutral considering it did not have access to basic information about the government's assumptions in respect of commodity prices and the volume of commodity sales.

Senate Committees, the Executive and Departments

3.87 A theme running through the hearings has been the issue of a lack of transparency. This theme of a lack of transparency was also evident in the Senate Select Committee on Fuel and Energy which conducted the initial inquiry into the RSPT, MRRT and expanded PRRT.

3.88 The Senate has been engaged in the scrutiny of the RSPT, the MRRT and the expanded PRRT since the Senate Select Committee on Fuel and Energy began its inquiries into the tax on 5 July 2010. That committee's report released in July 2010, provides a detailed account of the lack of disclosure of key information to the Senate and Senate Committees by the government.

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55 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Peter Freyberg, Chief Executive Officer Xstrata Coal, *Committee Hansard*, 13 December 2010, p. 24.

3.89 After ignoring repeated requests by the Senate to provide relevant information about the MRRT and expanded PRRT for months, the Treasury eventually released much of the information sought following a Freedom of Information request by various media outlets.

3.85 On 5 July, a public hearing was held to seek information on the new MRRT and the expanded PRRT. It was attended by the then Secretary to the Treasurer, Dr Ken Henry and Treasury officials. The hearing sought information about the new taxes and their associated revenue projects.

3.90 During the hearing, 13 questions were taken on notice. These were focussed on the underlying commodity price and production assumptions, inquiries about where the revenue was expected to come from geographically and by sector. The Senate Fuel and Energy committee requested replies by 9 July 2010. The Senate was attempting to provide transparency to enable the states and territories as well as key stakeholders to more engage in the development of the MRRT and the expanded PRRT.

3.91 On 9 July 2010, the Treasury provided responses to the questions taken on notice, but not all questions were answered. As a result, the Senate Committee on Fuel and Energy invited the Treasury to appear at another hearing on 13 July 2010 and the Chair of the Committee, Senator Mathias Cormann, sought advice from the Clerk of the Senate regarding the committee's ability to obtain information.

3.92 Before the public hearing on 13 July 2010 the committee wrote to the Prime Minister to request that the Secretary to the Treasury answer questions about the new resource rent tax arrangements. No reply has ever been received to this day.

3.93 At the hearing on 13 July 2010, the Senate Committee on Fuel and Energy sought responses to the Questions on Notice that were placed at the hearing on 5 July 2010. In summary, the committee was advised that the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, would place more information into the public domain that would go to addressing questions placed on notice at the hearing on 5 July 2010.

3.94 A further series of Questions on Notice were placed by the Senate Committee on Fuel and Energy. The committee requested replies by 16 July 2010. The second interim report of the Senate Committee on Fuel and Energy noted that:

> 2.38 Despite the fact that Dr Henry suggested that the Treasurer would address 'some' of the committee's questions in his *Economic Statement July 2010*, the Treasurer really only addressed one—how much tax revenue the MRRT would raise when using the same price forecasts. Moreover, Dr Henry led the committee to believe that the government's announcement would include commodity-specific information on prices and volumes and also some region-specific data. This was not the case. Given the election has now been called, the committee will not be able to pursue further

> whether that has been as a result of deletions in the report imposed by the government.[56]

3.95 With the calling of the 2010 Commonwealth Election, the Questions on Notice issued by the Select Senate Committee on Fuel and Energy lapsed. With the creation of the Senate Select Committee on the Scrutiny of New Taxes, the issue of the government's refusal to release data and costings underpinning the MRRT and expanded PRRT was pursued again.

3.96 The government's unwillingness to release costings and assumptions extended to requests of this committee. When this matter was initially raised with them, the Treasury were unable to provide a comprehensive reason for their failure to provide the requested information although they were able to confirm that the modelling had been completed.

> CHAIR—We have had a very specific order of the Senate and we have had questions on notice. In fact, there have been two orders of the Senate. Treasury completely ignored that specific order. You made one consolidated response to all three orders and the question about you providing us with the breakdown on a commodity-by-commodity basis of the mining tax revenue estimate was completely ignored. Why is that?
>
> Dr Henry—...I am pretty sure that that was one of those questions that we took on notice to refer to the Treasurer. I suspect strongly that it was the Treasurer’s decision what material should be released to the committee rather than a decision taken by the department.
>
> CHAIR—But if a decision is made not to release information sought by a committee, and we have sought this information on a number of occasions now, you would be well aware of the need to point to a public interest ground and parliament would—
>
> Dr Henry—I am aware of that, but I do not agree that I need to point to such a claim.
>
> CHAIR—You can refer it to the Treasurer.
>
> Dr Henry—Indeed.
>
> CHAIR—I understand that, but whoever deals with the Senate committee’s request or the Senate’s request—
>
> ...
>
> CHAIR—has to point to a public interest ground and to explain the public harm.
>
> Dr Henry—I do not think you can fairly bring this one back to us. I think it is a matter as between this committee and the Treasurer.
>
> CHAIR—Are you aware of any reason why it would not be in the public interest to release the breakdown?

56 Senate Select Committee on Fuel and Energy, *The mining tax; Still bad for the economy – Still bad for jobs,* Second interim report, July 2010, p.11.

Dr Henry—It is a matter for the Treasurer.

CHAIR—But you can confirm that that is analysis that has been done? That is what you told us on 5 July, so it has been done. It is information that is held by Treasury; it is information that is held by the government but the Treasurer has decided not to release that information.

Mr Parker—That is right. We have the information.

CHAIR—You have the information?

Mr Parker—We have done the analysis by commodity.[57]

3.97 After further questioning however, Dr Henry advised that the assumptions relied on for modelling purposes could not be released as they were commercial in-confidence.

CHAIR—You mentioned earlier—and this is the reason why the government does not want to release this information—that in part the commodity price forecasts are based on commercial-in-confidence information provided by BHP Billiton, Rio and Xstrata. You are confident that BHP Billiton, Rio and Xstrata have provided the government with internal commercial-in-confidence data about expected commodity prices?

Dr Henry—Yes, indeed.

CHAIR—They have provided the government with commercial-in-confidence data about their internal commodity price expectations?

Dr Henry—That is correct.

CHAIR—They have not just pointed you to publicly available data from market analysts?

Dr Henry—No.

CHAIR—Have BHP, Rio or Xstrata asked Treasury not to release the government's commodity price assumptions used to estimate the revenue from the RSPT or the MRRT?

Mr Parker—I can answer that. In addition to the Senate requests for information we have had a number of FOI requests. In the context of those requests we have an obligation to consult with the companies which provided the information, and they have objected to its release.

CHAIR—I have asked a very specific question. Have the companies objected to you releasing information about the government's commodity price assumptions?

Mr Parker—Yes, they have, in the context of the FOI—but not the government's commodity price assumptions. They are published—

57 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Dr Ken Henry, Secretary and David Parker, Executive Director, Department of the Treasury, *Committee Hansard*, 22 November 2010, pp. 17–18.

> CHAIR—In relation to the Senate order for you to release commodity price information, the government's commodity price assumptions, have the companies asked you not to provide that information?
>
> Mr Parker—They have asked us not to provide the information which they have provided to us.
>
> CHAIR—But that is not the question I am asking. In relation to the commodity price assumptions, have the companies asked you not to provide the government's commodity price assumptions for iron or for coal?
>
> Mr Parker—No, of course not.
>
> CHAIR—Well, if they have not asked you not to provide it, why wouldn't you—why would you use those companies as an excuse not to provide that information?[58]
>
> ...
>
> CHAIR—So you are saying that the assumptions the government has used are so closely aligned with the commodity price expectations of the three companies that it would be commercially damaging to them for you to release that information?
>
> Mr Parker—That is a judgment that has been taken, yes.[59]

3.98 When this issue of the Treasury declining to disclose information on the grounds that it may be commercial in-confidence was raised with contributors to the committee, many were of the view that transparency is in fact preferable:

> CHAIR—...Do you think it is legitimate for the government to keep secret the commodity price, production volume and exchange rate assumptions that they have used to estimate the revenue from the tax?
>
> Prof. Garnaut—I think best practice is to be as transparent as possible on all of these things.[60]
>
> CHAIR—Do you think that a government that relies on revenue from the mining industry ought to be transparent about the assumptions they are using to estimate their revenue?
>
> Dr Moran—Yes.[61]

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58 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes, Dr Ken Henry, Secretary, Department of the Treasury, Mr David Parker, Executive Director, Department of the Treasury, *Committee Hansard*, 22 November 2010, pp. 4 - 5.

59 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes, Mr David Parker, Executive Director, Department of the Treasury, *Committee Hansard*, 22 November 2010, p.6.

60 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Ross Garnaut, *Committee Hansard*, 19 November 2010, p. 29.

61 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Alan Moran, Director, Deregulation Unit, Institute of Public Affairs, *Committee Hansard*, 19 November 2010, p. 5.

3.99 As mentioned earlier, an array of information has been released in response to a Freedom of Information request.

3.100 The contrast between the approaches of the Commonwealth Government with that of other governments could not be more stark. Both the Western Australian and the Queensland Governments publish their commodity price and production volume assumptions in their budget papers. That enables proper scrutiny of budget estimates and budget outcomes. In scrutinising the budget people can assess whether they are due to changes in any of these variables or whether they are because of decisions made by government.

Committee comment

3.101 This part of the report has explained and highlighted the flawed consultation and transparency mechanisms deployed during the development of the RSPT, as well as the MRRT and expanded PRRT.

Consultation: Committee Comment

3.102 The committee considers that the government's handling of the Henry Tax Review created an environment which made any constructive consideration of the Report's recommendations impossible. Although the report put forward a range of options for discussion, the government's decision not to release the findings for public consultation before announcing its response was justifiably criticised heavily by all relevant stakeholders.

3.103 The committee considers that the government's negotiation of the design of a revised tax on mining with the three largest miners was inappropriately exclusive and secretive. The government most definitely did not consult or negotiate with 'the' mining industry. Far from it.

3.104 In the Senate Select Committee Fuel and Energy Interim Report of July 2010, *The mining tax: Still bad for the economy, Still bad for jobs*, that committee's Recommendation 5 recommended real consultation and genuine engagement with small and mid-tier mining companies. That consultation has not occurred. The PTG was not formed with the intent of engaging on the real substance of the MRRT and expanded PRRT. In these circumstances, the committee is persisting with the recommendation made by the previous inquiry into the MRRT and expanded PRRT that genuine consultation beyond the select few must occur as a matter of urgency.

3.105 It is the committee's view that the Parliament should insist on genuine consultation taking place with all relevant stakeholders, including with the 99 per cent of the mining industry which has been excluded so far as well as with state and territory governments.

Transparency: Committee Comment

3.106 The committee takes the view that when a government seeks to introduce a new tax which is forecast to generate significant revenue and its revenue estimates are based on highly sensitive variables the government should be open and transparent about the assumptions used. All relevant forecasts and revenue assumptions should be made public to enable proper scrutiny of the implications of any such new tax on the economy, the budget, international competitiveness, jobs and investment in affected sectors of the economy.

3.107 In the Senate Select Committee Fuel and Energy Interim Report of July 2010, *The mining tax: Still bad for the economy, Still bad for jobs*, that committee's Recommendation 10 sought greater and more appropriate disclosure of Budget information and Recommendation 11 requested the disclosure of the above information. Those recommendations remain valid and current.

3.108 None of that information was provided by the government in its 2011-12 Budget for the MRRT and expanded PRRT. The Budget Strategy and Outlook (Budget Paper No.1) 2011-12 failed to provide open and transparent information. The committee will again recommend that such information be disclosed. The next Mid-year Economic and Fiscal Outlook provides an opportunity for the government to comply with that recommendation.

3.109 The committee has identified other areas of concern in relation to transparency and openness that have not been acted upon as recommended by the Senate Select Committee Fuel and Energy Interim Report of July 2010, *The mining tax: Still bad for the economy, Still bad for jobs*. Specifically, in that report Recommendation 4 sought the disclosure of the impact of new taxes on a range of variables such as employment, investment and certainty.

3.110 A Review of the 2011-12 Budget did not find such information for the MRRT and the PRRT. The Budget Strategy and Outlook (Budget Paper No.1) 2011-12 failed to provide such transparency and openness. In these circumstances, the committee has again found it necessary to recommend that such information be disclosed. The next Mid-year Economic and Fiscal Outlook would provide such an opportunity.

Other matters: Committee Comment

3.111 The committee has consistently sought input from the PTG throughout the course of its inquiry into a mining tax. The committee took the view that the PTG, established specifically by the government to consult with stakeholders and advise government on transitional issues, would provide valuable insight into development of the MRRT and the PRRT.

3.112 Invitations to appear before the committee however were declined by all members of the PTG, including the Chair Mr Don Argus. In future, it would be desirable for those entities engaged in any policy development process to use their

best endeavours to cooperate with the Senate as it inquires into matters of importance to the nation.

Recommendation 1

3.113 The committee recommends that the Parliament not support the deeply flawed and poorly designed MRRT and expanded PRRT.

3.114 Should the Parliament be inclined to consider the government's proposed mining tax contrary to this principal recommendation, the committee makes the following further recommendations:

Recommendation 2

3.115 The committee recommends that Parliament insist that government proposals to make major structural changes to Australia's tax system be based on an open, transparent and inclusive policy development process before final policy decisions are made.

3.116 The committee also recommends that the Parliament refuse to consider any changes to resource taxation which have implications for state and territory royalty arrangements until the government can demonstrate that it has actively engaged and reached agreement with state and territory governments.

Recommendation 3

3.117 The committee recommends that in line with the government's stated commitment to openness and transparency the Parliament require the public release of all mining tax related revenue assumptions, including commodity price and production volume assumptions.

3.118 To enable proper scrutiny of the government's mining tax revenue estimates, the committee recommends that the Parliament insist on release of that information before it agrees to consider any mining tax related legislation.

Recommendation 4

3.119 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 international competitiveness**
- **the Commonwealth's budget position**
- **State and Territory revenues**
- **cost of living; and**
- **the Australian Economy as a whole.**

Recommendation 5

3.120 The committee recommends that the Parliament insist on the government restoring confidence in good regulatory processes by:

- **formally recommitting to the best-practice regulation guidelines developed by its Office of Best Practice Regulation;**
- **confirming that proposals for new taxes require the development of Regulatory Impact Statements consistent with the requirements of the best-practice regulation handbook**

3.121 The committee recommends that before considering any mining tax related legislation the Parliament insist on a report from the Office of Best Practice Regulation about the extent to which the government's policy development processes for the RSPT, MRRT and expanded PRRT were consistent with its own best-practice regulation guidelines.

3.122 The committee recommends that the Office of Best Practice Regulation be required to make recommendations to improve the government's compliance with these principles.

Chapter 4

The Mineral Resources Rent Tax and expanded onshore Petroleum Resources Rent Tax

Introduction

4.1 The chronology of the mining tax's flawed development was set out in Chapters 2 and 3. As detailed in those chapters, the RSPT was replaced by the proposed MRRT and the onshore expansion of the offshore PRRT. The fundamental design features of the revised national mining tax arrangements were put in place by the Heads of Agreement, negotiated exclusively and in secret, between the government and the three largest miners operating in Australia.

4.2 This chapter examines the proposed MRRT and the expanded PRRT, as set out under the Heads of Agreement. It demonstrates that the new taxation arrangements do not meet the government's stated objective of being simpler and fairer than the status quo. The new arrangements increase distortions, are narrowly based and manifestly more complex. They are also unfair to large parts of the mining industry because of the competitive advantage the MRRT design gives to those three companies who were exclusively involved in the negotiations with the government. They are also unfair to those states and territories, like Queensland and Western Australia, whose 'own source revenue' includes a larger proportion of revenue from mining royalties. They are more heavily impacted by the Commonwealth Government's attempts to limit their capacity to make their own sovereign decisions about royalty arrangements into the future.

4.3 The cost of the government's related commitments to increase compulsory superannuation from 9 to 12 per cent over ten years, to reduce the company income tax rate and invest a small proportion of the anticipated revenue into infrastructure, are also assessed in this chapter. That assessment is particularly relevant given Treasury projections that MRRT revenue is expected to decline over the next ten years when the annual cost of those related commitments will continue to increase beyond the projected annual revenue from the MRRT.

The MRRT[1] – Increasing distortions

4.4 On 1 July 2010 the government signed a Heads of Agreement which detailed the broad features of the MRRT. In announcing the MRRT as a so called 'breakthrough agreement', the government explained that the 'improved' reforms (i.e. the MRRT) would focus on the most profitable resources, provide certainty to the industry, and in doing so, ensure that the government's 'central goal' to deliver a better

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1 The expansion of the petroleum resource rent tax to the onshore oil and gas industry is explored separately in this chapter.

return to the Australian people for the resources they own, was met.[2] But the proposed new tax on mining has been criticised on all fronts by the majority of stakeholders. Key aspects of the MRRT are outlined below:

Table 4.1: Key aspects of the Mineral Resources Rent Tax

Taxation feature	Mineral Resources Rent Tax
Rate	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	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. (The PRRT does not presently apply to the North West Shelf; rather petroleum royalties and crude oil excise apply.[3] Treasury have indicated that the existing royalty and excise arrangements will continue to apply to the North West Shelf project in the short term with liabilities being credited against the expanded PRRT. This is another unresolved area with longer term arrangements yet to be confirmed).[4]
Transferability	MRRT losses would be transferable to offset MRRT profits the taxpayer has on other iron ore and coal operations.[5] (Losses referred to here are those generated by having expenses larger than revenues. Transferability does not apply in respect of credits arising from royalties.)[6] 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 apply in respect of excess credits that arise from royalty payments.[7] In these circumstances, excess credits from the payment of

2 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*, Media Release, 2 July 2010.

3 These arrangements aim to provide a fair and reasonable return to the Australian community and at the same time provide an incentive for companies to explore and develop resources. Source: Department of Resources, Energy and Tourism, *Mineral and Petroleum Exploration and Development in Australia: A Guide for Investors*, p. 20.

4 Department of Treasury and Finance Western Australia, *Analysis of the Proposed Resource Rent Tax Regime*, July 2010, p. 12.

5 *Heads of Agreement*, p. 1.

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

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

	state and territory royalties are uplifted and carried forward to be applied to a project's future MRRT liabilities.[8]
Deductibility	An allowable deduction for income tax purposes.
Royalties	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% Small companies would have tax rate reduced to 29% from 2012-13.
Superannuation Guarantee	9% to 12% by 2019-20.
Regional Infrastructure Fund	Allocated $6 billion to a Regional Infrastructure Fund over ten years.
Scope	Approximately 320 mining companies.

A distortionary 'top-up' tax

4.5 The Henry Tax Review proposed the introduction of a resource rent regime that would apply to all minerals and replace state royalties. The proposal of a replacement tax, however, was not pursued by the government. The tax model put forward by the government through its announcement of an RSPT did not envisage replacement of the existing state and territory royalty regimes.

4.6 The government's RSPT did not envisage technical replacement of the existing state and territory royalty regimes, although it proposed a refundable credit for such royalties.

> CHAIR—...It is fair to say that your recommendation was for the national resource rent tax to replace state royalties completely. That is right, isn't it?
>
> Dr Henry—Yes, that is correct.
>
> CHAIR—And under the RSPT the distorting effects of royalties were effectively removed because they were completely refunded—is that right?
>
> Dr Henry—That is correct.
>
> CHAIR—But under the MRRT they are not, are they?
>
> Dr Henry—No, clearly they are not.
>
> CHAIR—So the distorting elements of state royalties, to the extent that they exist, have not been removed, have they?
>
> Dr Henry—To the extent that there is not a full credit provided for those royalties under the MRRT, the royalties would be impacting on investment decisions.

8 *Heads of Agreement*, p. 1.

CHAIR—Would be impacting on investment decisions?

Dr Henry—I would expect so, yes.

CHAIR—And, potentially, production decisions too, wouldn't they?

Dr Henry—Indeed.

CHAIR—Smaller projects that are not yet subject to the MRRT would continue to pay royalties?

Dr Henry—That is correct.[9]

4.7 Under the RSPT there was effectively a full refund of State royalties irrespective of whether any or how much RSPT was payable. In contrast, under the MRRT there is only a credit 'up to any MRRT liability' which is not transferable and not refundable. As a result, a mining project in the decline phase would have received a refund of royalties paid under the RSPT, but under the MRRT will only get a credit.

4.8 Given that once a project reaches its 'decline phase' it is never likely to make sufficient profit to incur an MRRT liability ever again, and the credits it has accumulated are not transferable between projects, those credits will be useless; the entity will not incur any MRRT liability against which the credits can claimed.

> ...With respect to royalties and companies' liability to bear the burden of royalties, there is a very significant difference between the original proposal—that is, the RSPT—which would have refunded those royalties to the companies, and the MRRT. The MRRT, instead of refunding the royalties in full to the companies, provides a credit against an MRRT liability. So as you say, Senator, if there is no MRRT liability then there would be no refund of royalties.[10]

4.9 It is this aspect of the design that makes the MRRT a top-up tax and makes the MRRT more distortionary than the status quo.

CHAIR—So we have just found a fourth area where the distorting effects, which Dr Henry has described as state royalties, will continue to play out—that is, within big companies, such as BHP, Rio or Xstrata, as well as within smaller companies, if I accumulate royalty credits within one project I cannot actually use those credits for other projects. Is that what you are saying?

Mr Parker—Yes, it is not a big company/small company issue at all.

CHAIR—With small companies the situation is very clear: if you have one project you accumulate them, you cannot offset them and you cannot get a refund, so they are distorted. We have already gone through that. But there

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9 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 8.

10 Dr Ken Henry, Department of the Treasury, *Fuel and Energy Committee Hansard*, 5 July 2010, p. 5.

is now a fourth element. What we said before is that the big companies which are likely to pay MRRT will actually also pay state royalties that are not creditable or refundable on projects within their portfolio of projects and will not be able to offset that against their MRRT liability. That is right, isn't it?

Mr Parker—That is right. There is a slight nuance here relating to the definition of a project, and that is a matter which is being worked on by the Policy Transition Group. You will see in the paper put out by the Policy Transition Group a discussion of the extent to which the concept of 'project' may cover more than one, if you like, mine.

...

CHAIR—...So whatever you might do to the definition of 'project' might help the BHP Billiton's, Rio's and Xstrata's; it will not help anybody else to soften the impact of ongoing state royalty payments on them.

Mr Parker—It is a basic feature of the tax that if the MRRT implicit liability is less than the royalty then there is no refund of the royalty. It is a basic feature of the tax. It is, if you like, a top-up tax at a lower rate than—

CHAIR—It is a top-up tax rather than a replacement tax.

Mr Parker—That is right—a top-up at a lower rate than the RSPT.

CHAIR—It is a top-up tax, but the RSPT was a replacement tax.

Mr Parker—That is right.

Dr Henry—That would have raised more revenue.

CHAIR—The RSPT was a replacement tax which would have raised more revenue, and this is a top-up tax where the Commonwealth raises a bit less revenue—

Mr Parker—Which raises less revenue, that is right.

CHAIR—but all of the complications and all of the features criticised in the royalty regime are still ongoing.[11]

4.10 What the Henry Tax Review recommended was a profit based tax which would replace production based royalties. What is proposed by government is a tax that will be inefficient and have a distorting impact on investment and production decisions.

4.11 According to the Heads of Agreement, under the MRRT:

[a]ll State and Territory royalties will be creditable against the resources tax liability but not transferable or refundable. Any royalties paid and not

11 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr David Parker, Executive Director, Department of the Treasury, *Committee Hansard*, 22 November 2010, pp. 16–17.

> claimed as a credit will be carried forward at the uplift rate of the LTBR plus 7 per cent.[12]

4.12 By requiring the MRRT to operate in addition to the existing state and territory royalty regimes as well as the company tax regime, the proposed regime will be more complex and more distortionary than the status quo.

4.13 When questioned by the committee, Treasury acknowledged that as a top-up tax, the proposed MRRT would result in additional complexities.

> Mr Parker—It is a basic feature of the tax that if the MRRT implicit liability is less than the royalty then there is no refund of the royalty. It is a basic feature of the tax. It is, if you like, a top-up tax at a lower rate than—
>
> CHAIR—It is a top-up tax rather than a replacement tax.
>
> Mr Parker—That is right—a top-up at a lower rate than the RSPT.
>
> ...
>
> CHAIR—but all of the complications and all of the features criticised in the royalty regime are still ongoing.
>
> Mr Parker—That is right. Of course, under the RSPT the replacement of royalties, as you mentioned, was a replacement in economic terms—that is, the royalty regime still existed; it was not replaced as a matter of law or as a matter of administration. It was replaced as a matter of economic effect. The complexity, which you have referred to, remained in place.[13]

4.14 This view was shared by Professors Henry Ergas and Jonathan Pincus, who identified that the requirement for existing royalties to interact with not only the company income tax regime, but also that of the proposed MRRT, would raise a 'myriad' of issues.[14]

> Royalties do discourage some economically valuable activity. A mine nearing the end of its useful life may get sales proceeds that cover the cost of extraction and marketing, but if it does not cover the royalty payments, the ore remains unmined. So the task of designing mining taxes is to find the best compromise between the desire of the tax collector to gather in

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12 The Hon. Julia Gillard MP, Prime Minister, the Hon. Wayne Swan MP, Deputy Prime Minister and Treasurer, the Hon Martin Ferguson AM MP, Minister for Resources, Energy and Tourism, Marius Kloppers, BHP Billiton, David Peever, Rio Tinto Australia, Peter Freyberg, Xstrata Coal, *Heads of Agreement*, p. 1.

13 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr David Parker, Executive Director Revenue Group, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 15.

14 Professor Henry Ergas, Professor of Infrastructure Economics, University of Wollongong, *Committee Hansard*, 30 March 2011, p. 7.

> pure rent and the desire not to discourage the effort, talent and risk involved.[15]

4.15 Professors Ergas and Pincus, together with economist Dr Mark Harrison of the Australian National University, also wrote in a recently published, peer reviewed journal article that:

> …the MRRT keeps the main inefficiencies of royalties and adds the inefficiencies of a rent tax. For example, royalties discourage production from mines near the end of their life, causing them to shut down too early. But that is precisely when profitability is likely to be low, so there are insufficient resource-rent tax payments against which to credit the royalty payments. Overall, the MRRT is likely to be an extremely inefficient tax, more distorting than the RSPT.[16]

4.16 Evidence received by the committee suggests that issues of complexity will be greater for smaller miners. The continuing application of royalties, in addition to the MRRT, and the fact that excess royalties are not transferable, will act as a disincentive. It will be a disincentive as royalties will be payable during both the slower start-up period, and the decline phase, during which times profits may not be realised, yet royalties will remain payable. This would not have been the effect had state and territory royalties been 'replaced' with a resource rent tax, as had been recommended by the Henry Tax Review.

4.17 The Henry Tax Review proposal was comprehensive and suggested not only that a Resource Rent Tax regime replace royalties but that the Commonwealth and state governments should negotiate the allocation of both revenues and risks from the regime.

4.18 Had the Henry Tax Review proposal been implemented, with state royalties being replaced by the proposed tax, during the less profitable phases (mine start-up and decline), taxation would only be payable on realised profits. In that situation, to the extent that there is a distortion caused by royalties, it would have been removed under the Henry Tax Review recommended resource rent tax; under the Gillard government's MRRT it is not. In fact the MRRT is more distortionary than the status quo.

4.19 It was the view of economists who appeared before the committee that, the application of both royalties and a rent tax, in the form of the MRRT, also has a negative effect on more risky projects.

> ...the reason the MRRT is going to tax risky investments is that if your project is a failure, the government does not want to know about it, is not going to pay you anything and gives you a credit that you can never use.

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15 Professor Jonathan Pincus, Visiting Professor, University of Adelaide, *Committee Hansard*, 30 March 2011, pp. 1–2.

16 Ergas, H. Harrison, M. and Pincus, J. (2010) "Some Economics of Mining Taxation," *Economic Papers*, 29(4): pp.369-383, p 378.

> But if your project is a success, the government is going to take their share. That is where the disincentive to risk-taking arises. On that basis if you look at existing projects, in my view there is a strong element of expropriation; the government is effectively acquiring shares. It does not actually acquire the shares, so it avoids the legalistic definition of expropriation, but it acquires the stream of cash flows that give the shares their value. So, from an economic point of view, it comes to exactly the same thing—even if it does not from a legal point of view—at less than their market value.[17]

4.20 The economists who appeared before the committee shared the view that both the RSPT and its replacement, the MRRT, through their treatment of royalties would result in inefficiencies and distortions:

> The MRRT has many of the same inefficiencies as the RSPT but adds some further serious inefficiencies of its own. Like the resource super profits tax, it discourages cost reductions and revenue expansions by miners and, like royalties, it discourages production from mines near the end of their lives. In addition, it distorts the distribution of the rates of return from mining, thus differentially discouraging higher risk profits. The MRRT reduces the expected rate of return for risky projects by more than it reduces those for less risky projects. In other words, the realised tax rate on risky projects after the event turns out to be higher, maybe far higher than that on less risky projects.[18]

4.21 In fact, Professor Freebairn, one of the 20 economists who had previously signed a letter in support of a resource rent tax, explained that the MRRT on top of ongoing royalties puts miners in a much worse position than the status quo:

> Prof. Freebairn—...the MRRT clearly increases the risks faced by miners because all it is doing is taking gains if there are gains to be had, and if there are losses it is not sharing in those losses at all. The MRRT, as proposed, is an asymmetric tax treatment of wins and losses.
>
> CHAIR—So it increases risk for miners. In that sense, it has a distorting effect in its own right, doesn't it?
>
> Prof. Freebairn—Yes.
>
> CHAIR—This is on top of the distorting effects of the royalties, to the extent that they are there?
>
> Prof. Freebairn—Yes.
>
> CHAIR—Compared to the status quo, does the MRRT put us into a better or worse position?

17 Professor George Fane, *Committee Hansard*, 30 March 2011, p. 26.

18 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 2.

> Prof. Freebairn—It puts the mining companies into a more riskier position because they still get the same treatment if it is a dud and they lose more if it is a success.[19]

4.22 Professor Pincus explained, in practical terms, the potential negative impact on smaller mining companies:

> A whole series of efforts by mining companies may end up leading to tax liabilities on MRRT which, without the tax, they would have engaged in more fully—more exploration, more thoughts about research and development and reducing their costs. All of those things could add to the profits they make but they are not a consequence of the value of the ore in the ground; they are a consequence of their efforts to make a profit. A tax on profits discourages all those things which make profits.[20]

4.23 Professor Freebairn and Professor Rolfe were invited to give evidence to the committee at the request of a government Senator as they were two of the 20 economists who had signed a letter in support of a resource rent tax.

4.24 In that context, it is telling that both Professor Freebairn and Professor Rolfe told the committee that they did not support the MRRT and that they would not have signed such a letter if the MRRT had been the proposal at the time. According to Professor Freebairn:

> CHAIR—…You captured again that royalties are the worst of all taxes. But of course, as you have said, the MRRT in a sense is worst than royalties.
>
> Prof. Freebairn—Yes.
>
> CHAIR—You say yes to that. When you signed the statement in support of a resource rent tax which would replace state and territory royalties, you would not have signed a similar statement in support of the MRRT as it is on the table?
>
> Prof. Freebairn—When we wrote that statement the MRRT was not actually out. It was the super profit resource tax which was going to be a replacement.
>
> CHAIR—If you were asked to sign a statement supporting the MRRT, you would not sign it?
>
> Prof. Freebairn—No.[21]

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19 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor John Freebairn, Ritchie Professor, University of Melbourne, *Committee Hansard*, 30 March 2011, p. 59.

20 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, pp. 4 - 5.

21 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor John Freebairn, Ritchie Professor, University of Melbourne, *Committee Hansard*, 30 March 2011, p. 54.

4.25 According to Professor Rolfe:

> CHAIR—...Would you have signed a statement in support of the MRRT as it is on the table?
>
> Prof. Rolfe—I would not have, actually.[22]

4.26 Professor Freebairn made it clear that while he was in favour of a resource rent tax that replaced royalties, such as that proposed by the Henry Tax Review, he was not in favour of the MRRT.[23]

A further distortion – the market based valuation for establishing the starting base

4.27 The distortions that will arise as a result of the arrangements to credit royalties is but one of the distortions that will provide larger miners with a competitive advantage over their more junior counterparts. In addition, the arrangements that the government has announced in respect of determining the starting base will favour the well established three multi-national, multi-commodity and multi-project miners.

4.28 In the Heads of Agreement, the government announced that the starting base for project assets (defined to include tangible assets, improvements to land and mining)[24] can be determined using either:

(a) book value, excluding the value of the resource; or

(b) the market value of the project (as at 1 May 2010).[25]

4.29 The taxpayer is to elect which method of valuation they will apply.

4.30 Evidence given to the committee by smaller miners in respect of this feature of the MRRT highlighted their concern that this design consideration inherently favours their larger competitors:

> The definitional aspects of 'projects' seem to be biased towards BHP and Rio. There is the issue of possible treatment of black-hole expenditure, which is particularly relevant for companies that are trying to develop but may not meet the definition of a project at this point in time.[26]

4.31 The ability to choose a market based method of valuation delivers larger, more capital intensive companies, a bigger capital base and therefore, a larger pool of deductions to draw from before they are required to start paying the MRRT. Such a

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22 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 59.

23 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor John Freebairn, *Committee Hansard*, 30 March 2011, p. 60.

24 *Heads of Agreement*, p. 1.

25 *Heads of Agreement*, p. 1.

26 Fortescue Metals Group Ltd, *Committee Hansard*, Monday 8 November 2010, pp. 21 - 22.

pool is a consequence of the large investments that mining companies have made in the past.

4.32 Many smaller mining companies are instead less capital-intensive and often pay for access to the infrastructure of larger companies. This means that they will not have access to as large deductions as the bigger mining companies. In addition, the payments they have made in the past to gain access to this infrastructure (and service the capital costs of the bigger miners) receive no recognition in terms of higher deductions for the MRRT. As commented by Mr Flanagan, Managing Director of Atlas Iron:

> Atlas is the classic example of those companies. We have gone in. We actually do not own our mining fleet. We do not own a railway line. We do not own a trucking fleet. So we do not get the benefit of the mine gate sale the way the majors do, where they can inflate the value of the service provided and those sorts of things, and that is a significant thing to point out. In this MRRT, effectively, for those companies which do not get the benefit of the transition provisions—and that is pretty much all of those iron ore companies that come after us now—they will not get the benefit of using market value of their assets and an accelerated write-off, which means that they can only use the book value to write off the assets.
>
> …… We will get caught in the transition provisions and we will get the benefit of the market value, but there are going to be a lot of companies to come in the future which are going to be penalised by only having access to that book value.[27]

4.33 Professor Ergas further pointed out that the greater risk involved in investing in smaller companies probably lowers their market values and hence limits the extent to which they have access to a tax shield.

> CHAIR—Would it be as advantageous for the smaller to mid-tier mining companies, having a market valuation method as part of the MRRT design?
>
> Prof. Ergas—Probably not because, their mining projects being typically more uncertain, it is likely that their current market valuations are relatively low and hence provide a much lower tax shield. Again, that is significantly affected by the precise way in which the depreciation provisions are ultimately crafted.[28]

4.34 Overall, although the market valuation method can protect against the government retrospectively taxing private investment, it is another design element which benefits larger companies, which had a voice inside the room, relative to the interests of smaller miners who were not even involved in the discussions.

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27 Atlas Iron Ltd, *Committee Hansard*, 8 November 2010, p. 2.

28 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Henry Ergas, *Committee Hansard*, 30 March 2011, p. 10.

4.35 These smaller miners consider that the introduction of the proposed tax will impede their ability to innovate, particularly through the scrapping of the exploration rebate, and the changes to the starting base calculations which favour larger, well established operations.

4.36 The obvious competitive advantage to the three big miners as a result of the design of the MRRT and expanded PRRT is covered in more detail in Chapter 5.

The MRRT - A narrowly based tax, but for how long?

4.37 The Henry Tax Review recommended that resource taxation be reformed through the introduction of a uniform resource rent tax. The RSPT put forward by the government in May 2010 would have applied uniformly to all minerals. However, in the Heads of Agreement negotiated between the government and the three big miners in the shadow of a difficult election for the government, the proposed MRRT would apply only to coal and iron ore, excluding all other minerals.[29]

4.38 Under the MRRT, the government's revenue is generated by the coal and iron ore industries. The original Resource Rent Tax and the RSPT were far broader, encompassing other non-renewable resources rather than two arbitrarily chosen resources. The table below, sourced from Treasury through a Freedom of Information process, demonstrates the narrowness of the taxation base:

Table 4.2: A narrower tax base, revenue from the MRRT[30]

Year / Total	Iron Ore ($m)	Coal ($m)	TOTAL MRRT ($m)[31]
2012-13	3,500	500	4,000
2013-14	5,000	1,500	6,500
2014-15	4,500	2,000	6,500
2015-16	3,500	2,000	5,500
2016-17	2,000	2,000	4,000
2017-18	1,500	1,500	3,000
2018-19	1,500	1,500	3,000
2019-20	1,500	1,500	3,000
2020-21	2,000	1,000	3,000
Total	**25,000**	**13,500**	**38,500**

29 *Heads of Agreement*, p. 1.

30 Source: Treasury Freedom of Information release:: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936 (accessed 20 June 2011)

31 Source: Treasury Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011)

Table 4.3: A comparison of the revenue from the RSPT and the MRRT[32]

Year / Total	TOTAL MRRT ($m)[33]	TOTAL RSPT ($m)[34]	DIFFERENCE ($m)
2012-13	4,000	3,000	1,000
2013-14	6,500	9,000	-2,500
2014-15	6,500	12,500	-6,000
2015-16	5,500	12,500	-7,000
2016-17	4,000	12,500	-8,500
2017-18	3,000	14,500	-11,500
2018-19	3,000	13,500	-10,500
2019-20	3,000	11,500	-8,500
2020-21	3,000	10,000	-7,000
Total	**38,500**	**99,000**	**-60,500**

4.39 Table 4.2 also shows that while the MRRT has a narrow base, most of the revenue from the MRRT is expected to come from iron ore production. According to the Treasury modelling, about 65 percent of MRRT revenue will come from iron ore production over the next decade. Given currently 99 per cent of iron ore royalties nationally are generated in Western Australia,[35] that means about 65 per cent of the MRRT revenue over the next decade will be generated from iron ore production in Western Australia. Imposing one national tax which has such a disproportionate effect on one state economy raises serious equity issues.

4.40 Table 4.3 compares the revenue that would have been raised under the RSPT with that projected to be collected under the MRRT over the initial ten years. These figures, however, give no insight into the assumptions used to calculate the forecasts; assumptions that, to this day, remain secret.

4.41 Although the RSPT would clearly have collected more revenue, the forecast MRRT figures remain misleading given the government's changed commodity price assumptions on which they were based:

> Sources familiar with the Treasury forecasts confirmed...that the original resource super profits tax (RSPT) projections were based on significantly lower iron ore and coal price and volume assumptions than the revised minerals resource rent tax (MRRT). If the higher price assumptions the

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32 Source: Treasury Freedom of Information release:: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936 (accessed 20 June 2011)

33 Source: Treasury Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011)

34 Source: Treasury Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011)

35 Commonwealth Grants Commission, *Report on GST Sharing Relativities – 2011 Update*, p. 42.

government are now relying on are applied to the original mining tax, the result is that it would have raised more than $20 billion a year.[36]

4.42 This creates more doubt about the ability of the proposed tax to cover the cost of the related budget measures, thereby placing further pressure on the government's budget position.

4.43 The Organisation of Economic Cooperation and Development has identified the narrow and distortionary nature of the MRRT as a concern, specifically:

> As conceived, the MRRT is likely to distort investment incentives between mining projects of coal and iron ore and those on other resources that are not subject to the tax, regardless of their underlying merits.[37]

4.44 Indeed, Professor Ross Garnaut, an economic adviser to the government, suggested that the decision to exclude the tax from all minerals, except coal and iron ore, was arbitrary and had no economic foundation.

> CHAIR—...Resources, as you mentioned earlier, are the properties of the states and it is the states on behalf of the people in those states who sell those resources, for royalties, to those mining companies. A butcher would buy it in a private market but the principle is the same. Why is it appropriate for this sort of tax to be applied to iron ore and coal but not to uranium, nickel or gold? Is there an economic argument in favour of picking those two resources and excluding others?
>
> Prof. Garnaut—There is no economic reason. If two mines are equally profitable, are the same size, take the same length of time and the same amount of exploration to bring into production there is no economic reason to tax iron ore more heavily than uranium, for example.
>
> CHAIR—So why do you think the government has picked them? ... Is it fair to say, then, that it is an arbitrary choice?
>
> Prof. Garnaut—I think that is fair to say. In the public discussion there has been some suggestion that these happen to be very large and very profitable activities at the moment, but not every iron ore mine is large and profitable, and not every other kind of mine is small and unprofitable. So yes, I think you would be struggling to find an economic justification for the distinction.[38]

4.45 Further, apart from having no economic foundation, there is a real concern that the restricted application of the proposed tax on iron ore and coal will have a

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36 John Kehoe, 'Mining tax hole tops $100bn', *Australian Financial Review*, 24 February 2011, pp. 1, 8.

37 Organisation of Economic Cooperation and Development (2010), *OECD Economic Surveys: Australia November 2010*, p.8.

38 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes, Professor Ross Garnaut, *Committee Hansard*, 19 November 2010, pp. 30–31.

distorting effect on investment in these two sectors as minerals other than coal and iron ore become more attractive to investors:

> Looking at the status quo, the answer has to be it makes these other minerals not touched relatively more attractive than the ones that are now facing a slightly higher tax bill.[39]

4.46 Professor Ergas concurred with this view:

> What is more likely to happen is that it will shift the focus of efforts of expanding the supply of coal and iron ore, a greater share of those efforts will ultimately go to other jurisdictions [overseas jurisdictions].[40]

4.47 The government's decision to limit the application of the MRRT to coal and iron ore production reduced the number of affected companies from 2,500 to approximately 320.[41]

4.48 There are however serious question marks as to how long other minerals and resources would be excluded from the scope of this new mining tax if it was passed by the Parliament. In evidence to the committee the Construction, Forestry, Mining and Energy Union (CFMEU) submitted that:

> The RSPT was a more consistent and fairer proposal than the MRRT. The MRRT is at best a useful starting point for fairer taxation of the resources sector and for greater returns to the Australian community...[42]

4.49 In evidence before the committee the CFMEU argued that:

> The Resource Super Profits Tax was a broader and better proposal than the MRRT. The MRRT represents a compromise with the mining industry that is undesirable with respect to its impact on fiscal policy, community benefit and overall economy-wide impacts. The MRRT is restricted to coal and iron ore. While these are hugely profitable industries and prime candidates for resource rent taxation, they are not alone in that respect and a more consistent tax would be applied more broadly.[43]

4.50 Senator Cameron, a government member of the committee, also recently argued that the minerals resource rent tax should be increased, flagging that an increase in the minerals resource rent tax will be proposed at this year's Labor Party National Conference:

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39 Professor John Freebairn, *Committee Hansard*, 30 March 2011, p. 60.

40 Professor Henry Ergas, *Committee Hansard*, 30 March 2011, p. 11.

41 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*, Media Release, 2 July 2010, p. 1.

42 Construction, Forestry, Mining and Energy Union, *Submission 13*, p 2.

43 Construction, Forestry, Mining and Energy Union, *Submission 13*, p 5.

> Labor's Left faction will demand an increase in the amount of money raised by the proposed mining tax, a challenge to the authority of the Gillard government's leadership... "We should have another look at whether the mining industry is paying their fair share, and whether the community is getting a fair outcome from it," a national convenor of the Left, Doug Cameron, told the *Herald*.[44]

4.51 Others argued that the limited application of the proposed tax to iron ore and coal will discriminate against these particular sectors of the mining industry:

> There is no justification for applying the MRRT only to iron ore and coal while exempting other minerals. While different types of mines have different distributions of costs and revenue across their working lives, the differences in their tax bills should be determined by applying the same set of rules to different circumstances—not by having one set of rules for iron ore and coal and another set of rules for the rest, as if the cost and revenue profiles depended only on the target mineral. Arbitrary line-drawing invites endless lobbying and rent-seeking on both sides of the line.[45]

> The Washington-based IMF, in a report on the Australian economy, said the mining tax should be broadened beyond coal and iron ore to other commodities to help reduce inflationary pressure, and many have pointed to the injustice of just targeting iron ore and coal, particularly when other commodities such as copper and gold have enjoyed and are forecast to continue enjoying meteoric price rises. Since the MRRT agreement gold and copper prices have continued to escalate.[46]

The MRRT - Uncertainty and compliance burdens

4.52 The proposed MRRT would be imposed on top of existing resource royalty and other taxation arrangements. Evidence before the committee indicates that the government has not adequately resolved issues with the interaction between the proposed MRRT and state and territory royalties. Resource royalties are only one aspect of Australia's current taxation arrangements applicable to the mining industry. In determining the impact of the proposed minerals resource rent tax, the cumulative effect of royalties, company tax and all other taxes needs to be considered. Investors are concerned not only with the applicable royalty rate but the effective rate of overall taxation.[47] The specific royalty regimes and implications for federal-state financial relations from the proposed mining tax are discussed in more detail in Chapter 6.

4.53 However, as identified, the Henry Tax Review recommended the replacement of state and territory royalty regimes with a uniform resource rent tax regime. This is not what the government has proposed to do with its MRRT/expanded PRRT. The

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44 Peter Hartcher, 'ALP Left takes on Gillard', *Sydney Morning Herald*, 14 June 2011, p. 1.

45 Prosper Australia, *Submission 1*, p. 5.

46 Australians for Northern Development and Economic Vision, *Submission 5*, p 10.

47 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 32.

fact that the proposed MRRT will apply in addition to existing royalties rather than replacing those state and territory royalty arrangements has been the focus of much criticism during this inquiry.

4.54 Because the government had not taken the time to make the effort to engage with state and territory governments on genuine tax reform, it had to come up with a work-around in relation to the issue of royalties. The three big mining companies which were involved in the government's negotiations on the MRRT, were particularly sensitive about this issue. In their evidence to the committee, they indicated on a number of occasions, how central the treatment of royalties under the MRRT was to their ultimate agreement.

> We are concerned with the recent comments made by some parties seeking to move away from all royalties being creditable. It was clear from the context of discussions we had with government and later with Treasury that ‘all’ meant all, current and future. The ‘all’ is essential for the MRRT to set a maximum rate of tax on the earnings of the iron ore and coal operations which, combined with the proposed company tax rate, is approximately 45 per cent. Any departure from this point would undermine a critical design feature of the MRRT.[48]
>
> What I will say is that the heads of agreement entered into by the then government and the three mining companies in our view begins the process of rebuilding Australia’s reputation as a predictable place to invest.
>
> On this basis Rio Tinto has recently made a number of significant investment decisions. These reflect our expectation that the terms of the heads of agreement entered into with the government will be honoured in full. This includes the crediting of all state and territory royalties including future increases. This is absolutely vital to ensure that the overall rate of taxation remains internationally competitive over the long haul.[49]

4.55 Xstrata Managing Director, Mr Peter Freyberg, went so far as to say that if the government had not addressed the issue of state and territory royalties they would not have signed the MRRT Heads of Agreement.

> For us the statement 'all royalties' is very clear. We would not have signed the agreement had we thought it was ambiguous.[50]

4.56 In the Heads of Agreement signed on 1 July 2010, the government committed the Commonwealth to crediting all state and territory royalties:

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48 Mr Gerard Bond, Group Head of Human Resources, BHP Billiton, *Committee Hansard*, 8 December 2010, pp 5–6.

49 Mr Mark O'Neill, Chief Adviser Taxation, Rio Tinto, *Committee Hansard*, 8 December 2010, p. 37.

50 Mr Peter Freyberg, Chief Executive, Xstrata Coal, *Committee Hansard*, 13 December 2010, p. 20.

All state and territory royalties will be creditable against the resources tax liability but not transferable or refundable. Any royalties paid and not claimed as a credit will be carried forward at the uplift rate of LBTR plus 7 per cent.[51]

4.57 Following the public release of the Heads of Agreement on 2 July, the arrangement regarding royalties received widespread attention. It came under particular scrutiny following speculation that, despite the statement made in the Heads of Agreement, the government would not credit future royalty increases but only those royalties that were in place at the time the announcement was made. Such speculation caused widespread concern:

> Mr Edwards—If there is uncertainty of the crediting of state royalties or if state royalty rises are not credited what will happen is the maximum effective tax rate companies pay will increase. That will lead to uncertainty and they will face a double tax whammy. What we are looking for is certainty in that all royalties are credited so investors in the resources industry know the maximum effective tax rate that they will be paying. If you do not credit royalties, they will not know. It could go up and up and up.
>
> CHAIR—The Commonwealth would say two things though. First, they would say, 'We do not want to erode our own revenue by states increasing their royalties'. The second thing is that if the states were to increase their royalties now that would essentially be an unexpected increase in your tax burden as well. What is the difference?
>
> Mr Edwards—We would ask for the same process that we are asking the federal government in that we would sit down with the state government and understand what the impact of those royalty increases is going to be. Until we fully understand that, do not increase the royalty rate.[52]

4.58 The mining companies who had been involved in the exclusive and secret negotiations with the government in relation to the MRRT, raised their concerns in relation to the government's unwillingness to confirm their commitment to credit all state royalties against the resources tax liability with the committee:

> For the MRRT to be successful, all of the elements of the heads of agreement need to be delivered. On the treatment and crediting of state royalties, it was made very clear by Xstrata, BHP Billiton and Rio that our understanding was that all state royalties would be credited and refunded under the MRRT. The wording of the signed heads of agreement was quite specific for that reason. From Xstrata's perspective, all means all.[53]

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51 *Heads of Agreement*, p. 1.

52 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Mr James Edwards, Executive Officer, Economics and Tax, Chamber of Minerals and Energy Western Australia, *Committee Hansard*, 8 November 2010, pp 47–48.

53 Mr Peter Freyberg, Chief Executive, Xstrata Coal, *Committee Hansard*, 13 December 2010, p. 18.

The 'big three mining' companies

4.59 When giving evidence to the committee, Xstrata Coal indicated that the crediting of all royalties was a critical issue necessary for their support of the tax.

> Mr Freyberg—For us the statement 'all royalties' is very clear. We would not have signed the agreement had we thought it was ambiguous. One of the big subjects discussed during the consultations was the issue of sovereign risk. The fact that the spectre of sovereign within the Australian resource sector had now been opened up made us argue the point that, given that this was an increase in tax, we needed certainty for the future and hence argued for the point of all royalties being credited. This went a very long way to addressing the sovereign risk issues that we were concerned about, particularly with reference to investments we want to make in the future...
>
> CHAIR—So this was not just an incidental discussion; it was a significant focus of the discussions with the government.
>
> Mr Freyberg—The discussions were comprehensive on a number of issues: retrospectivity, sovereign risk, royalties and so forth. We saw the heads of agreement as a complete set of criteria against which the MRRT needed to be detailed.[54]

4.60 BHP Billiton was also of the view that their discussions with government had been very clear concerning the issue of royalties.

> CHAIR—There is a well publicised dispute now...between the government and principally BHP Billiton and Rio...about the mining tax and the treatment of state royalties. Are you certain that under the agreement you reached with the government on the MRRT all state royalties would be credited and refunded, including future increases?
>
> Mr Bond—Yes, I am.
>
> CHAIR—Why are you so certain?
>
> Mr Bond—The discussions we had in relation to the proposed MRRT tabled by the government centred round prospectivity and competitiveness as threshold issues. The tax as designed is a top-up tax and by definition it sets the maximum rate of tax that would be levied on these two products. A top-up tax only operates when the royalties are credited in full. The point around prospectivity and competitiveness as it pertained to the royalties was paramount to that discussion. This was not a wedge tax; this was a top-up tax and the government made it very clear that the royalties would be credited against the MRRT liability in full.
>
> CHAIR—Including future increases?
>
> Mr Bond—That goes to the point of prospectivity and competitiveness.

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54 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Mr Peter Freyberg, Chief Executive, Xstrata Coal, *Committee Hansard*, 13 December 2010, p. 20.

> CHAIR—So how much discussion was there on this point in your discussions with the government?
>
> Mr Bond—The discussions extended for many hours on a range of matters.
>
> CHAIR—Sorry, on this matter: was it an incidental discussion?
>
> Mr Bond—I do not believe it was incidental. The point was also discussed with the Treasury representatives when we reviewed the document referred to as the heads of agreement.[55]
>
> CHAIR—...How important was your understanding that all state royalties, including future increases, would be credited?
>
> Mr Bond—It is very important and it was also very clear. The mere absence of any other wording pertaining to the royalties, such wording that that did exist in relation to the RSPT, also evidences in our opinion that the points of discussion on the point have been fully reflected in the heads of agreement: all means all.[56]

4.61 When asked to explain their understanding of the agreement they had struck concerning royalties, Rio Tinto also advised:

> Mr O'Neill—Our view is that the words in the heads of agreement accurately reflect the understanding that we reached in the discussions at least from our point of view. We signed that agreement on the basis that that issue had been resolved. I know that there has been some doubt cast on that, but our very clear view is that those words were carefully chosen and they are an important part of the agreement.
>
> CHAIR—You say that it is your view that the words in the agreement accurately reflect this. So are you certain that under the agreement that you reached with the government all state royalties, including future increases, would be credited? Are you certain that, under the agreement that you reached with the government, that would be case?
>
> Mr O'Neill—From our point of view, the answer would be yes.
>
> CHAIR—What makes you so certain? Was there a specific focus on this point in the discussions that led you to the conclusion that there was a clear understanding? When this particular passage in the heads of agreement was put together was there a particular discussion around the specific wording?
>
> Mr O'Neill—I cannot recall clearly the exact moment at which this was agreed, other than to say that all of the wording in the heads of agreement was extensively discussed—every clause. That included this particular section.

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55 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Mr Gerard Bond, Head of Group Human Resources, BHP Billiton, *Committee Hansard*, 8 December 2010, pp. 11–12.

56 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Mr Gerard Bond, Head of Group Human Resources, BHP Billiton *Committee Hansard*, 8 December 2010, p. 13.

CHAIR—So every clause was extensively discussed, including this particular section. If this particular section had not been part of the heads of agreement would Rio Tinto have signed up to the agreement?

Mr O'Neill—...it was a key point for us, so I believe that it would have created significant difficulty for us in signing.[57]

The Treasury

4.62 The Treasury, however, took a different view:

Dr Henry—It is my understanding that there would be no credit provided under the MRRT for those future increases.

CHAIR—No credit. So that means that companies would be subject to paying the MRRT as well as the increases in state royalties moving forward?

Dr Henry—That is my understanding.

CHAIR—...Once a mine becomes less profitable towards the end of its mine life, presumably it might fall out of the MRRT liability situation...

Dr Henry—That is correct.[58]

4.63 The discussion continued:

CHAIR—Thank you. You mentioned earlier that future state and territory royalty increases will not be creditable against the mining tax liability, but the heads of agreement is pretty clear, isn't it? It does say:

> All State and Territory royalties will be creditable against the resources tax liability …
>
> Why is there any argument about this?

Dr Henry—Well, I could point out that it does not say 'all future royalties', for example.

CHAIR—What limitation is there on 'all'?

Dr Henry—Obviously, as my colleague Mr Parker indicated earlier, there is some dispute, which you are obviously well aware of, among various parties about the meaning of that particular phrase, and that suggests—

CHAIR—But 'all' is pretty all-encompassing, isn't it?

Dr Henry—'All' is obviously all-encompassing. I think that is a tautology.

CHAIR—Indeed.

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57 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Mr Mark O'Neill, Chief Adviser Taxation, Rio Tinto, *Committee Hansard*, 8 December 2010, p. 41.

58 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, pp. 8–9.

> Dr Henry—But does it refer to all things in existence now or all things in existence at any point in time? That is the question.[59]

4.64 Treasury disputed that the reference in the Heads of Agreement that all State and Territory royalties would be credited did not mean 'all future royalties.'

> Dr Henry—Well, I could point out that it does not say ‘all future royalties’, for example... But does it refer to all things in existence now or all things in existence at any point in time? That is the question.
>
> ...What I am suggesting to you is that there was a lot that was in people’s heads that is not captured in that document [the Heads of Agreement]...when the MRRT is legislated you will see, quite possibly, hundreds of pages of legislation to give effect to that agreement. You should not expect, I suggest, that that agreement captures all of the detail that you as a senator would want to see in a piece of legislation you were scrutinising.[60]

4.65 While the Heads of Agreement clearly stated that 'all state and territory royalties' would be 'creditable against the resources tax liability', the government continued to dispute that 'all' meant 'all'. So it was left to the Policy Transition Group to consider and resolve this issue.

4.66 The PTG has since made its recommendation to the government.[61] In its report,[62] it confirmed the government should comply with the terms of the Heads of Agreement and credit all royalties, including future increases in royalties:

> ...the PTG recommends that there be full crediting of all current and future State and Territory royalties under the MRRT so as to provide certainty about the overall tax impost on the coal and iron ore mining industries. Equally, the MRRT should not be used as a mechanism to enable States and Territories to increase inefficient royalties on MRRT taxable commodities.[63]

4.67 The PTG did however suggest that, in crediting all current and future royalties, the Australian Government:

59 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 12.

60 Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, pp. 12–13.

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

62 The PTG's report to government was delivered in December 2010. That report made 98 recommendations (94 concerning the mining tax and four concerning exploration incentives).

63 Policy Transition Group, *Report to the Australian Government – New Resource Taxation Arrangements*, December 2010, Commonwealth of Australia, p. 17.

> ...put in place arrangements to ensure that State and Territory governments do not have an incentive to increase royalties on coal and iron ore. This would limit their negative impacts, while allowing the Australian Government's taxation regime to maximise the return to the community during the highpoint of the resources cycle, so achieving the balanced outcome described above.[64]

4.68 On 24 March 2011, the Treasurer and Minister for Resources announced that the government had accepted all 98 of the PTG's recommendations. In making that announcement the Treasurer and the Minister for Resources specifically stated that the government accepted the PTG's recommendations in relation to royalties:

> We're pleased to accept all 98 recommendations of the Policy Transition Group (PTG)....The Government supports the recommendation that all current and future royalties be credited, and that all levels of government should ensure the taxation of Australia's resources preserves our international competitiveness. We agree with the PTG that the Mineral Resource Rent Tax is a more efficient way to provide Australians with a return on their mineral wealth and that we shouldn't give a green light to the states to increase their royalties.[65]

4.69 Just how the government will ensure that the states and territories are not given a 'green light' to increase royalties has yet to be clarified. Treasury suggested to the committee, however, that such action might occur through the payment of tied grants.

> CHAIR—Would the Commonwealth be able to force states and territories into a position where they cannot either charge or increase state royalties?
>
> Dr Henry—Of course the Commonwealth could, if it wished...
>
> The Commonwealth has the power, and it has used it on occasions to have the states do things or not do things. Principally the Commonwealth's power comes through the state's reliance on the Commonwealth for such a large proportion of their funding. The Commonwealth is pretty much in control of that funding. I say 'the Commonwealth' because I am talking about the Commonwealth parliament, since mostly what I am talking about is appropriations made by the Commonwealth parliament to the states. If the Commonwealth parliament decided the states should do something they are not presently doing, or stop doing something they are presently doing,

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64 Policy Transition Group, *Report to the Australian Government – New Resource Taxation Arrangements*, December 2010, Commonwealth of Australia, p. 17.

65 Joint media release, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP and the Minister for Resources, Energy and Tourism, the Hon Martin Ferguson MP, *Government accepts Resource Tax Recommendations*, http://minister.ret.gov.au/MediaCentre/MediaReleases/Pages/GovernmentAcceptsResourceTaxRecommendations.aspx (accessed 21 April 2011).

> the appropriations power affords the Commonwealth parliament a fair degree of leverage.[66]

The Western Australian Treasury

4.70 The Western Australian Treasury department sought advice about the interaction of the state royalty regime with the proposed MRRT and expanded PRRT. Their requests for clarification, however, went unanswered:

> Mr Marney—We have sought clarification as to how future increases...would be treated. We are yet to receive clarification.
>
> CHAIR—Since you appeared before the previous Senate committee on 13 July, have you had any in-depth discussion with federal Treasury on how the mining tax and interaction with state royalties is to operate?
>
> Mr Marney—No, we have not. We have a number of pieces of correspondence in to them and we are awaiting a response.
>
> ...
>
> Mr Marney—We have had one meeting with the Policy Transition Group. Many of the issues we have sought clarification on fall outside the terms of reference of that group.[67]

MRRT – Less fair, royalty credits which are non-refundable, non-transferable

4.71 Although the PTG has now settled the issue of crediting all future royalties, the fact that royalties will be creditable but not transferable or refundable means that distortions and disincentives will remain under the proposed MRRT model.

4.72 The distortions and disincentives occur because, in some circumstances, credits will accrue but will not be able to be used. Economists who gave evidence to the committee identified this as an issue:

> CHAIR—...the mining tax deal between the government and the big three miners that all state royalties will be credited against the mining tax. The mere fact that they are going to be credited does not actually mean that they are going to be refunded, does it?
>
> Prof. Pincus—No. They are only credited and not refundable. If no MRRT tax is paid you do not get a refund from the Commonwealth.
>
> CHAIR—So if your project is in the decline phase, as has been said—and royalties supposedly accelerate the closure of a mine—presumably you are

66 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, pp. 11–12.

67 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Mr Timothy Marney, Under Treasurer, Department of Treasury and Finance, Western Australia, *Committee Hansard*, 8 November 2010, p. 66.

> at a stage of your mine life where you are never again going to be sufficiently profitable to be subject to the mining tax. Whatever credits you accumulate will not serve any purpose whatsoever, will they?
>
> Prof. Ergas—That is correct. In the simple case of an entity which operates a single mine and where there is no scope to transfer the liabilities associated with royalties or the credits associated with royalties across projects, then the royalties will have whatever distorting effects they have at the moment. The situation may be more complex if you are an entity that is operating multiple projects and can transfer.
>
> CHAIR—Is it? In the heads of agreement it says very clearly that royalty credits are not transferable between projects. So even if you have got multiple projects, if you cannot transfer—which, as I understand it, you cannot—then the problem is still there. If you are a mine in the decline phase, you are not any better off; in fact you are probably worse off because you have got to go through the administrative processes of the mining tax.
>
> Prof. Ergas—That is indeed the case. The point we make in the article is that the risk is that you will accumulate the distortions associated with the royalties with the distortions associated with what is effectively a profits based tax.[68]

4.73 The government's proposed MRRT, as a top-up tax, not only results in complexities due to its interaction with the existing state royalty regimes, but, by treating royalties as creditable but not transferable or refundable, the government has perpetuated a further distortion through the proposed 'carry forward' arrangements that can be applied. Although the government views the 'carry forward of unused credits' feature as a solution to the problem of potential double taxation, if it results in a change in taxpayer behaviour, distortions may in fact be compounded.

4.74 Submitters to the inquiry identified that this feature of the proposed MRRT may in fact result in two different distortions. In some instances, smaller miners will be discouraged from investing in riskier projects as credits for royalties paid will accumulate but may not be able to be used whereas, on the other hand, a larger miner with larger operations may choose to delay or restrict production volumes to future years in an attempt to capture the gains that can be realised as a result of the uplift factor that will be applied to carried forward credits.

The 'carry forward' arrangements for royalty credits

4.75 Under the Heads of Agreement, credits accumulated (for royalties paid) but unable to be transferred or refunded are to be carried forward for future use. The government announced that these credits would be carried forward at the uplift rate of the long term bond rate (LBTR)[69] plus 7 per cent.

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68 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Professor Henry Ergas, *Committee Hansard*, 30 March 2011, p. 9.

69 The long term bond rate in Australia is currently around 5.5 per cent.

4.76 The application of an uplift factor to the carried forward credits is appropriate in order to recognise the effect of the passage of time on the value of money; however, the uplift factor to which the government has now agreed (of the LTBR plus 7 per cent) is considered by some to be far too generous and a source of further distortion:

> On the one hand, the treatment of tax credits by the government is mean in the sense that, if the project fails, you cannot use them. So there is the disincentive to taking risk. On the other hand, the treatment of the tax credits by the government is too generous. They are being accumulated at 12 per cent tax-free, whereas they should be accumulated at five per cent and pay tax—in other words, at 3½ per cent tax-free. I do not think that produces an incentive to minimise profits. You still want however much of the profits the government takes and still want more rather than less as long as the tax rate is less than 100 per cent. But it gives you an incentive to develop a mine more slowly than you would if the tax credits were being carried forward at 3½ per cent.[70]

4.77 This treatment of unused royalty credits, as set out in the Heads of Agreement, differs from the treatment of royalties proposed under the original RSPT model as, under that model, taxpayers would have received a refundable credit for state royalties paid. There would be no carry-forward required.

4.78 Professor Fane identified the possibility for distortion that could arise from the proposed carry forward provisions. Professor Fane suggested that the ability to carry forward unused credits at such high rates would encourage those within the mining industry to develop more slowly because by doing so they would avoid some taxation:

> CHAIR—...You talked about how, because of the crediting arrangements, there is an incentive to delay projects and hold credits because there is a 12 per cent risk-free return, effectively, by just holding the credits. Can you talk us through that in a bit more detail?
>
> Dr Fane—Under the Brown tax, suppose that in a particular period a company has no receipts and it spends $2 and there is a 50 per cent tax. Under the Brown tax, the government would give it $1—or $1 billion if we wanted to make it large numbers. Under the Henry proposal, the government is going to give it one dollar's worth of government bond. If it really gave it one dollar's worth of government bond the company would have to pay tax on the interest on that bond.
>
> CHAIR—So it is a tax-free return?
>
> Dr Fane—But in the case of the Henry proposal, the idea was to give them a tax-free government bond.
>
> CHAIR—I am interested in the MRRT.
>
> Dr Fane—It has a still larger effect because instead of giving them a tax-free government bond that pays five per cent, they will give them a tax-free

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70 Professor George Fane, *Committee Hansard*, 30 March 2011, p. 41.

government bond that pays 12 per cent. A company that have been given a government bond that pays 12 per cent and is tax-free have an incentive to hold onto that bond. They cannot sell it to somebody else; they want to keep it as long as possible. To keep it as long as possible, they want to delay earning the revenue against which they will eventually use it. This is because the way in which they are going to get their return is by taking their credit and offsetting some receipts in the future.

> CHAIR—Of course, the MRRT would not apply. They will not be paying additional tax on the 12 to 13 per cent that they have received from the uplift factor the credits. That is right?
>
> Dr Fane—It is free of company tax.
>
> CHAIR—It is free of company tax, but would they pay any tax on it?
>
> Dr Fane—No, they would not. It is going to be used as a credit against future payments of resource rent tax.
>
> CHAIR—Which would be less because the credits have been escalated. What you are really saying is that by holding those credits and not incurring the tax you can have a risk-free and tax-free return of 12 to 13 per cent, which you would not be able to get anywhere in the market?
>
> Dr Fane—That is right. But if you earn the revenue next year that you have to pay this against, then the party is over next year. But if you wait for two years the party goes on for two years.
>
> CHAIR—Is it compounded?
>
> Dr Fane—Yes.
>
> CHAIR—So a compound return of 12 to 13 per cent, tax-free, does provide quite a perverse incentive to not go ahead with making profits.
>
> Dr Fane—It is an incentive to develop more slowly or extract the resources more slowly.[71]

4.79 To address this issue, Professor Fane suggests that a much more appropriate uplift rate at which to carry forward unused credits would be 3 per cent:

> The point that the Henry committee did not make, but it should have made, is that it is the long-term government bond rate after tax. Because if you give a company a government bond it is paying interest, if you want to have a neutral tax system, the company should be paying tax on that interest. So the appropriate interest, unless the implicit interest on the tax credits is included in company tax, which I am confident it will not be in Australia, then the appropriate interest rate is not, let us say, five percent of the government bond rate it is that minus the company tax rate, so it is a number like three per cent which is the appropriate carry forward interest rate.[72]

71 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Professor George Fane, *Committee Hansard*, 30 March 2011, pp. 28 - 29.

72 Professor George Fane, *Committee Hansard*, 30 March 2011, pp. 24 - 25.

MRRT – More complex and administratively burdensome, the $50 million profit threshold

4.80 The MRRT and expanded PRRT are designed so that taxpayers with low levels of resource profits would not have to pay the tax. The threshold at which liability to the tax commences has been set at $50 million. Concerns have been raised that the $50 million threshold increases compliance costs of the proposed tax, adds complexity and further discriminates. In addition to these concerns, confusion remains in regard to how the threshold would operate:

> CHAIR—Have you made a decision on the $50 million threshold, how it will operate—as to whether the MRRT will apply to $51 million or to the $1 million et cetera above $50 million?
>
> Mr Parker—That is a matter that the PTG is consulting on. We will be making a recommendation to the government, and the government will make a decision.[73]

4.81 Smaller miners raised concerns that the calculation of the threshold would only occur after the end of the financial year and, therefore, they would incur a complex administrative compliance burden in order to ascertain their liability. Because of this, they have advocated for the threshold to be raised:

> Mr Bennison—I think it is fair to say that there are some concerns about how it is going to apply.
>
> CHAIR—Do you know how it is going to apply now?
>
> Mr Bennison—No, we do not. We put a tax-free threshold at that mark. We have obviously asked for it to be increased from $50 million to $250 million and we want a tax-free threshold up to that point.
>
> CHAIR—Has anybody been able to explain to you how they determined the $50 million?
>
> Mr Bennison—No.[74]

4.82 The Chamber of Commerce and Industry of Western Australia agreed with the view put forward by small miners that the $50 million threshold may not be appropriate:

> Mr Richards—...I think the problem there is that we do not know where that $50 million figure comes from, and that is why our comments in that area have been fairly limited. We do not really know what assumptions and calculations went into actually calibrating that threshold. What is clear in our minds is that the threshold ought to serve primarily the issue of tax

73 Senator Mathias Cormann, Chair, Senate Select Committee of the Scrutiny of New Taxes and Mr David Parker, Executive Director, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 49.

74 Mr Simon Bennison, Chief Executive Officer, Association of Mining and Exploration Companies, *Committee Hansard*, 8 November 2010, p. 11.

> efficiency in order to protect smaller miners and also to ensure the government is not allocating resources unnecessarily where they are going to have a small tax intake from that particular part of the sector. So our feeling is very much that that threshold ought to be calibrated around the issue of tax efficiency to ensure that smaller miners are protected and administrative efficiencies are achieved in the tax so that the government is not exerting too many resources.[75]

4.83 Their concerns were shared by the Chamber of Minerals and Energy Western Australia who say that the threshold would be particularly detrimental to miners of low value/grade minerals:

> The chamber has significant concerns over the quantum of the threshold, how it was arrived at, whether $50 million is adequate and also how it is operating. We advocate it operates as a tax-free threshold. The chamber also has significant concerns with regard to low-value resources, which usually require significant processing to value add and whose operators will be required to undertake significant and costly compliance measures even though they will be paying minimal or no tax under the MRRT. These concerns also apply to junior developers trying to get their projects up and running.[76]
>
> Mr Edwards—As I have said before, the MRRT does go some way to providing competitive neutrality. Having the taxing point at the mine gate to some extent addresses that. Having a tax-free threshold goes some way to addressing that. Getting your full realisation of your downstream assets when valuing your resource goes to an extent to get competitive neutrality. However, our argument is: is the $50 million threshold adequate to provide that neutrality? We do not know; the government has not modelled it.
>
> Senator MARK BISHOP—We are talking about the principle. You and I both know that financing costs and the taxation imposts are different between a gold mine, a coal operation and a high-quality iron ore proposition. None of those are competitively neutral. So how do you reconcile the two?
>
> Mr Edwards—A higher valued resource will pay more tax. That is fine. But what I am saying is that the impact of the tax relative to each of the commodities must not adversely affect that...[77]

4.84 The Magnetite Network, a lobby group representing magnetite miners, (magnetite is a low value mineral that requires extensive processing to produce a

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75 Mr Noel Richards, Senior Policy Adviser, Resources and Energy, Chamber of Commerce and Industry of Western Australia, *Committee Hansard*, 8 November 2010, p. 83.

76 Mr James Edwards, Chamber of Minerals and Energy Western Australia, *Committee Hansard*, 8 November 2010, p. 46.

77 Senator Mark Bishop and Mr James Edwards, *Committee Hansard*, 8 November 2010, p. 50.

saleable good),[78] confirmed that their inclusion in the tax regime would result in substantial compliance costs:

> Ms Megan Anwyl—...when it is mined magnetite has a very low value and it is very difficult to even track this because it has not traditionally been sold as raw ore. It is really only after the beneficiation process that magnetite has a value. We note that the beneficiation process is similar to some other base metals that have been exempted from the tax and we will come back to that shortly. We also think that the taxation of magnetite concentrate is contrary to the policy intent stated by the Prime Minister and a range of other senior ministers...
>
> Mr Mackenzie—...Essentially, our case is for exclusion of the production of magnetite concentrate.... Less than two per cent of Australia's iron ore is produced as magnetite concentrate and that is because we are well endowed with the direct shipping stuff. The USA, China, Canada and Brazil have extensive deposits of magnetite, which they are mining and concentrating into magnetite concentrate and using as feedstock into their steel business...[79]

4.85 The concerns raised by industry stakeholders were acknowledged by the government through the PTG which, through its terms of reference, was asked to consider the issues that had been raised, and develop a workable exclusion for taxpayers with profits of less than $50 million. The PTG was asked to develop an exclusion that would address the concerns of smaller miners in regard to increased compliance costs even though they would not be liable to pay the tax.

4.86 In response, the PTG advised government that although the existence of the threshold would be unlikely to reduce compliance costs for taxpayers (as they will still be required to maintain records and undertake the full MRRT calculations regardless of whether they are above or below the threshold), to avoid a large change in their MRRT tax bill as they cross the $50 million threshold and changes in production behaviour, the PTG recommended phasing in a taxpayer's MRRT liability from an annual MRRT profit of $50 million.[80]

4.87 Further, in recognition of concerns raised by smaller miners that they would be required to account for the MRRT but never be liable to pay the tax, the PTG recommended that tests be designed to identify those taxpayers and provide them with a low cost compliance option.[81]

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78 Magnetite Network (MagNet), *Submission 25*, pp 3–4.

79 Ms Megan Anwyl, Executive Director, Magnetite Network, Mr William Mackenzie, Chairman, Magnetite Network, *Committee Hansard*, 8 November 2010, p. 94.

80 Policy Transition Group, *Report to the Australian Government – New Resource Taxation Arrangements*, December 2010, p. 16.

81 Policy Transition Group, *Report to the Australian Government – New Resource Taxation Arrangements*, December 2010, p. 16.

The Petroleum Resource Rent Tax

4.88 The government's revised mineral taxation framework also included changes to the existing PRRT regime. The existing PRRT is a profit-based tax, which is applied on a project basis - each entity with an interest in a PRRT liable project is liable for the PRRT.[82]

4.89 The existing PRRT is levied at a rate of 40 per cent of a project's taxable profit (that profit being calculated for PRRT purposes). Taxable profit is the project's income after all project and other exploration expenditures have been deducted from all assessable receipts. PRRT payments are deductible for company income tax purposes.

4.90 Under the proposed changes, the PRRT will be extended and be payable by all onshore and offshore oil and gas projects including the North West Shelf.[83]

4.91 The extension of the PRRT to onshore projects will involve:

(a) the tax's continued application at a rate of 40 per cent;

(b) a range of uplift allowances for unused losses and capital write-offs will be offered;

(c) all expenditure can be immediately expensed;

(d) the tax value of losses can only be transferred in limited circumstances;

(e) all state and federal resource taxes will be creditable against current and future PRRT liabilities; and

(f) transitional arrangements will be provided for oil and gas projects moving into the PRRT.[84]

4.92 Since the government's announcement of the changes to the MRRT and PRRT however, there has been little focus on the extension of the existing PRRT regime to onshore oil and gas. Despite this lack of attention, there remains concern within the industry that broadening its application would have significant detrimental impacts on domestic gas production. The concerns that have been raised by industry participants have focused on two main issues:

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82 Source: http://www.ret.gov.au/resources/enhancing/taxation/prrt/Pages/PetroleumResourceRentTax(PRRT).aspx (accessed 3 May 2011).

83 Australian Government, *Fact sheet - A new resource taxation regime: improved resource tax arrangements*, 2 July 2010, p. 2.

84 The points identified as key features of the PRRT have been sourced from the Government's fact sheet, *A new resource taxation regime: improved resource tax arrangements,* 2 July 2010, pp 2 - 3.

(a) the extension of the PRRT to onshore oil and gas would have a detrimental effect on domestic energy supply and lead to increased costs for consumers; and

(b) the application of both royalties and the PRRT would add administrative complexity and costs.

4.93 There is a view amongst the onshore oil and gas industry that the lack of attention that has been given to their concerns in relation to the extension of the PRRT is due to the industry's small size compared to the offshore industry:

> CHAIR—Most of the focus in the public debate on this mining tax package, which was announced on 2 July, has centred around the MRRT. There has not been much discussion on the impact of the onshore expansion of the PRRT. Why is that?
>
> Mr Streitberg—We are the most active onshore explorer in Western Australia, and my staff who can focus on these things are me and my CFO.
>
> CHAIR—You are saying there are not enough people who are able to dedicate the time to hit the drum on it.
>
> Mr Streitberg—Absolutely.[85]

The impacts of the expanded PRRT

4.94 The DomGas Alliance[86] is concerned that Australia's limited domestic energy supply would be put under further strain as a result of the changes leading to higher prices for consumers:

> We believe that any proposal to extend the PRRT to onshore and near onshore projects could have serious unintended consequences for supply...our studies show that a 40 per cent PRRT could make some of these projects uneconomic. It could also lead to high energy prices. If this were able to be passed through to customers we believe that such a pass-through would be contrary to the principle of the tax on resources and therefore it should not flow through to the customers. Our preference would be that domestic production of gas should be exempt from the PRRT. ...there are other options available.[87]

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85 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Mr Eric, Streitberg, Executive Director, Buru Energy, *Committee Hansard*, 8 November 2010, p. 113.

86 The DomGas Alliance was formed in 2006 in response to serious gas supply shortages in Western Australia. Members include: Alcoa of Australia, Alinta, Burrup Fertilisers; Dampier Bunbury Pipeline, ERM Power/NewGen Power, Fortescue Metals Group, Horizon Power, Newmont Australia, Synergy, Verve Energy and Windimurra Vanadium. Source: DomGas Alliance, *Submission 6*, p. 9.

87 Mr Anthony Petersen, Chairman DomGas Alliance, *Committee Hansard*, 8 November 2010, p. 33.

4.95 There is a concern that the extension of the PRRT to onshore gas has not been fully thought through, that its extension has been based on a simplistic understanding of the operation of the offshore model, yet, in comparison to offshore gas, onshore supplies are smaller and much more costly to extract.[88]

> As you are aware, the onshore oil and gas business has been subject to the royalty regime and then, to our astonishment, we were told that we were going to be pulled in under the PRRT regime. That raises a significant number of issues for us. It is both in relation to what the tax burden might happen to be and also the fact that we are trying to force a tax that was designed for the offshore into the onshore where the structure of the industry is quite different, and that raises all sorts of issues for us...apart from the other coal seam gas producers on the East Coast, the rest of the onshore industry is relatively small.[89]

4.96 Stakeholders who will be affected by the extension of the PRRT to onshore oil and gas have identified that the changes will raise significant issues. They have identified particular concerns with the administration of the PRRT, and how it might interact with royalties.

> The revenue from the application of PRRT to the small onshore explorers is likely to be very small but it will bring a compliance burden that is extremely difficult for us. It is a complex tax. Nobody really understands it very well. It is not administered particularly effectively by the ATO [Australian Taxation Office]. We have a very small number of people in the company, as do most small companies, and the compliance burden is going to be very onerous for us.[90]

> ...it is an extraordinary administrative burden. We do not really understand how it all works because there is only a handful of companies that pay PRRT at the moment—the Chevrons, the Woodsides et cetera—and most of the PRRT expertise is actually inside those companies, so it is very difficult to find it, even amongst the consultants. We have had to make a lot of assumptions about how all this stuff will work.[91]

The PTG's findings in respect of PRRT

4.97 The concerns raised by stakeholders who would be affected by the extension of the PRRT to onshore oil and gas were, however, recognised by the PTG. As a result, although the PTG's limited terms of reference restricted it from making recommendations, it did acknowledge there were problems in the proposed design of

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88 Mr Anthony Petersen, Cahir Domgas Alliance, *Committee Hansard*, 8 November 2010, p. 33.

89 Mr Eric Streitberg, Executive Director, Buru Energy Limited, *Committee Hansard*, 8 November 2010, p. 110.

90 Mr Eric Streitberg, Executive Director, Buru Energy Limited *Committee Hansard*, 8 November 2010, p. 110.

91 Mr Eric Streitberg, Executive Director, Buru Energy Limited, *Committee Hansard*, 8 November 2010, p. 112.

the expanded PRRT and suggested that the government consider improving the design of the tax:

> The PTG's terms of reference are limited to providing advice to Government on the extension of the PRRT. There is no PRRT equivalent of the MRRT Heads of Agreement that outline design features of the transition so the PTG has looked to the principles already in place in the PRRT... While it is not within the PTG's terms of reference to make recommendations on these matters, in several instances, the PTG considers there is merit in improving the design of the PRRT as part of its extension to transitioning petroleum projects. This could include modernising the PRRT Act and aligning it with the tax code.[92]

4.98 Whilst appearing before the committee, Alliance members drew the attention of the committee to what they consider to be an inconsistency between the government's decision to extend the PRRT to onshore gas, and actions taken by government in Western Australia to provide incentives to domestic gas suppliers to encourage supply to the domestic market:

> ...in Western Australia, where we face a shortfall for domestic gas in the coming years. We also recognise that the government here in Western Australia has relaxed royalties on tight gas from 10 per cent to five per cent to encourage this investment in tight gas exploration and development, and we would ask that the committee make sure that there is no contrary effect by the PRRT on these royalties to incentivise domestic gas production.[93]

Committee comment

4.99 The committee is concerned that with the MRRT and expanded PRRT the government has not put forward genuine and well thought out tax reform proposals, but rather went for a quick and opportunistic grab for additional cash.

4.100 The MRRT and expanded PRRT are top-up taxes which will increase complexity and increase distortions in the market.

4.101 When it comes to the treatment of royalties, the MRRT, structured as a top-up tax, was always going to expose either the mining companies or the Commonwealth Government's budget bottom line to additional risks. Either the mining companies liable to pay the new tax would still face ongoing exposure to state and territory royalty increases; or the Commonwealth Government had to carry the risk to its budget bottom line that state and territory governments may increase their royalties on iron ore and coal production in the future.

4.102 As it turned out, the three big mining companies had enough leverage over a government facing a difficult election and exhausted from two months of intense

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92 Policy Transition Group, *Report to the Australian Government – New Resource Taxation Arrangements*, December 2010, p. 89.

93 Mr Anthony Petersen, Chair, Domgas Alliance, *Committee Hansard*, 8 November 2010, p. 33.

public fighting over the RSPT. They obtained a commitment that all state and territory royalties would be creditable against any MRRT liability.

4.103 The recent decision by the Western Australian Government to remove a royalty concession on iron ore fines is the first practical consequence of the Commonwealth Government's failure to think through the implications of the mining tax for royalty and GST sharing arrangements. The Western Australian Government's decision to remove that concession has already blown a $2 billion hole in the federal budget over the current forward estimates. Other states could make similar decisions about royalty arrangements in their jurisdictions and there is nothing the Commonwealth could do about it. Every time a State government decides to increase its royalties, federal revenue from the mining tax would be reduced. Yes, there would be implications for GST sharing arrangements; but all that would do is share more GST revenue across all states and territories, not return any of the additional revenue to the Commonwealth.

4.104 The committee considers that the government has only got itself to blame for this outcome. The promise in the mining tax deal to credit 'all state and territory royalties' was always going to expose the federal budget to this risk.

4.105 The committee is at a loss to understand how the federal government ever thought they could 'reform' resources taxation and royalty arrangements without actively engaging the states and ultimately reaching agreement with them. The government knew they needed to negotiate with the states, as the Henry Tax Review had recommended it. It seems they never even tried.

4.106 Yet when the Prime Minister and the Treasurer signed the mining tax deal, they went ahead and committed the Commonwealth to crediting all state and territory royalties against any national mining tax liability. That was always going to expose the federal budget bottom line to future royalty increases in any state or territory.

4.107 The Commonwealth Government ought to have known that under our Constitution, changes to royalty rates are the exclusive prerogative and responsibility of the states.

4.108 The committee is not surprised the government failed to deliver on its stated commitment to a simpler and fairer tax system given the inadequacies of its policy development process. The evidence received by the committee is clear – distortions of investment and production decisions under the MRRT would be worse than under the status quo. That is the conclusion not only of mining industry stakeholders, but also of two economists who appeared before our inquiry having previously signed a statement in support of resource rent taxes. The proposed new tax is not competitively neutral and it would have a disproportionate impact on resource rich states like Western Australia, Queensland, New South Wales and the Northern Territory.

4.109 When the Henry Tax review was commissioned it was supposed to be root and branch reform to deliver a simpler and fairer tax system. The government has failed spectacularly to deliver on that objective.

4.110 The government's decision to pick up the Henry Tax Review recommendation to introduce a resource rent tax, change it, pursue it in isolation of everything else and without consultation, was never going to work. The government chose not to engage in the more difficult and challenging processes, such as negotiating with the mining industry as a whole or engaging with the states and territories, reaching agreement on necessary related changes to federal-state financial relations. The policy and political mining tax mess the government is faced with today is the inevitable conclusion of the government's mismanagement of the issue and a deeply flawed process.

4.111 In summary, the MRRT and expanded PRRT would impose more economic distortions than the existing royalty arrangements. The MRRT is imposed on a narrow base which penalises some resource sectors (iron ore and coal). Negotiations were rushed which led to an ambiguous agreement and degenerated into a semantic argument over the definition of 'all'. Moreover, these new taxes would impose substantial compliance costs even on sectors which may not necessarily have a large liability (such as the onshore gas and petroleum sector). Overall, the government's response to the Henry Tax Review has exposed the Commonwealth Budget to a higher degree of risk. The government has proposed various associated measures which will become increasingly costly over time to be funded by a tax which could be dramatically impacted at any time by increases in royalties by state governments. These deficiencies completely refute the government's argument their proposed changes create a more efficient tax system.

4.112 In the committee's view the design of the MRRT and expanded PRRT is irretrievably broken. Any attempt to 'fix' the defects in these taxes would sucker a government into a series of quid-pro-quos with affected companies which could never be the foundation of enduring taxation reform. Instead, the government should scrap its first but failed attempt to respond to the Henry Tax Review and start again.

Recommendation 6

4.113 The committee again recommends that because the government's proposed MRRT and expanded PRRT would impose more economic distortions than existing royalty regimes, the Parliament not support any plans by government to pass legislation to give effect to these proposed new taxes.

Chapter 5

Broader economic consequences of the flawed Mineral Resources Rent Tax and the expanded Petroleum Resources Rent Tax

Introduction

5.1 As detailed in Chapter 4, the flawed policy development process of the MRRT and expanded PRRT has lead to a distortionary, complex and unfair taxation regime to be imposed on one of the most important industries for Australia's economic prosperity into the future. Chapter 4 identified and examined the specific design concerns that stakeholders continue to have despite the work done by the PTG. The focus of that chapter was on the impact on the industry.

5.2 In addition to the specific design concerns raised by stakeholders and set out in Chapter 4, a number of broader concerns were raised. Those broader issues are outlined and examined in detail in this chapter. In particular, concerns were expressed about the lack of competitive neutrality of the proposed MRRT, the negative impact on Australia's international competitiveness and the sovereign risk implications impacting on investment in this important sector of the economy. Importantly, this chapter also examines some of the implications of the MRRT and expanded PRRT on the Commonwealth Budget.

Competitive advantage for the big three miners

5.3 As clearly set out in Chapter 3, the process employed by the government to develop the MRRT and the expanded PRRT was deeply flawed. Many contributors to this inquiry who are stakeholders in the mining tax debate were excluded from the discussions. These stakeholders view the government's decision to consult with the industry's three largest miners as providing those miners with a competitive advantage. This view is legitimate, as these three large miners were given exclusive access to both information and decision makers and were able to directly influence the design of the tax.

> The design of the tax is biased in favour of BHP and Rio in particular—given that they are our major competitors in the iron ore industry in a number of ways—in terms of both design and the combination of elements of the design.[1]

5.4 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

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1 Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 21 – 22.

mining tax - ultimately costing taxpayers up to $60 billion.[2] 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.

5.5 On Wednesday, 30 June 2010, Mr Gerard Bond of BHP Billiton sent by email to the then Treasurer's Chief of Staff, Mr Chris Barrett, and the Minister for Resources' then Chief of Staff, Ms Tracey Winters, a draft of the MRRT Heads of Agreement. The next day, 1 July, Mr Barrett provided the email to David Parker, who was at the time the Treasury Executive Director of the Revenue Group, along with another senior Treasury officer and 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[3]

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

> Gerard,
>
> Final, clean version for your signature. Please let me know if any issues at your end.
>
> Regards,
>
> Chris[4]

5.7 The more junior stakeholders take the view that, the features of the proposed tax, negotiated exclusively, provide a competitive advantage to the well established three multi-national, multi-commodity and multi-project miners.

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

3 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)

4 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)

> The main points are around the application of the mining rights value versus the principles involved in historical cost; the low value they appear to be arguing should be placed on infrastructure, where they are likening it to a railroad in central Melbourne as opposed to high-risk infrastructure linking a port to a mine; the way 'projects' looks as if it is being defined through the consultative panel; and the transferability rules. It is the combination of those particular factors that tends to favour companies with established mines and infrastructure and clusters of mines that help to de-risk that infrastructure in remote locations. The definitional aspects of 'projects' seem to be biased towards BHP and Rio. There is the issue of possible treatment of black-hole expenditure, which is particularly relevant for companies that are trying to develop but may not meet the definition of a project at this point in time...There is also the cost of compliance. The cost of compliance for this thing, per tonne, for the smaller players is going to be horrendous compared to the per-tonne cost of compliance for the larger companies.[5]

5.8 Andrew Forrest, Chief Executive of Fortescue Metals Group, explained recently that the particular changes to the starting base, to enable market valuation to be placed on projects, will provide a particular advantage to the large, well established miners with existing projects, at the expense of smaller ventures:

> If you don't have that large market value, like developers don't, then you start paying the tax immediately whereas the multinationals don't start to pay it for decades, if at all... If you have the balance sheet to fund a project, that's fine, you're OK... But if you don't have that balance sheet, then you're not going to be allowed to deduct interest before you pay this tax - that works directly against project financiers.[6]

5.9 This will make it more difficult for smaller emerging miners to develop as the ability for the large multinationals to claim a deduction for the market value of their projects will provide them with a tax shelter:

> Running the model based on the government's assumptions means a new miner with a $1 billion capital investment can deduct this value over the five-year transitional period, so the outcome is an MRRT bill of $185 million. Using this same model for an established miner with a $3 billion market value resource base, to depreciate that asset over an assumed eight-year life of the mine results in the miner paying no MRRT at all. Put simply, the new miner will pay $185 million in MRRT and the established miner will pay none.[7]

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5 Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 21-22.

6 Mr Andrew Forrest, quoted in, Sue Lannin, Revised mining tax un-Australian: Forrest, *ABC News*, 13 June 2011, http://www.abc.net.au/news/stories/2011/06/13/3242507.htm (accessed, 14 June 2011).

7 Mr Stephen Pearce, Tax man digs a hole for emerging miners, *Australian Financial Review*, 22 June 2011, p. 63.

5.10 It is a travesty that smaller home-grown companies are penalised at the expense of multinationals.

> There's never been a penalty like that against Australian companies in the history of our constitution... It shouldn't start now and, if it were to be adopted, it creates a very dangerous precedent.[8]

5.11 These smaller stakeholders also completely rejected the government's assertion that the deal struck, as set out in the Heads of Agreement, was a deal made with the mining industry:

> ...the agreement that was struck between the Prime Minister and the three companies was a deal done between the Prime Minister and those three companies. It was not a deal that was done with the industry. It provides a competitive advantage to those three companies to further strengthen their dominance.[9]

5.12 One of the concerns raised by these smaller miners is that the introduction of the proposed MRRT and expanded PRRT would impede their ability to innovate, particularly given the scrapping of the exploration rebate and the changes to the starting base calculations which favour larger, well established operations.

5.13 There are concerns that the preferential treatment of the signatories of the Heads of Agreement may in fact stunt the continued growth of Australia's mining sector, particularly junior miners who are generally the early innovators and risk takers. Such concern is particularly worrying, given the possible impact on the national economy.[10]

> CHAIR—So you are saying that we have an Australian success story like BHP, Rio and so on because of the risks taken in the past and the MRRT today will make it less likely for us to have similar success stories in the future because there is a disincentive to take on the sorts of risks which were taken on 30 or 40 years ago by BHP and Rio; is that right?
>
> Prof. Ergas—Yes, that is correct. It will also have the effect of distorting decisions and the allocation of resources between large established miners, such as BHP Billiton, Rio and Xstrata, and newer mining entities that do not have as wide a portfolio as the established miners have and as much scope to offset gains and losses within that portfolio.
>
> CHAIR—So what you are saying then—and I am not wanting to put words into your mouth, so correct me if I am wrong—is that those three big mining companies that had the privilege of sitting around the table with the

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8 Mr Andrew Forrest, quoted in, Sue Lannin, Revised mining tax un-Australian: Forrest, *ABC News*, 13 June 2011, http://www.abc.net.au/news/stories/2011/06/13/3242507.htm (accessed, 14 June 2011).

9 Mr David Flanagan, Managing Director Atlas Iron, *Committee Hansard*, 8 November 2010, p. 5.

10 Mr Morgan Ball, CFO and Company Secretary, BC Iron Ltd, *Committee Hansard*, 8 November 2010, p. 6.

> Prime Minister, the Treasurer and the Minister for Resources and Energy are receiving more favourable treatment under the way the MRRT is designed than those competitors and potential future competitors who were excluded from the process when this tax was negotiated behind closed doors.
>
> Prof. Ergas—Yes, I think that is a reasonable summary of the situation. Essentially we have a tax that is in many respects a highly distorting tax but it is especially highly distorting in respect of those who were not included in its negotiation... .I do not believe it is competitively neutral. It is distorting the decisions that will be taken by the major established miners and will have significant distorting effects in that respect; but it is also distorting in terms of the allocation of resources between those established miners and potential, and at this point unknown, future challenges.[11]

Sovereign risk

5.14 As it is expected that demand for commodities from China and India will remain strong into the future,[12] Australia as a destination for foreign investment will increasingly compete with other suppliers of coal and iron ore. There is a concern amongst miners that the surprise announcement of the MRRT and extended PRRT has damaged Australia's reputation as a stable environment for such investment.

> The MRRT… continues to severely damage Australia`s sovereign risk and reputation as a safe place in which to invest.[13]
>
> [The MRRT] …is a direct transfer from shareholders to the government and also reinforces fears about sovereign risk.[14]

5.15 Perceptions of increased sovereign risk because of the proposed MRRT and PRRT, will see Australia face increased competition from lesser developed countries that have large, untapped reserves of mineral resources:

> The "Pilbara's of Africa" are a real danger to the people of Australia, because if they get their iron ore going at the level of the Pilbara then all those jobs, all those earnings and all those taxes will be enjoyed by other countries and not by Australia.[15]

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11 Senator Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Henry Ergas, *Committee Hansard*, 30 March 2011, p. 6.

12 Dr David Gruen, Executive Director Macroeconomic Group Australian Treasury, 'The Resources Boom and Structural Change in the Australian Economy', *2011 Economic and Political Overview Committee for Economic Development of Australia*, 24 February 2011.

13 Association of Mining and Exploration Companies, *Submission 3*, p 1.

14 Institute of Public Affairs, *Submission 15*, p 7.

15 Mr Andrew Forrest, CEO, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 19.

5.16 Academics also share the concern that there could be a global response to the proposed changes to Australia's mineral taxation regime that reduces Australia's competitiveness as a supplier of resources:

> The MRRT will make investing in Australian coal and iron ore projects less attractive than those overseas and less attractive than investing resources not subject to tax, and it will penalise high-risk projects, that is, compared to situations without such a tax. Moreover, the MRRT falls less heavily on mature projects that are included in a portfolio of Australian mining assets. It falls less heavily on those that have high market values and less heavily on miners who have ready access to overseas alternatives. And the three mining companies that negotiated the MRRT with the Gillard government have these exact characteristics.[16]

5.17 The Australia Institute, however, does not accept this argument and suggest that the concept of sovereign risk has been misconstrued by the mining industry:

> 'Sovereign risk' is a concept that the miners have re-introduced into the debate. It used to refer to the risk of nationalisation or expropriation in some third-world countries in the past. Nowadays, it seems to refer to just any tax increase that affects a mining company. For example, it was used in the context of the proposed emissions trading scheme. There is, of course, the 'risk' that any democratic country will change tax rates, environmental laws, industrial relations legislation, land rights and a host of other circumstances. But in a democracy, questions about spending and taxing are always subject to debate and change.[17]

5.18 Given the differing views held on what could be considered a first order issue for future economic growth in the sector, the matter of sovereign risk was raised with Treasury. Treasury officials advised that the matter is multifaceted:

> ...taxation arrangements are one consideration but only one consideration among many. And if taxation was the extent of sovereign risk that was of concern to a mining venture, it would be of a lesser order of magnitude in risk terms than many other forms of sovereign risk that one could find around the world in places that are well endowed with mineral resources... it is very difficult to make an assessment of the extent to which concerns about sovereign risk actually affect individual investment decisions.[18]

5.19 The Treasury view of taxation and sovereign risk differs from that of many professional economists. For example, Professor Fane wrote, in reference to the government's original RSPT proposal, that:

> The resource rent tax looks like the answer to a Treasurer's prayer: a non-distorting tax that allows the community to share equitably in the value of

16 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 3.

17 Australia Institute, *Submission 14*, p 7.

18 Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 42.

> resources that rightfully belong to the community. Unfortunately, it is a chimera. Applied to existing successful projects with no compensation for past investment, it would be equivalent (economically, if not legally) to the nationalisation, without compensation, of 40 per cent of the equity in the relevant projects.
>
> Unless the government proposes to search out all those who have invested in failed projects and refund them 40c per dollar of losses, plus accumulated interest since 1901, or whenever, then a rent tax applied to existing successful projects, with past investment carried forward at the government bond rate, is equivalent to the nationalisation with less than full compensation of part of the equity in the relevant projects. Such a policy would only be non-distorting if the government could offer a cast-iron guarantee that it would never be repeated. But in the context of a rent tax applied to existing as well as new projects, the "cast-iron guarantees" that the tax rate will never be raised and that tax credits on future projects will be honoured are a joke: it is like being offered a guarantee from someone who has stolen your wallet that they will never steal from you again.[19]

5.20 Treasury's view also contrasts with the reality of the experiences of industry participants. An illustration is the experience of Fortescue Metals Group Ltd who explained to the committee that, in recent capital raising negotiations, which occurred after the announcement of the MRRT and expanded PRRT, over 400 individual institutions raised concerns about sovereign risk:

> We had contact with 426 different institutions in our recent capital raising. Each one of them expressed their concern about the unnecessary, unpredictable and discriminatory basis of Australia’s purported taxation regime as considered under the MRRT. I say to you at the outset that this harms Australia. The very discussion harms Australia.[20]

5.21 It is clear that issues of sovereign risk affect the three multinational signatories to the Heads of Agreement to a lesser extent than they do local junior miners within the sector who do not share the same ability to spread their risk across different jurisdictions. This is the view of Fortescue Metals Group Ltd who observed that BHP Billiton, Rio Tinto and Xstrata all have investments in countries that are ultimately competing with Australia for market share.[21]

5.22 Indeed, Xstrata confirmed that this was the case and that, in considering investment, stability in 'fiscal type issues like tax and royalties' does play a part in the decision making process:

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19 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

20 Mr Andrew Forrest, Chief Executive Officer, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 18.

21 Mr Andrew Forrest, Fortescue Metals Group Ltd, *Committee Hansard*, 8 November 2010, p. 26.

> Like any other business there is a finite amount of capital available for investment and so prospective projects from around the world are ranked and prioritised. In this context Australian projects must compete for investment capital with other projects in different geographies...
>
> ...when we look at investing in countries around the world—and we have investments in 19 countries, some in Africa, some in South America, obviously here in Australia, New Caledonia and so forth—we look at the level of stability that we expect to get in terms of fiscal type issues, like tax and royalties and so forth, and we understand what changes have happened historically, the nature of the decisions the governments have made and whether or not we should be concerned about big changes in the future in those sorts of policies. Then we make investment decisions on our perception of risk.[22]

A flawed foundation – pure resource rents do not exist

5.23 The committee considers that of the design concerns raised during the inquiry process, the most notable is a concern held by many academic economists that although the concept of pure economic rents works in theory on the presumption that such taxes have no effect on investment behaviour, in practice, they are bound to fail.

5.24 Professor Pincus, a Visiting Professor of Economics at the University of Adelaide, explained why, in his view, pure rent taxes cannot exist, in reality:

> ...it is not feasible to tax mining in a neutral way such that the industry is unchanged except that the owners obtain less profit. If such a neutral tax did exist then it would be a tax on pure rents, and on pure rents only. Although the concept of a frictionless machine is very useful in theory, in practice no such machine exists; similarly, the concept of a tax on pure rent is useful in theory but in practice no such tax can exist. The definition of pure rent is, 'A payment made to the owners of a productive input which is in excess of that which is necessary to bring the productive input into being.' Nature put minerals in the ground and put them there with no payment. Thus, by definition, any payment for ownership rights over those minerals in the ground is pure rent. So, in theory, any tax on those pure rents, even a 100 per cent tax, will not alter the amount that is in the ground. In contrast, almost nothing else would come into existence in a market economy unless somebody is paid for the effort, the knowledge and the risk necessary to bring things into being. If a tax reduces those rewards then the tax will discourage production of all those other things.[23]

5.25 Professor Pincus explained that the gap between economic theory and practice can be attributed to information asymmetry and that reliance on generalised

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22 Mr Peter Freyberg, Chief Executive Officer, Xstrata Coal, *Committee Hansard*, 13 December 2010, pp. 17, 30.

23 Professor Jonathan Pincus, Visiting Professor of Economics, University of Adelaide, *Committee Hansard*, 30 March 2011, p. 1.

assumptions results in the failure of the economic theory when it is applied to real life situations:

> So there is a gap between economic theory and practice, and that gap arises because mining companies have information about their activities that is not available to government. Thus, a taxing authority cannot, with perfect accuracy, divide mining profits into two piles: that which is due to the value of minerals in the ground; and that which is due to the efforts, talents and risk taking of the owners, the workers and the suppliers. A tax will inevitably fall on some revenues that are not pure rents. The abandoned super profits tax is not a knife you can take to a magic pudding, which is the mining industry, cut out a slice and leave the pudding no smaller.[24]

5.26 The view that achieving economic rents in the resource sector requires investment by both public and private enterprise, and that there must therefore be some incentive for private investment to be undertaken, was a common observation made by economists who appeared before the committee:

> Essentially, the Henry review is saying: 'Virtually all of this resource rent is available for capture if government wants to, it could all be taken by government, and we'll set a rate that's a bit lower.' But in fact there are these opposing drivers for resource rents: there is clearly a strong government role for both the investment reason and the capital reason, which suggests that the resource rents or the amount of capture by government should be well above zero; and there is also a very strong private interest in there, which means that any tax on resource rents or any royalties should be well below 100 per cent. The resource super profits tax and the minerals resource rent tax are both in the middle somewhere—it is just that the Henry review did not explain why it is in the middle. The Henry review just came up with a number, but there was really no justification there for it. That is the first key problem—that we need a lot more rigorous analysis.[25]

5.27 Professor Rolfe, a Professor in Regional Development Economics from Central Queensland University, went as far as suggesting that the Henry Tax Review had been simplistic in its approach and had not adequately accounted for the role of both public and private investment in generating resource rents.[26] In his opinion:

> The Henry review downplays the important role that property rights and private investment have, as well as public investment, in creating resource rents. This is where there is a difference between text book economics and the real world. In textbook economics it assumes that we have a resource out there, and because of its physical location and the fact that you cannot shift it, it can earn these super profits. It takes that as a given and then looks to the ways of allocating those super profits, or rents as we call them. The

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24 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 1.

25 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 44.

26 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 44.

> problem is that both public investment and private investment over time create those rents.[27]

Revenue, spending and structural deficit under the MRRT and PRRT

5.28 The revenue projections surrounding the RSPT, MRRT and expanded PRRT have been the focus of much scrutiny since the first announcement of resource rent tax reform. This section of this chapter explores the revenue and spending implications of the MRRT and the PRRT and, in doing so, exposes the structural deficit that is associated with its fiscally irresponsible combination of volatile and reducing tax revenues and the increasing cost of associated budget measures. That cost of associated budget measures per annum progressively increases beyond Treasury's revenue projections for the MRRT.

Revenue under the RPST, MRRT and the PRRT

5.29 Commentators have pointed out that historically, revenues from resource rent taxes in Australia have been notoriously difficult to predict with a great deal of accuracy. For example:

> Using Treasury’s own Budget forecasts of revenue for the Petroleum Resource Rent Tax (PRRT) over the past 10 years, versus actual revenue collected from that tax during each of those years, it is apparent that Treasury’s revenue forecasts have been out by as much as 86 per cent in a single year.
>
> In 1997-98, the difference was 6.71 per cent, in 1998-99 it was -56.35 per cent; 1999-00: 64.44 per cent; 2000-01: 85.86 per cent; 2001-02: -4.83 per cent; 2002-03: 12.63 per cent; 2003-04: -8.75 per cent; 2004-05: 32.64 per cent; 2005-06: 42 per cent; 2006-07: -35.98 per cent; 2007-08: -5-51 per cent; 2008-09: -28.12 per cent. Check for yourself.
>
> No wonder Ms Gillard wants the nation to look forward, looking at Treasury’s history of preparing economic advice based on its forecasting of commodity prices shows that it is hopeless.
>
> Ms Gillard and Mr Swan want the nation to believe they are presenting hard economic data to justify their claims to economic responsibility but the figures they present are as firm as a dissolving blancmange.[28]

5.30 The government has never acknowledged the following basic fact: that other things being equal, a tax which produces a revenue stream which is highly volatile (or more precisely, highly correlated with overall economic activity) should have a lower value attached to it than a tax which produces the same revenue on average, but is less volatile.

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27 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 43.

28 P, Akerman, 'Gillard is Smoke and Mirrors Surpluses', *The Daily Telegraph,* 15 July, 2010, http://blogs.news.com.au/dailytelegraph/piersakerman/index.php/dailytelegraph/comments/gillard_con_is_smoke_and_mirrors_surpluses/

5.31 In other words, the risk or uncertainty attached to resource rent tax revenues is an important component of their value to the Australian community. As Ergas, Pincus and Harrison (2010) wrote:

> Public discussion of, including government commentary on, the RSPT and now the MRRT has focussed on the "rivers of gold" that it is claimed these taxes will yield. However, these claims embody fiscal illusion. When valued appropriately, the transfer of wealth from the miners to the taxpayers is less, possibly far less than is suggested by Treasury estimates of tax collections...
>
> ...In short, far from yielding "rivers of gold," such taxes yield highly risky returns, which taxpayers would rationally discount substantially in arriving at an estimate of the social value of the income stream. However, the promise of such "rivers," unaccompanied as it is (not least in AFTS) by any qualification as to the risk being placed on taxpayers, encourages fiscal illusion, that is, an underestimate of the social cost of funding spending commitments. This seems to make it more likely that such taxes will serve to increase low value public spending, compounding the inefficiencies involved in raising the revenue.[29]

5.32 When the RSPT was announced in the 2010-11 Commonwealth Budget, the government forecast that it would raise $12 billion over the forward estimates period.[30] The $12 billion is the summation of the first two years operation of the MRRT, that is, from 2012-13 to 2013-14, as set out in the first line of the table below.

Table 5.1: Revenue from the MRRT 2012-13 and 2013-14[31]

Stronger, fairer, simpler tax reform — resource super profits tax

Revenue ($m)	2009-10	2010-11	2011-12	2012-13	2013-14
Australian Taxation Office	-	-	-	3,000.0	9,000.0
Related expense ($m)					
Australian Taxation Office	-	*7.7*	*23.9*	*32.2*	*27.3*
Related capital ($m)					
Australian Taxation Office	-	-	*9.8*	*5.6*	-

5.33 Following the revision of the proposed RSPT to the MRRT and expanded PRRT, the government updated its revenue forecasts. Initial projections suggested that revenue to be collected from the much narrower MRRT (which would apply only to coal and iron ore and at an effective rate of 22.5 per cent rather than 40 per cent) and the expanded PRRT, was not significantly less than that for the RSPT and over the

29 Ergas, H. Harrison, M. and Pincus, J. (2010), *Some Economics of Mining Taxation*, Economic Papers, 29(4): 369-383, pp 380, 382.

30 Department of the Treasury, *Federal Budget 2010-11, Budget Paper No.2*, p. 45.

31 Department of the Treasury, *Federal Budget 2010-11, Budget Paper No. 2,* p. 45.

forward estimates period (over its first two years of operation) would raise $10.5 billion.[32] The MRRT and expanded PRRT would raise only $1.5 billion less than the RSPT.

5.34 The lack of significant difference between the revenue estimates over the forward estimates under a universal RSPT and its much narrower replacement, the MRRT, was questioned at the time. It was in fact an issue raised by the previous Senate Select Committee on Fuel and Energy. Evidence given by Treasury to that committee explained that the difference in the revenue forecasts was the result of changes to the assumptions (in particular significant increases in undisclosed commodity price assumptions) on which the estimates were based and the smaller scale of the MRRT's application.

> ...The $12 billion figure for the RSPT was, if you like, a whole system costing—that is, it took the RSPT gross revenue, netted off royalty refunds, accounted for the deductibility of RSPT payments in corporate income tax. So in the number there was the corporate income tax effect. It also took into account the effect of changed company tax payments at the personal level, so it was a full system costing. The same full system costing has been done for the MRRT—that is, netting off royalties to the extent that MRRT payments are in excess of royalties, otherwise creditable, taking account of the effect under company tax and also under personal tax. The whole system, the nature of the costing, is unchanged in that sense, but embedded in that are a number of ups and downs by taking into account the interactions between the profits based tax and the corporate income tax and at the shareholder level.
>
> So the differences in the costing come about for two reasons: one we have already explored, which is the change in commodity prices that have occurred since budget time, and the other effect that is relevant is the smaller scope of the MRRT compared to the RSPT in particular. In fact the MRRT applies only to coal and iron ore and the RSPT was to apply to the whole sector.[33]

5.35 This, however, did not explain why a uniform resource rent tax such as the RSPT would only raise $1.5 billion more than a narrow MRRT and expanded PRRT over the forward estimates period. The committee sought to understand how the base assumptions had changed and repeatedly requested that information from the Treasury.

> CHAIR—...Revenue estimates from the mining tax keep bouncing around quite a bit, based on changes in underlying assumptions. Are you now in a position to release those assumptions?

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32 Department of the Treasury, http://www.treasury.gov.au/documents/1962/PDF/MRRT_Model.pdf (accessed 6 May 2011).

33 Mr David Parker, Department of the Treasury, Senate Select Committee on Fuel and Energy, *Committee Hansard*, 5 July 2010, p. 14.

> Dr Henry—The government released a Mid-Year Economic and Fiscal Outlook recently which contained our most up-to-date forecasts for revenue from the mining resource rent tax. The Mid-Year Economic and Fiscal Outlook indicated the assumptions upon which those most recent estimates were based. As I am sure the committee would be aware, the revenue estimates are sensitive to movements in both commodity prices and exchange rates... That [recent] movement in the exchange rate has had a significant impact on a number of heads of revenue, but the mining resource rent tax revenue is one of those. The Mid-Year Economic and Fiscal Outlook explains how that occurs and sets out the assumptions with respect to the exchange rate, anyway, and commodity prices upon which the MRRT revenue forecast has been based.[34]

5.36 The Treasurer never volunteered the reasons for the small fiscal impact over the forward estimates of the significant change in scope of the newly proposed resource rent tax. The Treasurer again had to be forced to – eventually – make the concession that the reason was significant increases in commodity price assumptions in particular. As detailed in Chapter 3, the government's unwillingness to release assumptions and modelling has exacerbated uncertainty around the taxes' potential operation. Continued requests for the government to release the modelling assumptions were denied by the Treasurer on the grounds that the information was supposedly commercial-in-confidence and its release would be a breach of that confidence.[35] This is in contrast to the actions of both the governments of Western Australia and Queensland which publish their commodity price, production volume and exchange rate assumptions in their budget papers.

Revenue, Mid-year Economic and Fiscal Outlook: more volatility

5.37 Despite a reluctance to release the assumptions on which the revenue projections have been based, the government has repeatedly acknowledged the severe volatility of the revenue that is forecast to be generated by the proposed MRRT and expanded PRRT. In the 2010-11 Mid Year Economic and Fiscal Outlook the government stated:

> The potential for a renewed deterioration in the major advanced economies and transmission of weakness to the developing world presents considerable risks to the domestic economic outlook...risks surrounding the global economy have heightened in recent months. Were the global economy to falter, it is likely that Australia would be affected through both financial and trade channels, including through lower prices for our key commodity exports. Australia's terms of trade and income growth are heavily influenced by the prices of several key non-rural commodities that

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34 Senator Mathias Cormann, Chair Senate Select Committee on the Scrutiny of New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, 22 November 2010, p. 2.

35 Treasury Portfolio, answer to question on notice, 20-21 October 2010 (received 2 February 2011).

> are currently trading around record levels and which are highly sensitive to demand from the Asian region... the continuing uncertainty around the growth prospects for many of the world's major economies...is a potential source of volatility for budget estimates.[36]

5.38 The 2010-11 Mid Year Economic and Fiscal Outlook (MYEFO) showed that the revenue projections from the proposed MRRT and expanded PRRT had been revised down. The volatile nature of the factors underpinning the MRRT and the expanded PRRT revenue were beginning to be demonstrated:

Table 5.2: Revenue volatility of the MRRT[37]

Stronger, fairer, simpler — improved resource taxation arrangements

Revenue ($m)

	2009-10	2010-11	2011-12	2012-13	2013-14
Australian Taxation Office	-	-	-	-1,000.0	-6,500.0

5.39 These revised revenue forecasts were explained as having been revised down as a result of 'significant volatility':

> As the global supply of iron ore and coal increases, the medium-term outlook is for Australia's terms of trade to decline. However, the rapid pace of economic development in emerging Asia... underpins expectations that the medium term decline will be gradual, notwithstanding the potential for significant volatility over shorter time horizons.[38]

Revenue - Commonwealth Budget 2011-12: more volatility

5.40 More recently in its 2011-12 Federal Budget, the government acknowledged that the MRRT and expanded PRRT are:

> ...a highly variable source of revenue as they are heavily influenced by commodity prices and exchange rate levels.[39]

5.41 The budget went on to explain that in 2012-13:

> ...revenue from resource rent taxes is expected to grow by 295 per cent ($6.0 billion) largely reflecting the MRRT commencing in 2012-13.
>
> In the projection years, revenue from resource rent taxes is expected to grow by 9.6 per cent in 2013-14, but decline by 17.6 per cent in 2014-15.

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36 Department of the Treasury, *Mid Year Economic and Fiscal Outlook, 2010-11*, pp 9, 11, 23.

37 Source: Department of the Treasury, *Mid-Year Economic and Fiscal Outlook 2010-11*, p. 226.

38 Department of the Treasury, *Mid Year Economic and Fiscal Outlook, 2010-11*, p. 3.

39 Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 5: Revenue*, p. 5-29.

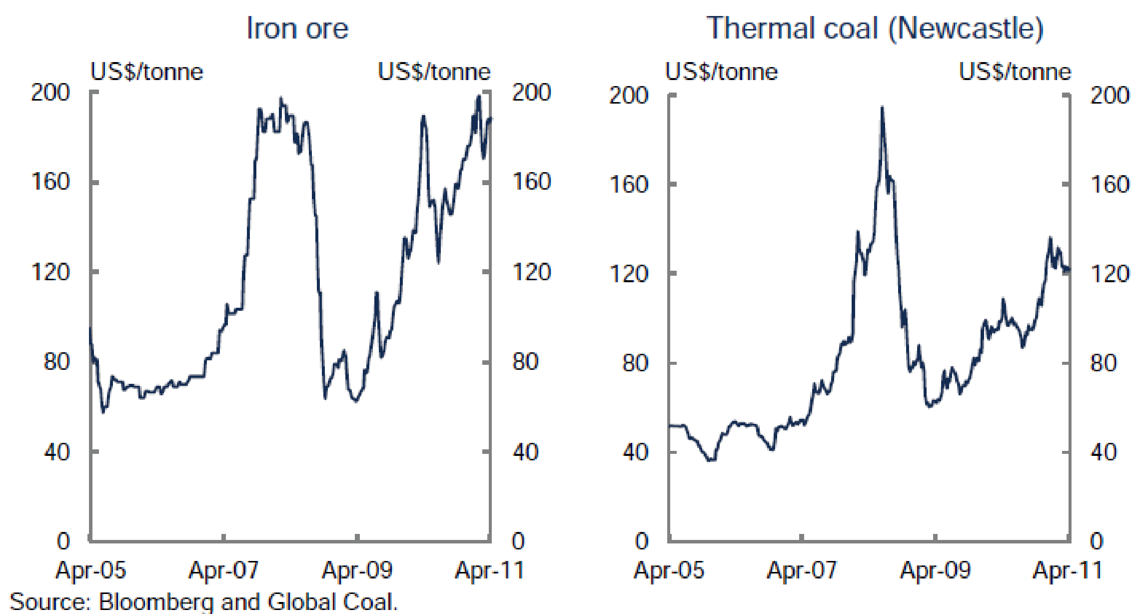
> These changes largely reflect changes in forecast commodity prices and anticipated production trends.[40]

5.42 Although the budget did not identify specific revenue projections over the forward estimates period, it did acknowledge that an increase in the global supply of commodities such as coal and iron ore (presumably from the 'Pilbara's of Africa'):

> ...is expected to weigh on commodity prices over the next two years, with further gradual commodity price declines projected over the medium term. The terms of trade are forecast to fall ¼ of a per cent in 2011-12 and 3 per cent in 2012-13, largely reflecting a modest fall in non-rural commodity prices.[41]

5.43 Chart 5.1 below illustrates the volatility associated with commodity prices.

Chart 5.1: Volatility of commodity prices[42]



5.44 The view that revenues sourced from the mining sector are highly speculative as they are based on highly volatile commodity prices, and therefore that forecasts made often turn out to be inaccurate and require revision is a view held by more than just the Department of the Treasury.

40 Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 5: Revenue*, p. 5-29.

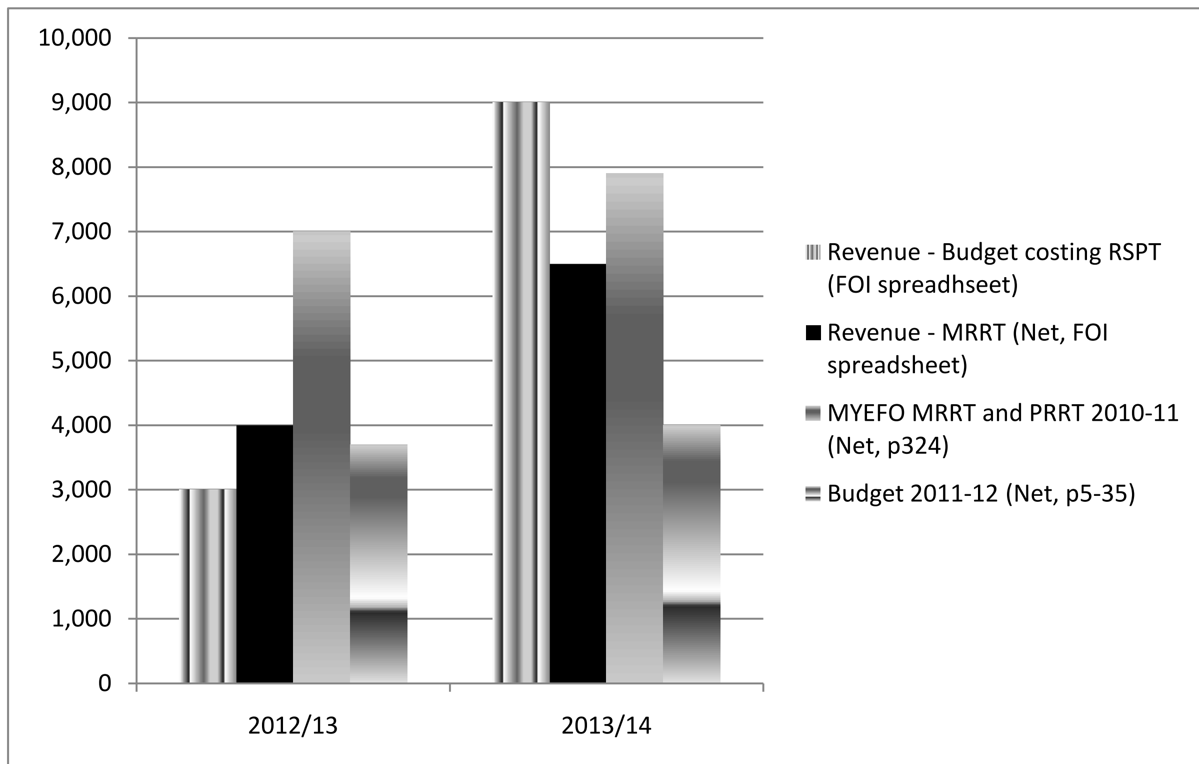
41 Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 2: Economic Outlook*, p. 2-28.

42 Source: Department of the Treasury, *Budget Strategy and Outlook, Budget Paper No. 1, Statement 2: Economic Outlook*, p. 2-28.

> The revenues from taxes such as the RSPT or the MRRT are usually overstated because these revenues are risky. The failure to take account of the risky character of those revenue streams could lead to fiscal illusion and make it more likely that unwise public spending commitments will be made. The background is that the government is planning to spend the forecast revenues—they are in the forward estimates. Without the mining tax revenues the government will have to cut its spending if it is to meet its announced fiscal targets. The Treasury has made various forecasts of the expected revenues from the proposed mining tax; some of them tens of billions of dollars larger than others. To note this is not to criticise Treasury forecasters; nobody can accurately and consistently predict the future.[43]

5.45 The history of the volatility is set out below. It covers the Treasury Freedom of Information costing for the RSPT, the net revenue for the MRRT in the Freedom of Information release by Treasury, as well as the 2010-11 Mid Year Economic Forecast and Outlook and the Commonwealth Budget. The Net figure used below 'represents the net impact on receipts across several different revenue heads. This includes offsetting reductions in company tax, crude oil excise and interactions with other taxes'.

Chart 5.2: RSPT and MRRT Revenue ($billions)[44]



43 Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 3.

44 Department of the Treasury, *Mid-Year Economic and Fiscal Outlook 2010-11*, p.283; Department of the Treasury, *Budget Strategy and Outlook – Budget Paper No.1 2011-12*, p. 5-35.

Revenue raised from the MRRT

5.46 Table 5.3 below provides a summary of the Treasury projections of MRRT revenue at the time the government signed the MRRT Heads of Agreement.

Table 5.3: Revenue breakdown from MRRT[45]

Year / Total	Iron Ore ($m)	Coal ($m)	TOTAL MRRT ($m)
2012-13	3,500	500	4,000
2013-14	5,000	1,500	6,500
2014-15	4,500	2,000	6,500
2015-16	3,500	2,000	5,500
2016-17	2,000	2,000	4,000
2017-18	1,500	1,500	3,000
2018-19	1,500	1,500	3,000
2019-2020	1,500	1,500	3,000
2020-21	2,000	1,000	3,000
Total	**25,000**	**13,500**	**38,500**

Costs of measures associated with the MRRT and expanded PRRT

5.47 Despite repeated requests for information about the projected fiscal impact of the various budget measures associated with the MRRT and expanded PRRT, at the time of printing, the government had refused to provide it. However, information contained in recent Commonwealth Budgets has enabled a construction of the cost to the Budget of measures associated with the MRRT and expanded PRRT. Those costs related principally to the cost of foregone taxation revenue as a result of the proposed increase of compulsory super contributions from 9 to 12 percent, the foregone revenue associated with a reduction in the company tax rate and spending over ten years through the regional infrastructure fund.

45 Source: Treasury Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011).

Cost of the phased increase of compulsory super contributions from 9% to 12%

5.48 The increase in the superannuation guarantee was announced as part of the original RSPT measures and was carried over into the MRRT and expanded PRRT initiatives. The superannuation guarantee rate will rise from 9 per cent to 12 per cent in 2019-20. The measure starts in 2013-14. Table 5.4 below provides an overview of the measures.[46]

Table 5.4: Cost of the increase in the compulsory superannuation levy[47]

Year / Total	Rate of the compulsory Superannuation Guarantee (%)	Revenue foregone ($ millions)
2013-14	9.25	240[48]
2014-15	9.5	520
2015-16	10.0	1,136
2016-17	10.5	1,752
2017-18	11.0	2,368
2018-19	11.5	2,984
2019-20	12.0	3,600[49]
2020-21	12.0	4,200[50]
Total		**16,800.0**

Company taxation rates

5.49 The cost to revenue of funding a reduction in the company income tax rate has been projected using the limited information available to the committee. The committee has sought to obtain more accurate information through Senate processes however, such information has not been forthcoming.

46 Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 18 April 2011.

47 Parliament of Australia, Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 18 April 2011.

48 Department of the Treasury, *Budget 2010-11, Budget Measures, Budget Paper No.2*, p.42.

49 Department of the Treasury, *Budget 2010-11, Budget Measures, Budget Paper No.2*, p.42.

50 Estimate.

5.50 Table 5.5 below provides an overview of the projected cost of the reduction in company taxation rates:

Table 5.5: Revenue foregone as a result of the cut to company tax

Year / Total	Cost of revenue forgone as a result of the reduction it the company tax rate ($ millions)
2010-11	
2011-12	0
2012-13	400.0
2013-14[51]	1,450.0
2014-15[52]	1,493.5
2015-16[53]	1,533.8
2016-17	1,575.2
2017-18	1,617.8
2018-19	1,661.4
2019-20	1,706.3
2020-21	1,752.4
Total	**13,191.0**

51 For 2011-12 – 2013-14, please refer to Budget - 2010 - p.39; Budget - 2010 - p.43; MEYFO - Appendix A, Part 2 - policy decisions taken between the 2010-11 Budget and the 2010 PEFO; Economic Statement 2010 - p. 24.

52 Projection from 2014-15 increased at Budget 2011 forecast economic growth rate of 3.0%.

53 Projection from 2015-16 increased at the Inter-generational report (40 year average) of economic growth rate of 2.70%.

Regional Infrastructure Fund and Regional Development Australia Fund

5.51 The table below provides an overview of infrastructure spending measures associated with the MRRT and expanded PRRT.

Table 5.6: Cost of the Regional Infrastructure Fund

Year / Total	Cost of regional infrastructure spending ($ millions)
2010-11	12.0
2011-12	42.4
2012-13	704.3
2013-14	866.8
2014-15[54]	665.5
2015-16[55]	618.0
2016-17	618.0
2017-18	618.0
2018-19	618.0
2019-20	618.0
2020-21	618.0
Total	**6,000.0**

The structural deficit

5.52 The previous sections of this report highlighted the volatility associated with the MRRT and the expanded PRRT. Since the announcement of the RSPT there has been considerable volatility in the factors, such as exchange rates and commodity prices, that underpin the revenue stream. As outlined above, the spending and revenue commitments represent a substantial outlay of funds.

54 For figures covering 2010 to 2015, please refer to 2011-12 *Budget Papers, Australia's Federal Relations, Budget Paper No.3*, 2011-12, p. 74 -75 – 10 May 2011

55 For expenditure over the period, 2015-16 to 2019-2020 please note that it comes from the difference between $6.0 billion, which is the total infrastructure spending committed against the MRRT and the amount spent as 2014-15 (the last year of the Budget forecast) which is $2.3 billion. The figure of $2.3 billion is then divided by the remaining years of forecast MRRT outlays to 2020/21, which is 6 years. This gives an average of $618 million.

5.53 The table below provides a comparison of the outlays and revenue associated with the MRRT:

Table 5.7: Structural deficit under the MRRT

Year / Total	Revenue raised from the MRRT ($ millions)[56]	Combined cost of measures associated with the MRRT ($ millions)
2010-11		12.0
2011-12		42.4
2012-13	4,000.0	1,104.3
2013-14	6,500.0	2,556.8
2014-15[57]	6,500.0	2,678.5
2015-16[58]	5,500.0	3,288.0
2016-17	4,000.0	3,945.4
2017-18	3,000.0	4,604.0
2018-19	3,000.0	5,263.6
2019-2020	3,000.0	5,924.3
2020-21	3,000.0	6,570.6
Total	**38,500.0**	**35,989.9***

*final total may not add exactly due to rounding various sources

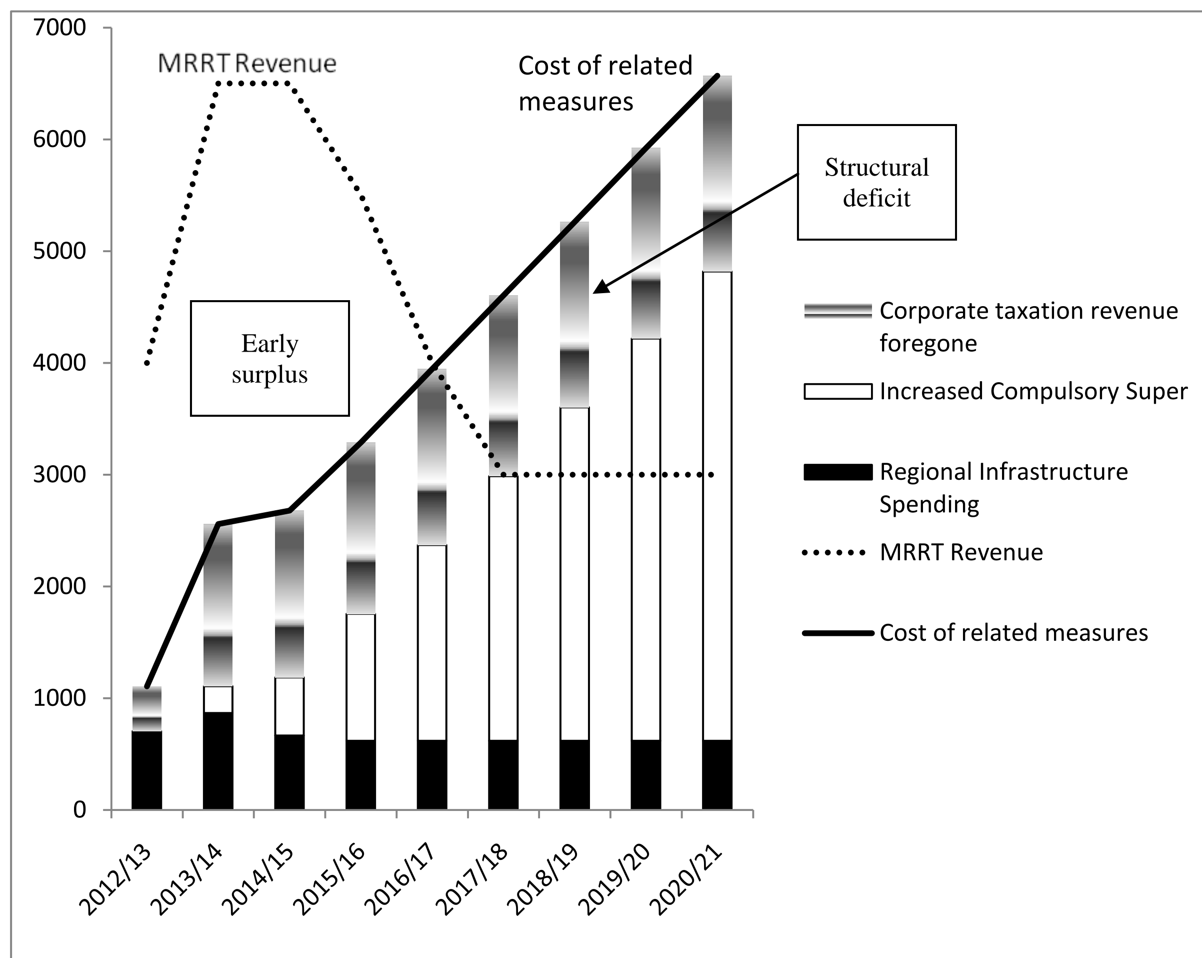
5.54 The chart below overlays the revenue and associated spending and revenue foregone from the MRRT. It is clear from the graph that there is a structural deficit associated with the fiscally irresponsible combination of taxing and spending from the flawed MRRT.

56 Source: Treasury Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011).

57 For figures covering 2010 to 2015, please refer to *Budget Papers 2011-12, Australia's Federal Relations, Budget Paper No.3*, 2011-12, pp. 74 -75.

58 For expenditure over the period, 2015-16 to 2019-2020 please note that it comes from the difference between $6.0 billion, which is the total infrastructure spending committed against the MRRT and the amount spent as 2014-15 (the last year of the Budget forecast) which is $2.3 billion. The figure of $2.3 billion is then divided by the remaining years of forecast MRRT outlays to 2020/21, which is 6 years. This gives an average of $618 million.

Chart 5.3: Structural deficit under the MRRT ($ billions)



5.55 This chart demonstrates how the mining tax and related budget measures were designed in such a way to ensure it helped create the illusion of an early surplus, with the increasing cost of related budget measures concentrated in the period beyond the forward estimates.

5.56 It is important to note that, since the Treasury modelling of the mining tax deal with the big three miners, revenue estimates for the MRRT have been downgraded in the budget, principally as a result of Australia's strong exchange rate. The MRRT is now expected to raise $3.7 billion in 2012-13 instead of 4 billion, $4 billion in 2013-14 instead of $6.5 billion and $3.4 billion in 2014-15 instead of $6.5 billion.[59]

5.57 It is also important to note that the above projections have not been able to explicitly account for the cost of other measures announced as part of the government's mining tax proposal. Other changes include instant write-off and simplified depreciation for small business, the refund of superannuation contributions for low income earners and the $50,000 concessional cap for super balances under

59 Department of the Treasury, *Budget 2011-12, Budget Paper 1*, p. 9-17.

$500,000. All of these were announced as part of the government's response to the Henry Tax Review. In that announcement, these three initiatives were costed at $2.645 billion in 2013-14.[60]

5.58 Adding these additional commitments means that the MRRT and expanded PRRT combined with the related budget measures are projected to become even more of a burden on the budget beyond the forward estimates. All other things being equal, this would create a significant structural deficit over the medium to long term.

5.59 Indeed, the year in which the MRRT and expanded PRRT would raise the most revenue would be in its first year of operation (2012-13), before many of the related budget measures begin to take effect. It seems like a convenient coincidence for the government that this year corresponds with the year in which they seek to return the budget to surplus. The government's mining tax would therefore, appear to be more to do with returning the budget to surplus in one year at the cost of creating a permanent structural budget deficit for the longer term.

5.60 Economists who appeared before the committee commented on the importance of what is done with revenues gained as a result of the proposed resource rent tax arrangements and were critical of the government's intention to spend them. They are of the view that such spending would result in future deficits:

> Prof. Pincus—...the intention to spend the revenue and rely upon its coming is a bad idea. Let me make an analogy: state governments found themselves with huge inflows of stamp duties during the property boom. Once that boom stopped, they said, 'Oh, we're short of money!' That is an inappropriate allocation of expenditures over a period of years. Do not spend so much in the good years and do not collapse the expenditure so much in the bad years. So the proposition we are making is that it is inappropriate to plan to spend the best estimate that the Treasury has made. The best estimate that Treasury makes for a whole lot of other taxes, fine, but for the—
>
> CHAIR—So the risk is that you essentially set yourself up for a structural deficit because your spending is in line with revenue expected at times when commodity prices and revenues are high, and then when the revenues drop you have a gap.[61]

A way forward

5.61 To address this concern of future deficits, some economists suggested that proceeds from any such tax arrangements may be better invested in longer term capital assets rather than being used by government in the recurrent revenue and expenditure mix:

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60 Australian Government 2010, *The Resource Super Profits Tax: A Fair Return to the Nation*, p. 16.

61 Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of New Taxes and Professor Jonathan Pincus, *Committee Hansard*, 30 March 2011, p. 12.

> A major problem with the Henry review in this area, and the subsequent justification of the resource tax, is that it does not put enough focus on capital. Clearly, an argument is that the resource tax is appropriate to minerals because it is relying on extractive industries. But the real economic argument, the sustainability argument, is that as we deplete natural capital it should be replaced with other forms of capital. The idea is that your total capital stock does not fall. So, clearly, you do not want proceeds out of extractive resources to go into consumption because that is running down your capital base. That is the Nauru example. So there should be a stronger sustainability framework and there should be much more clearly a very transparent system for saying that reductions in natural capital will be replaced by other forms of capital.[62]

5.62 The Organisation of Economic Cooperation and Development (OECD) has noted the risks of not acting prudently with the funds of the MRRT and the PRRT. They particularly note the risk of linking future public spending decisions to fluctuating tax revenues:

> If resource revenues are spent as they come in, which occurred to some extent in the boom of the 2000s, fiscal policy risks being pro-cyclical. *To avoid such risks, public spending decisions should be disconnected from the fluctuations in tax revenues caused by commodity price movements. While Australia's circumstances differ in important respect from other commodity producing countries, the authorities should nevertheless consider creating a reserve fund endowed with all resource tax revenues to assist in shielding the budget and the real economy from the effects of revenue volatility*.[63] (Emphasis in original)

Consequences for the broader economy

5.63 The implementation of the proposed tax will have consequences for the broader economy. In a recent report, the World Bank observed that:

> [f]rom a macroeconomic perspective, the optimal level [of taxation] is one that maximises the net present value of the social benefits flowing from the mineral sector, including government tax receipts, over the long term. This implies a balance, because if taxation is too high, investment and the tax base will decrease as investors shift their focus to other alternatives, and if taxation is too low, the nation will lose revenue useful to serve the public welfare.[64]

5.64 In making this observation, the World Bank noted that governments, when determining the optimal level of taxation, can look to empirical evidence of investor

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62 Professor John Rolfe, *Committee Hansard*, 30 March 2011, p. 43.

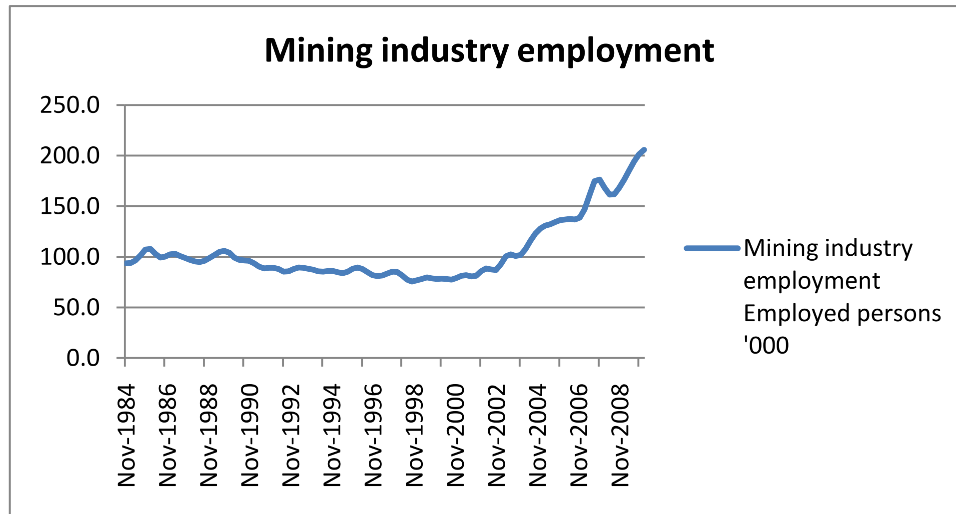
63 Organisation of Economic Cooperation and Development, *OECD Economic Surveys: Australia: November 2010*, p. 9.

64 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 266.

perceptions and behaviour.[65] In the Australian context this requires that consideration be given to how job losses in the mining industry would translate across other industries.[66]

5.65 Data released by the Australian Bureau of Statistics identifies that as at February 2011, the Australian mining industry employed 205,800 persons, an increase from 76,900 just 10 years ago.[67]

Chart 5.4: Mining Industry employment[68]



5.66 Bearing in mind that the mining industry in Australia has a multiplier effect of three, any job lost in a mine as a result of decisions to move investment to other jurisdictions, could translate into the loss of another three jobs in the community, for example in industries such as retail, health provision, education and property.[69]

5.67 The mining industry relies heavily on investment. If the proposed change to Australia's resource rent taxation regime does result in a change in investment behaviour and investment is driven offshore there will be negative consequences for employment.

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65 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 266.

66 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 223.

67 Australian Bureau of Statistics, *6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, Feb 2011*, 17 March 2011.

68 Source: Australian Bureau of Statistics: 6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, Feb 2011, 17 March 2011.

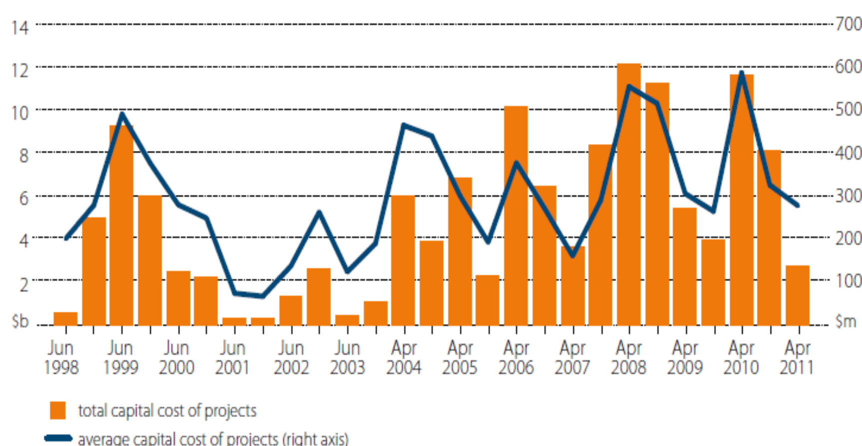
69 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 223.

5.68 In its *Major development projects –April 2011 listing*, the Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences identified that:

> The value of completed [mineral and energy] projects is the lowest since October 2005...Both in terms of total capital cost and average capital cost, the number of completed projects was lower than the previous listing and below the average (in 2010-11 dollars) for the previous eight years.[70]

5.69 Clearly, as identified by ABARES-BRS, investment in mineral and energy projects has declined since the announcement of a mining tax.

Chart 5.5: Completed projects, June 1998 to April 2011, total and average capital costs[71] (2010-11 dollars)



5.70 In fact, the World Development Report of 2005, when considering what constitutes a good investment climate suggested that:

> A good climate focuses on, among other things, minimising costs caused by taxation and policy uncertainty.[72]

5.71 The government would do well to keep this in mind and heed the advice of the World Bank that investors:

> ...take taxation into consideration when deciding where to invest.[73]

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70 Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences, *Minerals and energy, Major development projects – April 2011 listing*, 26 May 2011, p. 5.

71 Source: Australian Bureau of Agricultural and Resource Economics – Bureau of Rural Sciences, Minerals and Energy, *Major development projects – April 2011 listing*, 26 May 2011, p. 5.

72 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 215.

73 Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 216.

5.72 A survey of mining companies that ranks the most important investment considerations, identified four tax related criteria in the top 20 issues that they take into account when determining investment.

Table 5.8: Mining company ranking of investment decision criteria (out of 60 possible criteria)[74]

Importance Ranking		
Exploration stage	*Mining stage*	*Investment decision criteria*
1	n.a.	Geological potential for target mineral
n.a.	**3**	**Measure of profitability**
2	1	Security of tenure
3	2	Ability to repatriate profits
4	9	Consistency and constancy of mineral policies
5	7	Company has management control
6	11	Mineral ownership
7	6	Realistic foreign exchange regulations
8	4	Stability of exploration and mining terms
9	**5**	**Ability to predetermine tax liability**
10	8	Ability to predetermine environmental obligations
11	**10**	**Stability of fiscal regime**
12	12	Ability to raise external financing
13	16	Long-term national stability
14	17	Established mineral titles system
15	n.a.	Ability to apply geologic assessment techniques
16	**13**	**Method and level of tax levies**
17	15	Import-export policies
18	18	Majority equity ownership held by company
19	21	Right to transfer ownership
20	20	Internal (armed) conflicts
21	14	Permitted external accounts
22	19	Modern mineral legislation

Source: Otto 1992a.
Note: n.a. = not applicable.

5.73 As illustrated, the idea that the isolated application of a rent tax to certain sectors of the mining industry will not affect investment behaviour or have flow on consequences for the broader economy is fundamentally flawed.

Committee comment

Committee comment – 'Big three miners'

5.74 The committee is greatly concerned that the government has negotiated the design of a new tax exclusively and in secret with just three taxpayers, excluding their competitors and all other stakeholders from that process. The committee is particularly troubled by this approach given it has led to a tax design which is manifestly not

74 Source: Otto, J. et al, *Mining Royalties – A global study of their impact on investors, government and civil society*, World Bank, 2006, p. 216.

competitively neutral. It will make it harder for the small and mid-tier mining companies to compete with the big three who were given a seat at the table. That is a highly inappropriate precedent for the development of taxation policy and should not be allowed to stand. For this reason alone the Parliament should reject the government's proposed MRRT and expanded PRRT. The policy outcomes of this flawed process and the impact of this new tax design on competitive dynamics in this capital intensive industry, which by its nature, already favours larger more established miners are highly inappropriate and improper.

5.75 The committee understands that the three big mining companies were put in a very difficult position by the government. They were invited to attend a meeting and quite understandably accepted that invitation in the circumstances. Companies have a responsibility to act in the best interest of their shareholders, and they did. However, the Australian government is expected to act in the public interest and they did not.

5.76 The committee considers that it is incongruous that a government which claims to value innovation and research and development would design a tax that would hamper the capacity of smaller emerging miners to innovate, and therefore survive, in an increasingly competitive industry.

5.77 As identified in Chapter 4, the committee takes the view that the proposed taxes are not genuine 'root and branch' reform but are a simplistic and lazy approach to taxation reform resulting in an ad hoc tax grab which will, in reality, worsen the distortions in the taxation of Australian resources.

Committee comment – Sovereign risk

5.78 Despite Treasury's assertions that it is very difficult to make an assessment of the extent to which concerns about sovereign risk affect individual investment decisions,[75] the committee regards the experience of industry participants since the announcement of this proposed tax as more credible. In view of the miners' experiences, as put to our inquiry, the committee is concerned that the implementation of the MRRT and expanded PRRT will have a detrimental effect on future investment in Australia, and not only in the mining industry.

5.79 The committee acknowledges that it is the right of governments internationally to determine their tax policy settings and from time to time review and adjust those settings. However, the committee considers that major reform in any area of policy should be preceded by a period of open and transparent consultation and engagement. This did not occur prior to the announcement of the RSPT, MRRT or expanded PRRT. The committee is of the view that the government's flawed and secretive approach in these circumstances has done unnecessary damage to Australia's reputation as a stable destination for foreign investment. A change in tax policy

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75 Dr Ken Henry, *Committee Hansard*, 22 November 2010, p. 42.

settings after a period of open, transparent and inclusive consultation would not have exposed Australia to the same damage to its international reputation.

Committee comment – resources rent taxes

5.80 The fact that the foundation of the design of the MRRT and expanded PRRT relies on contested economic theory raises serious concerns.

5.81 The committee acknowledges the evidence it received, that in reality pure economic rents do not exist and as a result, is concerned by the government's view that the application of a super profits (rent) tax to the mining industry would not have any effect on the behaviour of mining companies and other stakeholders. The committee's concerns are compounded in light of the role the sector played in helping Australia avoid economic meltdown as a result of the global financial crisis.

> A tax will inevitably fall on some revenues that are not pure rents. The abandoned super profits tax [RSPT] is not a knife you can take to a magic pudding, which is the mining industry, cut out a slice and leave the pudding no smaller. Neither is the new MRRT.[76]

5.82 The committee acknowledges that resources in the ground are the property of the people in each State. Importantly, those companies who take risks to develop those resources, investing time, money, resources, and effort, in an activity which ultimately leads to public benefits, have the right to be rewarded for their efforts. It is appropriate that the risk-reward equation recognises the significant risks involved today for those trying to set up the big successful mining companies of tomorrow.

5.83 The committee takes the view that the government needs to stop viewing the mining industry as a 'magic pudding' that can solve all its financial woes and give due regard to the importance of this sector of the economy to our economic prosperity moving forward.

Committee comment – structural deficit matters

5.84 One of the intentions of the RSPT as announced in the 2010-11 Budget was to ensure that the community received a fair return for its mineral resource wealth. That tax, based on the design put forward by the Henry Tax review, was intended to ensure efficiency and effectiveness and also to reduce complexity within the tax system. The committee takes the view that this has not been delivered through the proposed MRRT and expanded PRRT.

5.85 The proposed resource rent tax arrangements in no way achieve the aims of the Henry Tax Review. Rather than to simplify our tax system it makes it more complex, rather than fairer it makes it less fair and, rather than removing distortions, it increases them compared to the status quo.

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76 Professor Jonathan Pincus, *Committee Hansard,* 30 March 2011, p. 1.

5.86 The tax as it stands would undoubtedly have adverse consequences for jobs in the important mining industry as well as across the broader community given the multiplier effect of jobs in the mining industry.

5.87 The committee considers that what has been proposed is not reform. Rather, it is a simple and lazy grab for cash designed to create the illusion of an early surplus. Furthermore, the committee considers that targeting one specific industry experiencing a boom is short sighted. To then tie spending commitments to revenue projections based on the assumption that commodity prices, which are inherently volatile, will remain high is fraught with risk and would worsen the current structural deficit.

5.88 The committee is strongly of the view that the proposed resource rent taxes should be scrapped and not proceed. However, if the Parliament decided to support the MRRT and expanded PRRT, the revenues raised should be used exclusively to pay off debt and, once debt is paid off, to be invested in a sovereign wealth fund like the Future Fund and used for building capital.

Recommendation 7

5.89 The committee recommends that, if contrary to its principal recommendation the Parliament is of a mind to pass these flawed resource rent tax arrangements, the Parliament amend the legislation to ensure revenues raised, which are subject to high volatility and likely to reduce over time, are used to increase the net financial worth of the Australian Government either through the payback of debt or investment in assets through the Future Fund.

Chapter 6

The taxation of non-renewable resources and implications for the federation

Introduction

6.1 This chapter provides an overview of the importance of the mining industry to the Australian economy and individual State economies. It considers the implications of the proposed MRRT and expanded PRRT for federal-state financial relations, in particular royalty and GST sharing arrangements.

6.2 Importantly, this chapter highlights the practical ramifications of the Commonwealth's tax raid on the own-source revenue base of the states and territories and the implications of undermining the sovereignty of the states and territories in their capacity to raise revenue.

The mining industry in Australia

6.3 According to the Association of Mining and Exploration Companies (AMEC), the general structure of the resources industry is similar in Australia to that found around the world.[1] Australia has about 2,500 companies comprising an industry structure with a few conglomerates dominating the overall market, followed by a small number of mid-tier and emerging firms with the major portion of the industry comprising 'juniors' engaged in exploration.[2]

6.4 These 2500 companies employ around 160,000 persons with a further 500,000 engaged in indirect employment in the services industry associated with the resources sector.[3] While the economic contribution of the mining sector is discussed below, it should be noted that it also contributes to rural and regional communities, through infrastructure partnerships with government as well as indigenous employment and Aboriginal cultural heritage protection.[4]

6.5 Australia's economic growth has been due, in part, to the strength and success of the mining industry. With today's high commodity prices, Australia's minerals

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1 Association of Mining and Exploration Companies – Submission to the Policy Transition Group: *The proposed minerals resources rent tax and the exploration development options*, (Note, submission provided to the Senate Select Committee on new Taxes: Mining Tax Inquiry) p.8.

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

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

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

sector accounts for 8 per cent[5] of gross domestic product (GDP) compared to a longer term average of around 5 per cent.[6] Being very capital-intensive, the sector employs only 1.7 per cent of Australia's workforce.[7] Australia is ranked in the top five producers of key mineral commodities including bauxite, alumina, uranium, lead, zinc, lithium, iron ore, manganese, nickel, black coal, aluminium, brown coal and copper.[8]

The mining industry and royalties

6.6 While the Report has focussed on the RSPT, MRRT and expanded PRRT, it is important to understand the royalty arrangements across Australia.

6.7 Royalties are levied to ensure that state and territory governments, representing the people of the states and as owners of the minerals, are compensated for the extraction of their natural resources. Within the Australian federation, royalties are levied at the state and territory level and the revenue generated is retained by those governments. The structure and type of royalties differs dramatically across state[9] jurisdictions although they generally fall within one of three general royalty categories:

- unit based;
- value based (ad valorem); or
- profit/income-based.[10]

'Specific' or 'unit based' royalties

6.8 Specific/unit based royalties are levied on a fee per unit of volume (per cubic metre) or weight (per tonne) and are generally applied to minerals that are homogenous (for example, sand or gravel), or sold in bulk (for example, coal, iron ore, salt etc).[11] Unit based royalties are the oldest form of royalty assessment. They

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5 Average calculated using statistics for 2006-07 to 2009-10 sourced from ABS: http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/$File/52040_2009-10.pdf, (accessed 1 November 2010).

6 Average calculated using statistics for 2001-02 to 2005-06 sourced from ABS: http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/556894E44C26469ECA2577CA00139858/$File/52040_2009-10.pdf, (accessed 1 November 2010).

7 Australian Bureau of Statistics, 6291.0.55.003 - *Labour Force, Australia, Detailed, Quarterly*, Aug 2010.

8 Minerals Council of Australia, *Fact Sheet: The Australian Minerals Industry and the Australian Economy*, November 2008, p. 1, http://www.minerals.org.au/__data/assets/pdf_file/0017/32804/Aus_min_industry_fact_sheet_Nov_2008_v5.pdf, (accessed 1 November 2010).

9 Note: A reference to state includes a reference to territories.

10 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 55.

11 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 50.

are simple to administer as assessments of price, value and cost do not need to be made and they are payable regardless of the profitability of a mine.[12]

'Value-based' or 'ad valorem' royalties

6.9 Value-based or Ad-valorem royalties are payable regardless of a mine's profitability but, as they are based on the value of the commodity being mined, will fluctuate with international commodity prices.[13] The method of calculating value can become complicated and may be defined differently in different jurisdictions.

Profit-based royalties

6.10 Profit-based royalties are based on the profitability of an operation. Unlike specific and ad-valorem regimes however, during the early years of a mining operation when establishment costs far exceed any income, minimal or no royalties will be collected. This has resulted in some public criticism on the basis that the minerals are being extracted yet no compensation is being paid.[14]

Australia's royalty regimes

6.11 In Australia, the ownership of minerals is determined by property law and the various State and Territory Acts. Royalties are levied differently in all states and on different bases on different minerals within the states. Generally, however, ad valorem or specific royalties apply. The exception is the Northern Territory which uses a profit-based regime.[15] The role of the states and territories to apply and change royalties is a function of Australian federalism and the corresponding allocation of taxation powers between the Commonwealth government and the states and territories.

6.12 It is important to note however that royalty regimes differ for states and territories in this important respect: territories are delegated legislative power from the Commonwealth Parliament and do not enjoy the autonomy and protection granted to the states by the Constitution. Consequently, the Commonwealth enjoys legislative freedom to act with respect to the territories which it does not enjoy when dealing with the states.

6.13 Table 6.1 provides an overview of the existing royalty regimes throughout Australia. Table 6.1 highlights a selected number of key commodities and their associated royalty arrangements.

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12 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, pp 50-51.

13 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 52.

14 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 64.

15 Parliamentary Library, *Briefing Note-Mining Royalty Regimes in Australia*, 2010, p. 1.

6.14 It is important to note that resource royalties are only one aspect of a country's tax regime. Therefore, in determining resource royalty regimes the cumulative effect of all taxes needs to be considered as investors will be concerned with the effective tax rate and whether or not royalties are tied to profitability.[16]

Table 6.1 - Royalty Regimes in Australia, 2009[17]

Mineral	State	Royalty Rate	Basis of Calculation	Last review/change
Coal	QLD	7% where the value of the coal produced does not exceed $100/tonne	Ad valorem	2008 – *Mines and Energy Legislation Amendment Regulation (No 2) 2008*
		10% on the value of the coal exceeding $100/tonne		
	NSW	**Open cut mining** 8.2%	Ad valorem	2008 – *State Revenue and Other Legislation Amendment (Budget Measures) Act 2008*
		Underground mining 7.2%		
		Deep underground mining 6.2%		
	VIC	**Brown Coal**	Ad valorem with quantum rate for brown coal	2006 – *Mineral Resources Development (Amendment) Regulations 2006*
		$0.0588 per GJ, adjusted in accordance with the consumer price index		
		Other than Brown Coal 2.75%		
	WA	**If exported** 7.5%	Ad valorem and quantum rate	2000 – *Mining Amendment Regulations (No. 4) 2000*
		If not exported		
		$1/tonne (adjusted each year at 30 June in accordance with comparative price increases)		
	SA	3.50%	Ad valorem	2005 – *Mining (Royalty No 2) Amendment Act 2005*
Iron Ore	QLD	2.70%		
		$100,000 threshold	Ad valorem	2005 – *Mining (Royalty No 2) Amendment Act 2005*

16 Otto, J. et al, *Mining Royalties – a global study*, World Bank, 2006, p. 32.

17 Source: Craig Bowie, Special Counsel, MinterEllison Lawyers, 8 April 2009, pp 1-5, http://www.minterellison.com/public/connect/Internet/Home/Legal+Insights/Newsletters/Previous+Newsletters/A-ERU3+mining+royalties+overview, viewed 27 October 2010 and Western Australian Budget 2011-12, Economic and Fiscal Outlook, Budget paper No.3, pp.90 – 91.

		Discount of 20% if processed in Qld and metal content is at least 95%		Ad valorem	2008 – *Mines and Energy Legislation Amendment Regulation (No 2) 2008*
	NSW	4%			
	VIC	2.75%			
	WA	**Beneficiated Ore** 5%		Ad valorem	No change since the introduction of the *Mining Regulation 2003*
		Fine Ore 5.625%		Ad valorem	Recent announced change, royalty concession on iron ore 'fines' to be phased out with royalties to rise to 6.5% from 1 July 2012 and to 7.5% from 1 July 2013.
		Lump Ore 7.5%		Ad valorem	No recent change
	SA	3.50%			

The importance of royalty revenue

6.15 Data published by the Commonwealth Grants Commission illustrates the comparative importance of mining revenue to Australia's state and territory governments. This is not surprising given many of Australia's mineral resources are concentrated in the north of Western Australia and Queensland.[18] As set out in Table 6.2, in both absolute and per capita terms, mining is of most importance in the states of Western Australia and Queensland. While smaller in its national importance, mining is also important to the Northern Territory government.

Table 6.2: State governments' revenue from mining 2008-09[19]

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Mining revenue ($m)	1278	46	3364	3184	152	32	0	227	**8286**
Mining revenue ($ per capita)	181	8	773	1444	94	63	0	1026	**382**
Proportion of State revenue (%)	5.2	0.2	16.7	29.3	2.4	1.9	0	21.6	**9.5**

18 Department of the Treasury, *Budget Paper 1*: *Statement 4 – Benefitting from our mineral resources: opportunities, challenges and policy settings*, 2010, p. 4.17.

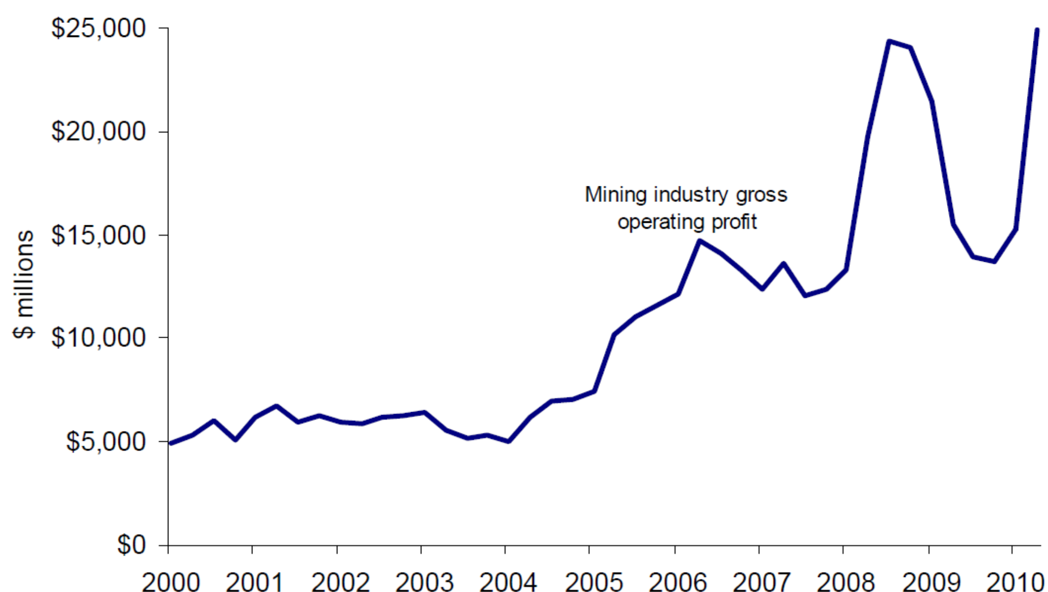
19 Source: Adapted from information published by the Commonwealth Grants Commission. Mining revenue includes mining royalties and exploration permit fees.

6.16 The Commonwealth Grants Commission recently noted that:

> ...mining revenue has grown substantially as a proportion of State revenue from 5.2 per cent in 2005-06 to 9.5 per cent in 2008-09. It grew in all States, but most particularly in Queensland and Western Australia due to increased coal and iron ore royalties.[20]

6.17 The large growth in profits in the mining sector this decade (Chart 6.1) has been the result of strong demand from China and India. Forecasts suggest that these economies will experience sustained growth over the long term thereby ensuring demand for these commodities remains high.[21] Demand for Australia's resources has generated the best terms of trade in 140 years.

Chart 6.1: Mining industry gross operating profit 2000-2010 (current prices)[22]



6.18 Although rapid growth in profits has been experienced over the recent boom years, it has been argued by the government that receipts from the application of the existing taxation arrangements have not experienced the same rate of growth. In its report to the Treasurer, the Henry Tax Review contrasted recent strong growth in profits and the corresponding tax take. The Henry Tax Review report detailed that the existing taxation arrangements governing Australia's resource sector are inefficient as

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20 Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities–2010 Review*, Chapter 8: Mining Revenue, 2010, p. 129.

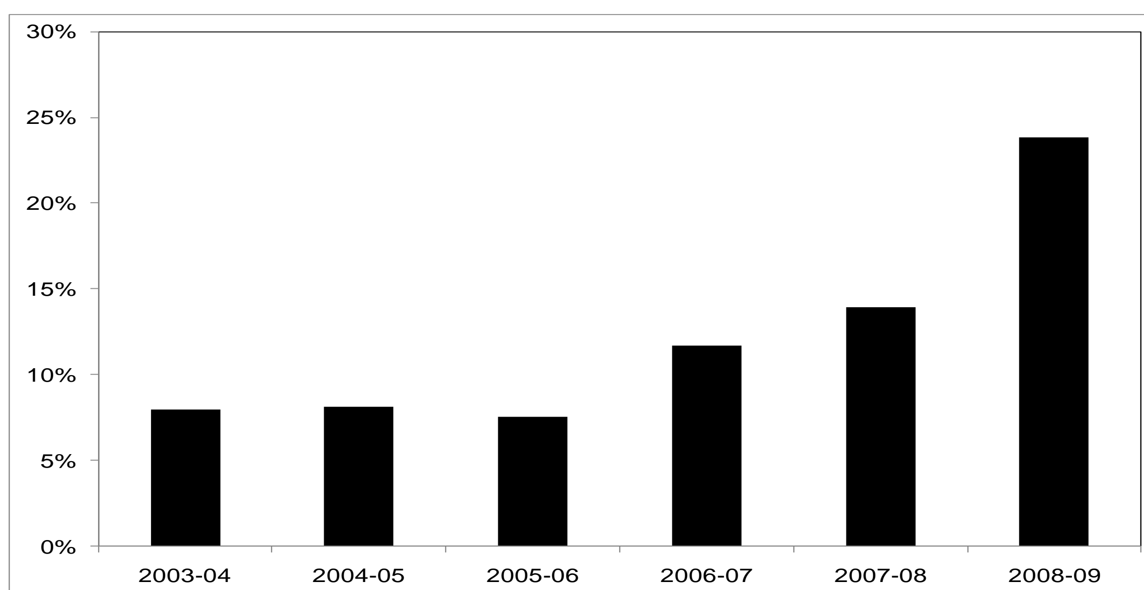
21 Department of the Treasury, *Budget Paper 1: Statement 4 – Benefitting from our mineral resources: opportunities, challenges and policy settings*, 2010, pp. 4-5.

22 Source: Australian Council of Trade Unions, *Submission 9*, p 6.

the returns they generate are not responsive to changes in profit and distort investment and production decisions.[23]

6.19 However, Australian Taxation Office data suggests that the mining sector's share of total company tax revenues has risen rapidly since 2003-04:

Chart 6.2: Mining sector share of total company tax revenue, 2003-04 to 2008-09[24]



6.20 A more complete snapshot of the various taxes raised from the mining sector is given in Table 6.3.

Table 6.3: Taxes and royalties paid by the mining industry, $ billion, 2007-08[25]

Taxes and royalties	Amount ($ bn)
Company tax	8.1
Royalties	4.6
Petroleum Resources Rent Tax	1.9
GST (net refunds)	-3.8
Fringe Benefits Tax	0.2
Income tax (PAYG)	4.4

23 *Australia's Future Tax System Review, Report to the Treasurer*, December 2009, Part Two, p. 217.

24 Source: Australian Tax Office, *Taxation Statistics,* Table 8: Company Tax.

25 Source: Treasury, Answer to 2010 Budget estimates question on notice BET 1.

6.21 Australia's ability to share the long-term profits from its resources sector among the community relies on reforming the taxation arrangements that apply to the extraction of these finite mineral deposits. Table 6.4 identifies the expected life of mineral deposits in Australia.

Table 6.4: Mineral resource exports, indicative resource life and ranking[26]

Mineral resources	Exports 2008-09($m)	Export shares(%)	Indicative life years at 2008(a)	World ranking at 2008(b)
Black coal	54,698	33.9	90	6
Iron and steel	35,602	22.0	70	3
Gold	16,146	10.0	30	2
Aluminium	10,932	6.8	85	2
LNG (Gas)	10,086	6.2	60	14
Crude oil and condensate	8,755	5.4	10	(c)
Copper	5,863	3.6	85	2
Nickel	2,656	1.6	130	1
Zinc	1,858	1.2	35	1
Manganese	1,406	0.9	20	4
Uranium	990	0.6	125	1
Others	12,538	7.8		
Total mineral resource exports	161,532	100.0		

a. Indicative life for a commodity is calculated as the stock of the accessible economic demonstrated resource (EDR) relative to annual production for that commodity or the relevant raw commodity.
b. The world ranking is based on the EDR in Australia compared to that in other countries.
c. The ranking is not available. Australia's reserves of crude oil and condensate accounted for 0.6 per cent of the world total in 2008.

Note: The data for crude oil and condensate and for LNG (Gas) are based on economic demonstrated resources, which for these two commodities is equivalent to accessible economic demonstrated resources.

6.22 As previously discussed, the Henry Tax Review recommended that the current state based resource royalties should be replaced with a project-based uniform resource rent tax, imposed and administered by the federal government and set at 40 per cent.[27] The review also recommended that the Government negotiate an agreement with the states as to an appropriate inter-governmental allocation of the revenues and

26 Source: ABARE, Geoscience Australia and Treasury.

27 *Australia's Future Tax System Review, Report to the Treasurer*, December 2009, Part One, p. xxi.

risks from the tax.[28] As outlined in this report, the MRRT and expanded PRRT do not have much in common with the Henry Tax Review recommendation.

6.23 For most industry participants, the proposed MRRT is more complex and less fair than the status quo and it was of course negotiated exclusively and in secret and came out of a deeply flawed process.

6.24 At the time of writing this report, still no inter-governmental agreement has been signed with the states and territories to give effect to the MRRT Heads of Agreement. In fact the government has not even started engaging with the states and territories about the implications of the proposed MRRT and expanded PRRT for them. There has been a complete failure to consult and negotiate with the states and territories in relation to an important State and Territory revenue base. In addition, the Heads of Agreement between the Australian Government and the big three mining companies of BHP Billiton, Rio Tinto and Xstrata appears to be ambiguous with respect to the interaction between state royalties, the MRRT and the RSPT:

> CHAIR—Dr Henry, I had a close look through your review document again. Chapter 6, 'Land and resource taxes', under 6.1, 'Charging for non-renewable resources', talks about how current charging arrangements distort investment and production decisions, thereby lowering the community's return from its resource—hence your recommendation. It is fair to say that your recommendation was for the national resource rent tax to replace state royalties completely. That is right, isn't it?
>
> Dr Henry—Yes, that is correct.
>
> CHAIR—And under the RSPT the distorting effects of royalties were effectively removed because they were completely refunded—is that right?
>
> Dr Henry—That is correct.
>
> CHAIR—But under the MRRT they are not, are they?
>
> Dr Henry—No, clearly they are not.
>
> CHAIR—So the distorting elements of state royalties, to the extent that they exist, have not been removed, have they?
>
> Dr Henry—To the extent that there is not a full credit provided for those royalties under the MRRT, the royalties would be impacting on investment decisions.
>
> CHAIR—Would be impacting on investment decisions?
>
> Dr Henry—I would expect so, yes.
>
> CHAIR—And, potentially, production decisions too, wouldn't they?
>
> Dr Henry—Indeed.

28 *Australia's Future Tax System Review, Report to the Treasurer*, December 2009, Part Two, p. 217.

> CHAIR—Smaller projects that are not yet subject to the MRRT would continue to pay royalties?
>
> Dr Henry—That is correct.[29]

6.25 In these circumstances, a key objective of the Resource Rent Tax has not been realised through the MRRT and expanded PRRT putting smaller mining companies into the worse position of all.

6.26 The states and territories were not consulted before the announcement of the MRRT. The implications of the MRRT Heads of Agreement for states and territories in terms of their capacity to make decisions about their own source revenue arrangements continue to be unresolved.

Mining, royalties and the federation

6.27 No state or territory is likely to agree to abolish its royalty arrangements. When asked during the Senate Fuel and Energy Committee inquiry whether any Western Australian government was likely to ever agree to the abolition of royalties, The Western Australia Department of Treasury and Finance Acting Under-Treasurer Mr Barnes, said:

> CHAIR—Thank you very much, Mr Barnes. Is there any prospect that Western Australia would give up imposing royalties on the extraction of its resources?
>
> Mr Barnes—I am speaking on behalf of the Department of Treasury and Finance and my strong view is that, under this government or under any future WA government, that would be an extremely remote prospect.[30]

6.28 Mr Barnes, continued:

> 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 along-side state royalties, with a tax credit available for state royalty payments, we are concerned that overtime 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

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29 Senator Mathias Cormann, Chair, Senate Select Committee on New Taxes and Dr Ken Henry, Secretary, Department of the Treasury, *Committee Hansard*, Monday 22 November 2010, p. 8.

30 Senator Mathias Cormann, Chair, Senate Select Committee on Fuel and Energy and Mr Michael Barnes, Acting Under Treasurer, Department of Treasury and Finance, Western Australia, *Fuel and Energy Committee Hansard*, 13 July 2010, p.3

> 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 to alter their royalty regimes as appropriate to their specific circumstances.[31]

Gillard Government version of the mining tax: A tax on Western Australia

6.29 Since the announcement of the Gillard Government's mining tax deal, various Senate Committees and the Senate itself sought access, again and again, to information about where the mining tax revenue was expected to come from. How much from Western Australia, how much from Queensland and how much from other States? For more than nine months the government refused to release any information in response to those requests. The government completely ignored them and continued to keep the information secret. This is even though David Parker, then the Executive Director the Department of the Treasury's Revenue Group, had given evidence to the Senate Fuel and Energy Committee back in July 2010 that it would not be a difficult piece of analysis to perform. Eventually some information was released by the Treasury under Freedom of Information.[32] Namely, Treasury released its MRRT model including revenue projections over a decade, which were broken down into revenue from coal and iron ore production.

6.30 That information which had been kept secret up until then finally revealed officially that the proposed MRRT is in fact a massive tax on Western Australia.

6.31 The table below provides the relevant breakdown of the mining tax revenue drawn from the Treasury's MRRT modelling conducted back at the time of the mining tax deal:

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

32 Department of the Treasury, Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011)

Table 6.5: Revenue breakdown from the MRRT[33]

Year	Total MRRT	MRRT on Iron Ore/WA	Per cent
2012/13	$4bn	$3.5bn	87.50%
2013/14	$6.5bn	$5bn	76.90%
2014/15	$6.5bn	$4.5bn	69.20%
2015/16	$5.5bn	$3.5bn	63.60%
2016/17	$4bn	$2bn	50%
2017/18	$3bn	$1.5bn	50%
2018/19	$3bn	$1.5bn	50%
2019/20	$3bn	$1.5bn	50%
2020/21	$3bn	$2bn	66.60%
Total	**$38.5bn**	**$25bn**	**64.93%**

6.32 This table demonstrates that at the time the Gillard Government entered into the mining tax deal it expected that more than 80 per cent of its MRRT revenue would come from iron ore production in Western Australia over the then forward estimates.

6.33 Over the period 2012/12 to 2020/21 nearly 65 per cent or $25 billion out of the total projected MRRT revenue of $38.5 billion is expected to come from iron ore production in Western Australia. The expectation then was that the about 35 per cent or $13.5 billion of the remaining MRRT revenue would come from coal production.

6.34 The reason we can legitimately reach these conclusions is because revenue from iron ore production is a reasonable proxy for revenue from Western Australia. That is because 98 per cent of iron ore production in Australia takes place in Western Australia. Ninety-nine per cent of iron ore royalties nationally are raised in Western Australia. Then Treasury Secretary Ken Henry agreed:

> Senator CORMANN ... It is fair to say that the iron ore share of the MRRT revenue is a proxy for the Western Australian share of the MRRT revenue, is it not?
>
> Dr Henry—That is probably a reasonable proxy, I would think.[34]

33 Department of the Treasury, Freedom of Information release: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1962 (accessed 20 June 2011)

6.35 No wonder the Gillard government did not want the people in Western Australia to know before the last election.

6.36 The committee considers that it is surely completely unreasonable, inappropriate and discriminatory for a single new national tax to target one specific State economy like this.

Horizontal fiscal equalisation

6.37 The fact that royalties are raised by individual states does not, of course, mean that only the residents of those states benefit from the mining boom. Income gains from higher commodity prices accrue to households through their shareholdings in mining companies (directly, or indirectly through superannuation funds) and where revenues would otherwise:

> ...accrue disproportionately to particular State governments, fiscal equalisation arrangements allocate those gains among all States and Territory governments [and] [t]he tax-transfer system in Australia further acts to spread the gains, as does the reallocation of resources within the economy.[35]

6.38 The tax-transfer system referred to above, relates to the way in which the Commonwealth and the states and territories share revenue. One mechanism through which this is done is via the Commonwealth Grants Commission (CGC) processes of horizontal fiscal equalisation (HFE).

6.39 The CGC recommends how the revenues raised from the (GST) should be distributed to the states and territories to achieve this goal. It is an independent statutory body which responds to requests sent to it by the Commonwealth Treasurer. It makes its recommendations in consultation with the States and Territories and based on data provided by them and independent statistical sources.[36]

6.40 Horizontal fiscal equalisation is:

> ...a process whereby the Commonwealth distributes money amongst the states so that they all end up with the same fiscal capacity, so that if they all made the same effort to raise revenue from their own sources, they would be able to provide a comparable level of services to their residents.[37]

34 Senator Mathias Cormann, Chair and Dr Ken Henry, Secretary, Department of the Treasury, Committee Hansard, *Economics Committee Estimates*, 24 February 2001, p. 25.

35 Department of the Treasury, *Budget Paper 1*: Statement 4 – Benefitting from our mineral resources: opportunities, challenges and policy settings, 2010, p. 17.

36 http://www.cgc.gov.au/ (accessed on 28 April 2011)

37 Mr John Spasojevic, Secretary, Commonwealth Grants Commission, *Committee Hansard*, 21 October 2010, p. 117.

6.41 Over recent years the application of HFE has seen the GST revenue allocation for both Western Australia and Queensland reduce.[38] The Grants Commission explains that the boom in the mining sector in these states raised the states' own revenue raising capacity due to the consequential impact on housing and jobs and therefore growth in stamp duties and payroll taxes.[39]

> CHAIR—Let me go back to your 2010 methodology review, where on page 13 you say that Western Australia has the highest assessed fiscal capacity due to its very high revenue raising capacity. What are the main factors that cause this highest assessed fiscal capacity?
>
> Mr Spasojevic—They have got a lot of iron ore.
>
> CHAIR—So it is fair to say that state government tax revenues from mining states like Western Australia and Queensland through your processes are then shared with other states.
>
> Mr Spasojevic—They are.
>
> CHAIR—Through the processes of horizontal fiscal equalisation.
>
> Mr Spasojevic—Correct; the revenue that they collect from royalties are redistributed, effectively, by the GST.... If I imagine I have one state which has a very high value of mining production and one which has a very low in per capita terms, they would have an unequal capacity to raise revenue from mining royalties. That unequal capacity to raise revenue from mining royalties then would feed through, other things being equal, into requiring less per capita in the GST in the state which has an above-average capacity to raise mining royalties. So there is a balancing process.[40]

6.42 The HFE process is contentious. Its relationship with State and Territory royalty regimes will depend on a wide range of factors.

6.43 According to the Commonwealth Grants Commission, following negotiations between the Western Australian Government and BHP Billiton and Rio Tinto, there was agreement to apply a higher royalty rate of 5.625 per cent to part of iron ore fines production, affecting about half of the total iron ore fines production in Western Australia. This increase aligned the royalty rate to that applying to other miners of iron ore fines in the State. Western Australia estimated this change would raise an additional $340 million in royalties in 2010-11.

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38 Commonwealth Grants Commission, *Report on State Revenue Sharing Relativities* 2009 Update, 2009.

39 Commonwealth Grants Commission, *Report on State Revenue Sharing Relativities* 2009 Update, 2009.

40 Mathias Cormann, Chair, Senate Select Committee on the Scrutiny of new Taxes, and Mr John Spasojevic, Secretary, Commonwealth Grants Commission, *Committee Hansard*, 9 December 2010, p. 1-2.

6.44 The majority of States said the 2010 Review assessment method grouped minerals according to whether their prevailing royalty rate was above or below 5 per cent. On that basis, iron ore fines should now be treated as a high royalty mineral. As the 2011 assessment grew closer Western Australia was concerned about the impact on it.

6.45 On 18 March 2010, the Western Australian Treasurer, the Hon Troy Buswell MLA, wrote to the Treasurer expressing the Western Australian government's concern about the operation of the Commonwealth Grants process and its application to decisions by the Western Australian government to increase its royalties:

> Also underpinning this request for a relativity floor is the need to address the distortionary impact on government policy making of the Grants Commission's method of assessing mining royalties. In this regard, the Commission's recommendations included a last minute change away from an energy/non energy categorisation (similar to that reported by the ABS) to a high royalty / low royalty rate split, with lump iron ore being included with fuel minerals in the high rate group.[41]

6.46 On 11 May 2010, the matter was pursued further in a letter from Western Australia Under-Treasurer, Timothy Marney, to the his counterpart, Dr Ken Henry:

> I also seek your assurance that the Commonwealth will guarantee that there will be no change to the Grants Commission's classification of "high" vs "low" royalty rate minerals as a consequences of the changes in royalty rates proposed by Western Australia (and other States), pending the next full review of the Grants Commission's methods.
>
> In this regard you may recall that an unintended consequence of the Grants Commission's late decision in its 2010 Review to base its assessment of mining royalty capacity on a high/low rate classification is that an increase in Western Australia's royalty rates on fine iron ore could lead to fine ore being reclassified as a high royalty rate mineral, reducing our GST by more than the additional royalty revenue we would collect.[42]

41 The Hon Troy Buswell MLA, Treasurer, Facsimile, 18 March 2010. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

42 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer, 11 May 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

6.47 Again, on 16 November 2010, in a letter from Western Australia Under-Treasurer, Timothy Marney, to the his counterpart, Dr Ken Henry:

> A change to the classification of iron ore fines would lead to a reduction in our GST of around three times the additional royalty revenue we would collect from removing the royalty rate concession on these fines. As we expect around $300 million per annum from this measure, our GST share could fall by nearly $1 billion. This would be an untenable outcome both in terms of the policy neutrality and equity of the GST distribution process.[43]

6.48 While Western Australia was making its case, the Queensland Treasurer wrote to the Chair of the Commonwealth Grants Commission and copied the letter to the Treasurer, with support for Western Australia's position. The Queensland Treasurer's letter of 9 February 2011, states that:

> Individual policies of states directly impact on their GST shares and there are clear incentives for states to alter their mining royalty regimes to maximise their GST. For example, when Western Australia removes some concessions for iron ore fines, they will lose far more GST from this policy change than is gained in mining revenue under the current methodology.[44]

6.49 On the 15 February 2001, the Treasurer wrote to the Grants Commission with terms of reference for its conduct of its distribution of GST revenue amongst the states in 2011-12. The Treasurer specifically instructed the Grants Commission to:

> The Commission should ensure that, with regard to the removal of iron ore fines royalty rate concessions in 2010, the classification or iron ore fine should not move between mineral royalty rate groups in between methodology reviews.[45]

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43 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer, 16 November 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

44 Letter, Queensland Treasurer copied to the Treasurer, 9 February 2011, p.2. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

45 Letter, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP to the Commonwealth Grants Commission (Mr Alan Henderson – Chairperson), http://www.cgc.gov.au/publications2/publications/latest_reports/2011_update/2011Update/contents/preliminaries (accessed on 23 May 2011)

6.50 As a consequence of the pressure applied to the Treasurer, the decision of the Grants Commission was:

> As noted above, the terms of reference direct the Commission not to change the treatment of iron ore fines because of the removal of royalty concessions in 2010 before the next methodology review.[46]

6.51 Western Australia was not penalised under the Grants process through the distribution of GST revenues.

6.52 The nature and extent of vertical fiscal imbalance has been a characteristic of the Australian federation for decades, but primarily since uniform income taxation was applied during the 1940s. The monopolisation of income and company tax by the Commonwealth has been exacerbated by the best terms of trade for 140 years, as the Commonwealth has enjoyed substantial increases and windfall corporate tax collections.

6.53 As part of the 2011-12 distribution of the Goods and Services Tax revenue, the Treasurer wrote to the Commonwealth Grants Commission to provide them with their terms of reference for the allocation. On 15 February 2011, the Treasurer wrote and expressly asked that:

> 11. The Commission should ensure that, with regard to the removal of iron ore fine royalty concessions for 2010, the classification of iron ore fines should not move between mineral royalty rate groups in between methodology reviews.
>
> 12. The Commission should also ensure that those payments which it has previously been directed to treat so that they had no direct influence on the relativities continue to be treated in that way. Where those payments are replaced, the treatment of the new payment should be guided by paragraphs 7 and 8 above, unless otherwise directed.[47]

6.54 As outlined above, the Commonwealth Government established that the states and territories would have some latitude in setting their royalties. It is important to note that the Treasurer's letter to the Commonwealth Grant's Commission occurred after the Heads of Agreement was signed.

6.55 While the Treasurer had instructed the Commonwealth Grants Commission to undertake the upcoming 2011 GST Review with a particular approach, the Government had further moves in mind, as outlined below.

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46 Commonwealth Grants Commission, *Report on GST revenue sharing relativities - 2011 Update*, p. 43.

47 Letter, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP to the Commonwealth Grants Commission (Mr Alan Henderson – Chairperson), http://www.cgc.gov.au/publications2/publications/latest_reports/2011_update/2011Update/contents/preliminaries (accessed on 23 May 2011)

Reforming the Commonwealth Grants Commission framework

6.56 As outlined above the impact of a surge in mining activity has had an impact for the financial relationships in the federation. During a visit to Perth on 30 March 2011, the Prime Minister and Deputy Prime Minister announced a review of the distribution of revenue from the Goods and Services Tax to the states and territories.

6.57 The Review is to be conducted by former New South Wales Premier, Mr Nick Greiner, former Victoria Premier, Mr John Brumby and Mr Bruce Carter. The purpose of the review is to improve the existing horizontal fiscal equalisation process.

6.58 The Review has the difficult task of addressing the issue of where the:

> ...States [are] facing penalties for economic growth and rewards for economic underperformance, the GST distribution process should encourage economic reform and better delivery of services, and provide States with certainty.[48]

6.59 One of the reasons the review is being undertaken, which is supported by evidence to this inquiry and material contained in the Henry Tax Review report is that, according to the joint media release by the Prime Minister and the Deputy Prime Minister:

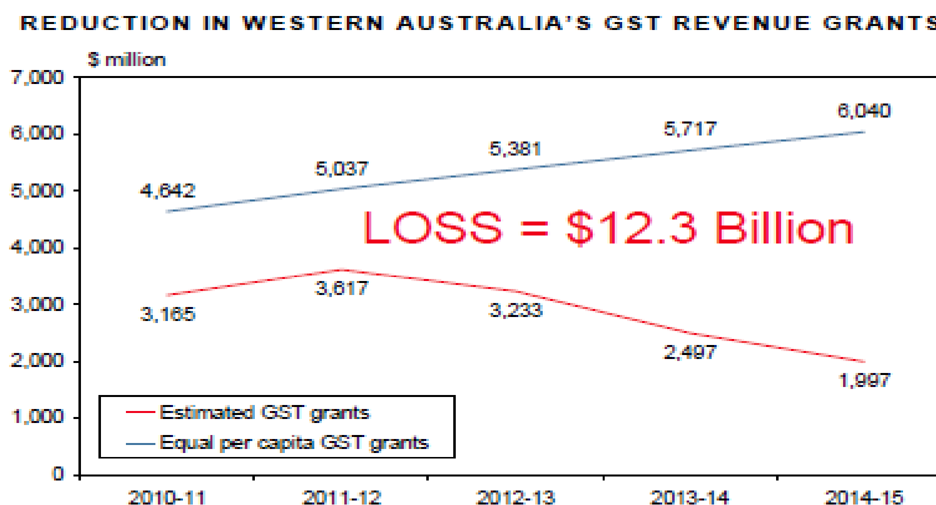
> In particular, we recognise growth in the mining sector is increasing the discrepancy in the amounts of revenue raised by States and Territories, as well as making it more difficult to anticipate GST distribution from one year to the next. [49]

6.60 The graph below, gives a practical view on the impact for Western Australia. As mentioned earlier, Western Australia derives a substantial portion of its revenue from mining royalties and in turn this has an impact on its treatment in the allocation of GST revenue. Chart 6.3 below from the Government of Western Australia (Budget factsheet 2011-12) provides an example:

48 Joint media release: the Prime Minister, the Hon Julia Gillard MP and the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP: *Review of GST Distribution*. (http://treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/028.htm&pageID=003&min=wms&Year=&DocType=) (accessed 21 April 2011)

49 Joint media release: the Prime Minister, the Hon Julia Gillard MP and the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP: *Review of GST Distribution*. (http://treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/028.htm&pageID=003&min=wms&Year=&DocType=) (accessed 21 April 2011)

Chart 6.3: Reduction in Western Australia's GST Revenue Grants[50]



6.61 The Review will be advised by a Heads of Treasuries Advisory Committee comprising representatives from all States and Territories, and will seek submissions from the public. It will be supported by a secretariat within the Commonwealth Treasury, with representation from the States and Territories as well as other agencies as appropriate.

6.62 The Review will provide an interim report to the Treasurer by February 2012 and a final report by September 2012.

6.63 In the meantime, the Commonwealth Grants Commission will continue as the independent organisation making recommendations on the distribution of GST revenue. The Commonwealth Government will request the CGC to update its methodology to reflect any agreed recommendations from the Review. The Review will not affect the distribution of the GST revenue in 2011-12 or 2012-13.

The Commonwealth declares a tax war against the resource states

More pitfalls from the flawed MRRT and expanded PRRT process continue to emerge – the Western Australia Budget 2011-12

6.64 On Thursday, 19 May 2011, the Western Australia Treasurer, the Hon C. Christian Porter MLA, delivered his first budget. A key component of the Budget was the decision to raise the royalty rate on 'fine' iron ore gradually from 5.625 per cent to 7.5 per cent by 2014. This measure would raise around $2 billion over four years. In the context of the Heads of Agreement and the impending GST

50 Government of Western Australia, *Budget 2011-12 Factsheet*. http://www.dtf.wa.gov.au/cms/uploadedFiles/State_Budget/Budget_2011_12/2011-12_fact_sheets_western%20australias%20gst%20share.pdf (accessed 23 May 2011)

Review, the decision by the Western Australia Government was an important step and was undertaken in response to the 'rapid and massive' decline in GST receipts.[51]

6.65 As a direct result of the governments ill thought out mining tax deal, the government under these arrangements would have to find about $2 billion out of its budget to fund credits for increased Western Australian royalties back to the those companies able to claim them against their resources tax liability.

6.66 The ongoing risk to the Commonwealth Budget could have been avoided. The government knew it needed to negotiate with the States, as then Treasury Secretary Ken Henry recommended this in his review. They never even tried. Yet when the Prime Minister and the Treasurer signed the mining tax deal, they went ahead and committed the Commonwealth to crediting all State and Territory royalties against any national mining tax liability.

6.67 Once the MRRT and the expanded PRRT is in place, however, '[t]he Commonwealth will also receive less revenue as a result of Mr Barnett's decision under the proposed Mineral Resource Rent Tax, which provides a full credit of state royalties paid by mining companies.'[52] This once gain highlights the shortcomings, of the decision to tie a volatile revenue stream to upward trending outlays – it magnifies the risk of the ongoing structural deficit identified in Chapter 5 of this report.

6.68 The failure to negotiate and agree the MRRT and the expanded PRRT with the states and territories has led directly to a situation in which the Commonwealth has exposed its fiscal position to erosion caused by increases in state and territory royalties. While the MRRT revenue rolls and announced expenditures combine to create a structural deficit, further pressure is placed on the Budget due to the risk that the states and territories will increase their royalties.

6.69 The absence of a Commonwealth, state and territory agreement was always going to expose the federal budget bottom line to future royalty increases in any state or territory. And of course under the Constitution changes to royalty rates are the exclusive prerogative and responsibility of the states and territories. In these circumstances, how the federal government ever thought they could 'reform' resources taxation and royalty arrangements without actively engaging the States and ultimately reaching agreement with them remains a mystery.

6.70 The reality is that the government has only got itself to blame. The mining tax deal the government negotiated exclusively and in secret with the three biggest mining companies prior to the last Federal election is the real cause of the blow-out.

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51 Andrew Burrell, 'Barnett blows $2bn hole in Swan's budget target', *The Australia*n, 20 May 2011, p. 1.

52 Media release, the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, *Barnett's 'own-goal' on iron ore royalties,* http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/057.htm&pageID=003&min=wms&Year=&DocType= (accessed 23 May 2011)

6.71 The appropriate level of royalties is of course a matter for the states as the appropriate level of income tax on mining company profits is a matter for the Commonwealth Government.

6.72 There is no need for a multi-billion dollar new tax on top of the existing taxation framework to ensure an appropriate return for the community. Royalties are the price paid by mining companies for the value of the non-renewable resource which is owned by the states.

6.73 The suggestion by the Treasurer that somehow state and territory governments must get his approval before making decisions about royalty rates was rightly condemned by state Leaders on both sides of politics. There is no constitutional basis for his assertion and no state Premier is a signatory to Labor's mining tax deal with the three big miners.

Who knew what, when

6.74 At the time of the announcement by the Western Australian Treasurer, the political process in Canberra went into overdrive. Much of the debate centred on what the Treasurer knew about Western Australia's plans to remove royalty concessions on iron ore fines. He had pleaded ignorance and surprise about the move to align royalty rates for iron ore fines and lumps.

6.75 The timeline below provides an overview of correspondence to the Treasurer on the matter of Western Australia increasing its iron ore fines rate.

> **Facsimile: Western Australia Treasurer, Troy Buswell MLA - 18 March 2010 – to the Treasurer, the Hon Wayne Swan MP:**
>
> '... if Western Australia successfully negotiates an increase in the royalty rates on fine iron ore that current apply under State Agreements (as it is currently endeavouring to do), and this leads to fine ore being reclassified as a high royalty rate mineral, our GST revenue would be reduce...'[53]

53 The Hon Troy Buswell MLA, Treasurer, Facsimile, 18 March 2010. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

Facsimile: Western Australian under Treasurer, Mr Timothy Marney – 11 May 2010 – to the then Treasury Secretary, Dr Ken Henry:

'...I seek your urgent conformation that "scheduled increases" in Western Australia would include the removal of existing iron ore royalty rate concessions, which would see both fine and lump iron ore royalty rates being levied at 7.5%, and beneficiated iron ore at 5%, by 1 July 2012.'[54]

Treasury Executive Minute 17 May 2011 – to the Treasurer:

'The proposed changes to royalties on some commodities in Western Australia at at Attachment C'.

Attachment C

'Western Australia indicated at a recent Commonwealth Grants Commission meeting (prior to the announcement of the Resources Super Profits Tax) it was considering increasing the royalty rate on iron ore fines from the current rate of 5.625% to the 7.5% for lump iron ore'.[55]

Facsimile: Western Australian Under-Treasurer, Mr Timothy Marney – 16 November 2010 – to the then Treasury Secretary, Dr Ken Henry:

''I refer to the matter of the Commonwealth Grants Commission's treatment of iron ore fines as outlined in my previous correspondence of 11 May 2010. [this is referred to above] I am very keen to receive confirmation as soon as possible that iron ore fines will not be reclassified (from low rate to high rate), given the potential implications for Western Australia's budget revenues and associated policy settings'.[56]

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54 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer,11 May 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

55 Freedom of Information release: Treasury Executive Minute: Mining projects and Royalties in Western Australia – 17 May 2010. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

56 Facsimile, Mr Timothy Marney, Western Australia Under Treasurer,16 November 2010, p.1. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

Letter: Queensland Treasurer, the Hon Andrew Fraser MP – copied to the Treasurer – 9 February 2011:

'For example, when Western Australia removes some concessions for iron ore fines, they will lose far more GST from this policy change than is gained in mining revenue under the current methodology.'[57]

Letter: The Treasurer – to the Chair of the Commonwealth Grants Commission, Mr Alan Henderson - 15 February 2011

'Terms of Reference for the 2011 Update of the State Revenue Sharing Relativities

11. The Commission should ensure that, with regard to the removal of iron ore fines royalty rate concessions in 2010, the classification or iron ore fine should not move between mineral royalty rate groups in between methodology reviews'.[58]

Facsimile: Western Australia, the Hon C. Christian Porter MLA – 19 May 2011 – to the Treasurer:

'I am writing to inform you of a decision in Western Australia's 2011-12 Budget, released today, to increase the royalty rate on iron ore 'fines' from the current 5.624% to 6.5% from 1 July 2012 and then to 7.5% from 1 July 2013'.[59]

6.76 The Treasurer certainly knew about those plans when he recommended to the Prime Minister that she sign off on the promise to credit all State and territory royalties.

Turning nasty – the threats fly

6.77 As outlined earlier, the Treasurer wrote to the Commonwealth Grants Commission on 15 February 2011, outlining the way in which the 2011 allocation of

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57 Letter, Queensland Treasurer copied to the Treasurer, 9 February 2011, p.2. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury.

58 Letter, Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP to the Commonwealth Grants Commission (Mr Alan Henderson – Chairperson), http://www.cgc.gov.au/publications2/publications/latest_reports/2011_update/2011Update/contents/preliminaries (accessed on 23 May 2011)

59 Facsimile, Western Australia Treasurer, the Hon C. Christian Porter MLA, 19 May 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

GST Review was to be conducted. It required that no penalty be imposed on the decision of states to alter their royalty schemes.

6.78 The Treasurer's most recent statements appear to contradict his earlier direction:

> '[o]ur advice is that the CGC [Commonwealth Grants Commission] is highly likely to revise up their estimate of Western Australia's revenue raising capacity, which means they will allocate less GST to the State'.[60]

6.79 As a result:

> '[t]he Federal Government does not intend to intervene in the CGC process to save Mr Barnett from the effects of his own decision to play politics with the mining boom.'[61]

6.80 The Treasurer's comments were supported by the Minister for Resources, the Hon Martin Ferguson AM MP. In Parliament on Monday 23 May 2011, Minister Ferguson stated:

> The outcome of the increase in royalties has sent a very strong message to the Commonwealth Grants Commission that the WA economy has a huge capacity to actually increase its revenue. In essence, we could end up with a situation by which the Western Australia Government could very likely lose more in GST revenue than it gains in additional royalty payments.[62]

6.81 As outlined above, the Treasurer's response to that is to threaten a tax war against Western Australia by letting the Commonwealth Grants Commission take even more of the GST away from Western Australia and by cutting infrastructure spending to that state even further. Never mind that none of the GST money would help him fix up his $2 billion budget hole. It would merely be redistributed among other States and territories.

6.82 Declaring a tax war against the people of Western Australia is not going to fix the mess the government has created by not thinking things through. The Treasurer cannot hide behind the Commonwealth Grants Commission either. What ultimately happens with Western Australia's share of GST as a result of their decision to remove royalty concessions on iron ore fines is entirely his decision.

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60 Media release, the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, *Barnett's 'own-goal' on iron ore royalties*. http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/057.htm&pageID=003&min=wms&Year=&DocType= (accessed 23 May 2011)

61 Media release, the Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, *Barnett's 'own-goal' on iron ore royalties*. http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/057.htm&pageID=003&min=wms&Year=&DocType= (accessed 23 May 2011)

62 House of Representatives, *Hansard*, Monday 23 May 2011, p. 58.

A risky business – the result of no deals with the states and territories

6.83 Holding the Heads of Agreement together could become increasingly difficult for the Commonwealth Government in the absence of an agreement made with the states and territories over royalties.

6.84 Another important consequence of the Western Australia Budget revolves around the willingness of the Commonwealth Government to hold to its agreement with the other parties to the Heads of Agreement. In particular:

> '[a] senior mining executive, who asked not to be named, said that big resources companies would not tolerate any back-down from the government and could walk away from the MRRT deal that was struck soon after Julia Gillard deposed Kevin Rudd as prime minister last year'.[63]

6.85 While the recent debate on the decision by the Government of Western Australia to raise its iron ore fines has ignited a controversy with the Commonwealth Government, the issue is still smouldering away in three other states, Queensland, New South Wales and Tasmania.

6.86 In New South Wales, the Premier the Hon. Barry O'Farrell has said that;

> '[R]oyalties are a state taxing instrument. They have gone up, they have come down, and as far as I'm concerned that's how it should be. That's an issue for state governments to determine. It's not an issue for us to be limited by federal governments. The same applies in relation to the gaming tax. I'm prepared to defend state revenues in the face of increasing attacks by federal governments. I'm not going to flag whether royalties are going up or down.'[64]

6.87 Also, in New South Wales, the Treasurer the Hon Mike Baird has said in the context of royalties that, '[w]e reserve the right to consider all measures in the budget. Our desire is to have a constructive relationship with the federal government but, we will make no apologies for standing up for NSW.'[65]

6.88 The New South Wales response to the encroachment of the Commonwealth on its taxation powers has been to see the matter in the context of Australia's federation, the Queensland Government has seen the matter through the prism of the right of governments not to bind their successors.

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63 Andrew Burrell, 'Barnett blows $2bn hole in Swan's budget target', *The Australia*n, 20 May 2011, p. 1.

64 Cole Latimer, NSW may raise coal royalty rates, 6 June 2011, http://www.miningaustralia.com.au/news/nsw-may-raise-coal-royalty-rates (accessed 7 June 2011)

65 Andrew Clennell, 'Barr O'Farrell's budget threat on rail money by increasing mining royalties, *The Daily Telegraph*, online article 6 June 2010, http://www.dailytelegraph.com.au/news/barry-ofarrells-budget-threat-on-rail-money-by-increasing-state-mining-royalties/story-e6freuy9-1226069739476 (accessed 7 June 2011)

6.89 The Premier of Queensland, the Hon. Anna Bligh has said that 'I will not sign up to agreement that binds a future Queensland Government that effectively ties their hands behind their back'.[66]

6.90 According to the Queensland Premier:

> 'We reserve the right to determine the appropriate royalties as a return for the minerals taken out of our state. We will certainly be maintaining our right completely to set royalties not only now, but I would expect any Queensland government of any political persuasion forever. If that has consequences for federal arrangements that would be something that needs to be negotiated frankly between the mining companies and the federal government.'[67]

6.91 The Tasmanian Government has taken the issue of a state's rights to raise a royalty further than just talking about such an option.

6.92 In its 2011-12 Budget, the Tasmanian Government foreshadowed an increase in its minerals royalty. According to the Tasmanian Budget, the minerals royalty will rise from $36.2 million in 2010-11 to $52.3 million in 2014-15.[68] According to the Budget:

> '[t]he increase in Mineral Royalties reflects the increase anticipated by the Department of Infrastructure, Energy and Resources and the introduction of a revised Royalty regime'.[69]

The further erosion of the credibility of the Commonwealth Grants process

6.93 The Commonwealth Grants Commission process and distribution of the GST revenue amongst the states and territories is a contentious process. The process is being made more contentious given the impact that the resources boom MkII is having on the financial relationships between the states, territories and the Commonwealth.

6.94 The extent of financial tension in the federation can be gauged from correspondence from the Hon Andrew Fraser MP, the Queensland Treasurer and the Commonwealth Grants Commission. In correspondence on 9 February 2011, the

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66 Francene Norton, 'No mining tax if states lose revenues: Bligh', *Eraming.com.au*, 22 December 2010, http://www.efarming.com.au/News/agricultural/22/12/2010/124679/no-mining-tax-if-states-lose-revenues-bligh.html (accessed on 7 June 2011)

67 Lisa Martin, 'Bligh defiant on mining royalties', 21 December 2010, *NineMSN*, ,http://news.ninemsn.com.au/national/8186928/bligh-defiant-on-mining-royalties (accessed on 7 June 2011)

68 Parliament of Tasmania, *The Budget – Budget Paper No.1*, Presented by Lara Giddings MP, Treasurer, for the information of Honourable Members, on the occasion of the Budget, 2011-12, p5.25.

69 Parliament of Tasmania, *The Budget – Budget Paper No.1*, Presented by Lara Giddings MP, Treasurer, for the information of Honourable Members, on the occasion of the Budget, 2011-12, p5.25.

Queensland Treasurer expressed concern that the revenue from the MRRT that has been put aside for states would be taken into account as part of the GST revenue distribution process. Such a move would penalise the largest two single recipient of the MRRT funding, Queensland and Western Australia:

> 'As you would appreciate, a redistribution of these [MRRT] funds would likely result unless such payments are excluded from the relevant assessment, an option that us possible under the current arrangements.
>
> This has potential to render the proposed allocations to the resources states illusory – with the benefits effectively clawed back by other states through a reduction in the GST grants to the resource states.
>
> A key policy goal of the MRRT stands to be frustrated should the infrastructure financing proposal not be excluded from the Grants Commission's consideration of GST allocation.'[70]

6.95 The impact of mining industry revenues on the Commonwealth Grants Commission process is exemplified by the fact that:

> 'It is clear that the Commission's methodology places undue emphasis on mining royalties. As outlined in Queensland's 2010-11 Budget papers, mining revenues comprises only 7 per cent of all revenue of all states. It however, represents 70 per cent of the GST funds that redistributed on states' revenue raising capacity.'[71]

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70 The Hon Andrew Fraser MP, Queensland Treasurer; Minister for Employment and Minister for Economic Development, Letter to Mr Allan Henderson AM, Chair of the Commonwealth Grants Commission, 9 February 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, executive Director, Fiscal Group, the Department of the Treasury.

71 The Hon Andrew Fraser MP, Queensland Treasurer; Minister for Employment and Minister for Economic Development, Letter to Mr Allan Henderson AM, Chair of the Commonwealth Grants Commission, 9 February 2011. 1 June 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, Executive Director, Fiscal Group, the Department of the Treasury.

6.96 The redistributive nature of the Commonwealth Grants Commission process can be demonstrated by Table 6.6 below:

Table 6.6: Commonwealth Grants process in action[72]

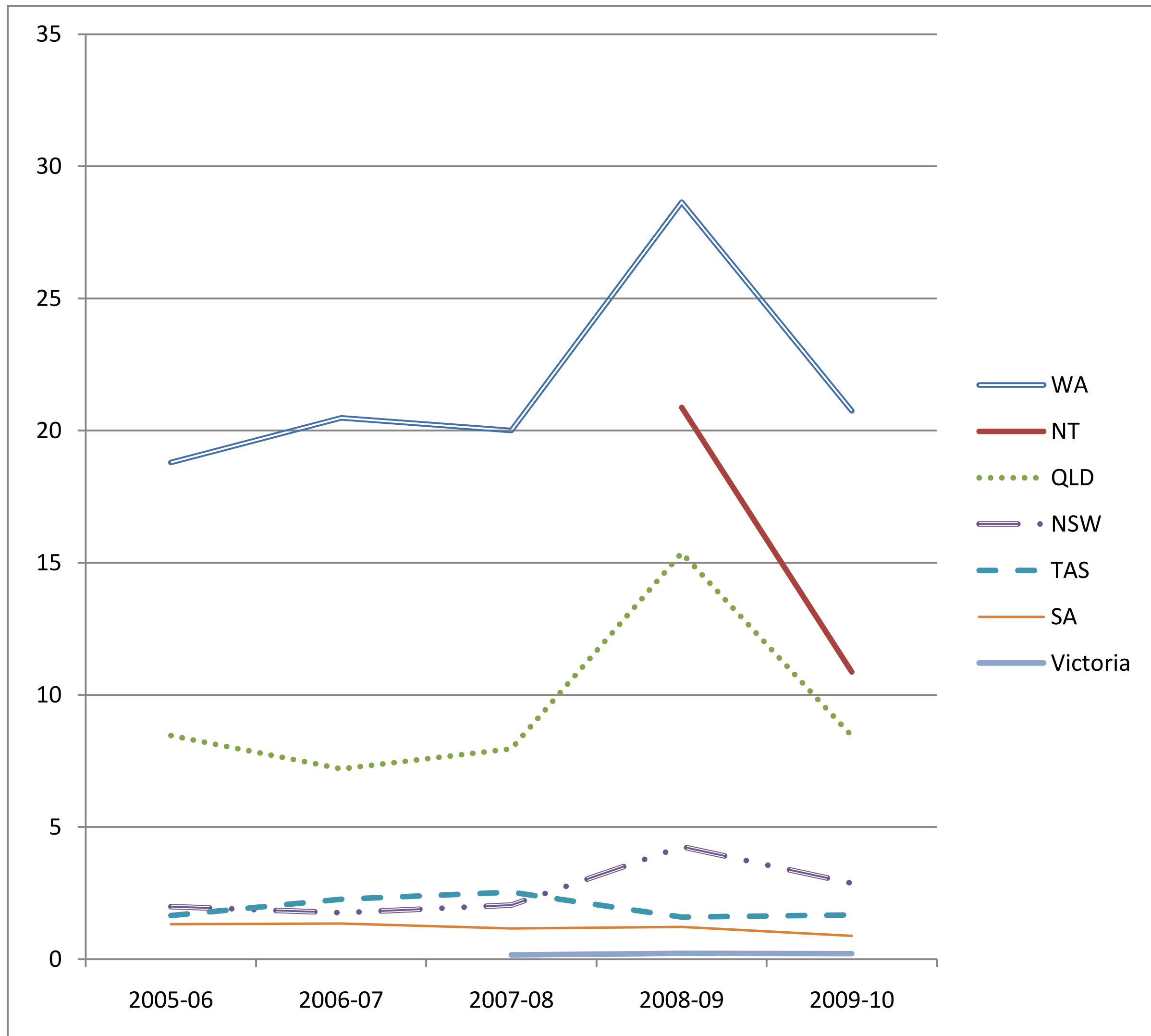
	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Mining Revenue ($m)	781	43	2,032	2615	147	36	0	136
2010 Review GST redistribution ($m)	1,123	1,501	-973	-2,097	292	107	103	-57
Net mining revenue ($m)	1,903	1,544	1,059	518	439	143	103	79
Net mining revenue ($ per capita)	274	294	250	242	276	289	302	363

6.97 As Table 6.5 highlights, Queensland and Western Australia in particular earn substantial revenue from mining revenue. Both earn more from mining revenue than the other states and territories, but end up on a per capita basis with least revenue from mining.

72 Source: The Hon Andrew Fraser MP, Queensland Treasurer; Minister for Employment and Minister for Economic Development, Letter to Mr Allan Henderson AM, Chair of the Commonwealth Grants Commission, 9 February 2011. Budget Estimates for 2011-12, Senate Economics Legislation Committee, Schedule of Tabled Documents by the Department of the Treasury. Tabled document No.5, 1 June 2011. Tabled by Mr Nigel Ray, executive Director, Fiscal Group, the Department of the Treasury.

6.98 The importance of royalties to the states and territories is set out in the chart 6.4, below. The chart below highlights the percent of own source royalty revenue across the states and territories. As the table indicates, Western Australia and Queensland have source much more of their revenue from mining than do the other jurisdictions.

Chart 6.4: Mining royalty revenue as a percentage of own source state and territory revenue, 2001-2010 [73]



73 Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 1 June 2011. Note: data for South Australia and Victoria unavailable. Note – no data available for the Northern Territory for 2005 – 2008 and for Victoria 2005 and 2006.

6.99 The importance of gambling revenue to the states and territories is set out in chart 6.5 below. As the table indicates, Western and Queensland are in the bottom three of jurisdictions that rely on gambling revenue.

Chart 6.5: Gambling revenue as a percentage of State own source revenue, 2001-2010[74]

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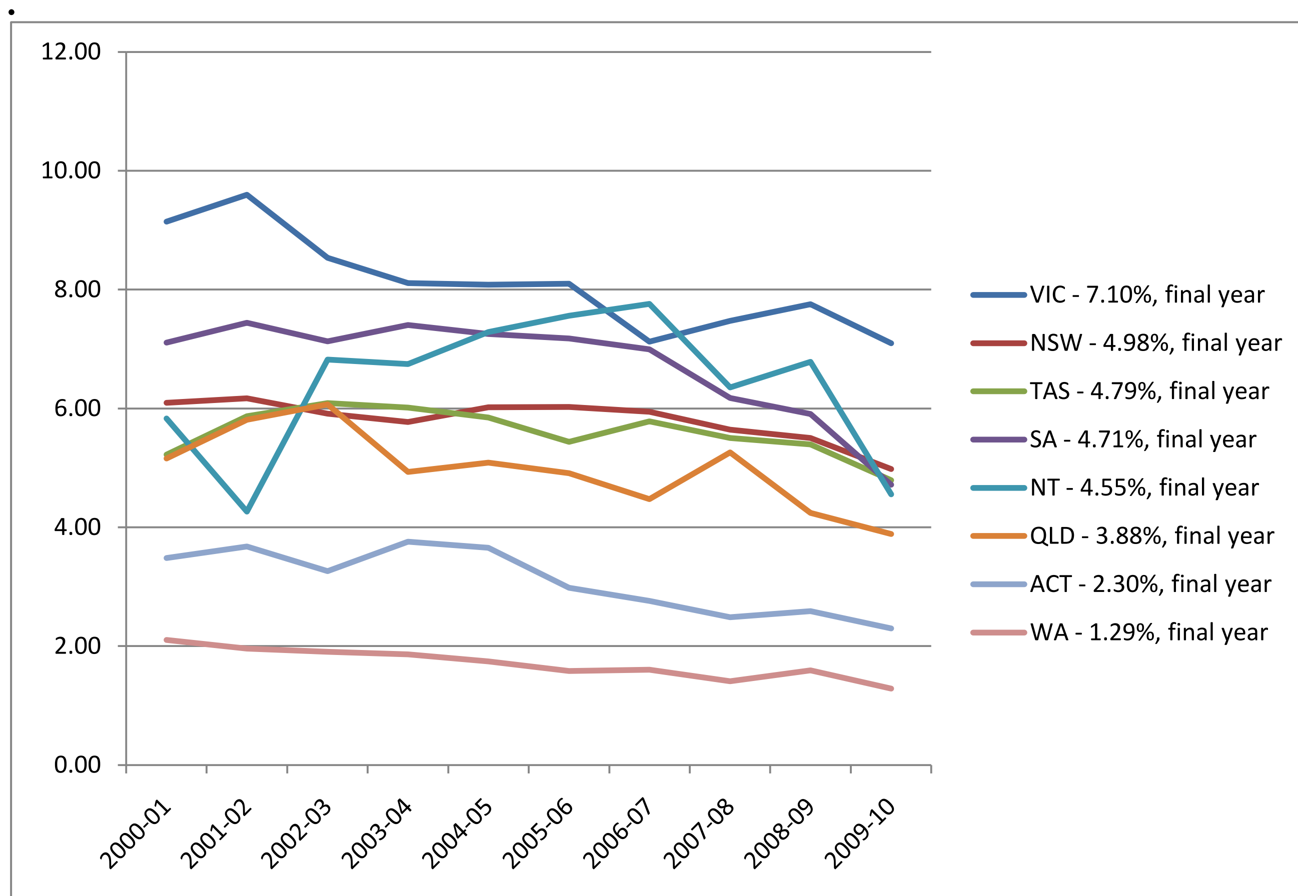

6.100 There is a curious interplay between the state and territory own revenue from mining and gambling:

> Senator CORMANN: But the factual question—confirm this one for me. If a state government increases either its tax base or its rate in relation to poker machines, it gets to keep 100 per cent of the revenue which it collects as a result of those decisions.
>
> Mr Spasojevic: It is true that if a state changes any revenue in relation to gambling there is no impact on its GST distribution.[75]

74 Department of the Parliamentary Services – Parliamentary Library, Client Memorandum to Senator Mathias Cormann, 1 June 2011.

75 Senator Mathias Cormann and Mr John Spasojevic, Secretary, Commonwealth Grants Commission, Proof Committee Hansard, *Estimates transcript of evidence*, 1 June 2011, p.67.

6.101 Under this arrangement of the GST distribution, the gaming states are never penalised for expanding their gaming revenue base but the mining states are penalised for expanding their mining revenue base.

6.102 The mining tax is bad policy which came out of a bad process. If the Government was fair dinkum about genuine tax reform it would start from scratch.

6.103 It would scrap the mining tax and engage in an open, transparent and inclusive process about tax reform not just targeted at one industry in isolation and involving all stakeholders including State and Territory governments.

6.104 The Commonwealth Government has only got itself to blame for the mess it is in over the mining tax. It should work on finding a way out without penalising Western Australia, Queensland or any other state or territory which decides to exercise its rights and responsibilities under the Constitution.

Constitutional issues

6.105 Proposed new taxation arrangements, particularly when they related to minerals and resources which are the property of the States, invariably raise questions about the constitutionality of such taxes. The Henry Tax Review version of a resource rent tax, the RSPT, MRRT and expanded PRRT have been no exception. The committee raised this issue with Treasury which provided inconclusive answers in relation to the constitutionality of the MRRT.

The Resources Rent Tax

6.106 In response to a Freedom of Information request, the Department of the Treasury released a range of documents that related to the policy development of the RSPT. These materials are available from the Department of the Treasury website.

6.107 On the Department of the Treasury website and released as part of the Freedom of Information request, there are two pieces of Australian Government Solicitor advice that discusses the constitutionality of the resource rent tax and the RSPT.

6.108 On 9 December 2009, the Australian Government Solicitor provided advice to the Department of the Treasury on:

> ... whether the proposed (resource rent tax) raises any constitutional issues.[76]

6.109 The advice was requested in relation to the Henry Tax Review recommendation for a resource rent tax. It is important to note that elements of the

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76 Freedom of Information disclosure. Department of the Treasury website: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936 (accessed 11 May 2011), Australian Government Solicitor legal advice, 9 December 2009, p.9.

Australian Government Solicitor's advice have been redacted under specific provisions of the *Freedom of Information Act 1982*.

6.110 Based upon those elements of the Australian Government Solicitor advice that have not been redacted, the advice states that:

> In our view, there are no significant issues raised by the proposal to implement a (resource rent tax) which would make the proposal infeasible. In particular, we do not think the (resource rent tax) would be a law with respect to taxation which discriminates between States for the purposes of section 51(ii) of the Constitution.[77]

The Resources Super Profits tax

6.111 As the government's tax plans evolved so did the nature of the advice sought from the Australian Government Solicitor. Under the Freedom of Information request outlined above, another piece of Australian Government Solicitor advice was released. It is dated 27 April 2010 and has had parts of it redacted under the various provisions of the *Freedom of Information Act 1982*.

The advice was sought because:

> You asked us to consider whether there are any constitutional problems with the proposal to introduce a tax credit/refund based on royalties paid to states, which can offset the RSPT liability.[78]

The advice covered two different mechanisms for dealing with the refund of state and territory royalties:

> As part of the implementation of the RSPT, it is proposed that State and Territory royalty regimes would continue, at least for a transitional period liable for both the RSPT and State taxes, but it is proposed that entities would receive a Commonwealth tax credit or refund for the royalties they pay under state regimes during this transitional period.{REF!}

6.112 The Australian Government Solicitor noted that:

> You seek an opinion on whether refunding or crediting state royalties in this way raises any constitutional issues.[79]

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77 Freedom of Information disclosure. Department of the Treasury website: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936 (accessed 11 May 2011), Australian Government Solicitor legal advice, 9 December 2009, p.9.

78 Freedom of Information disclosure. Department of the Treasury website: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936 (accessed 11 May 2011), Australian Government Solicitor legal advice, 27 April 2010, p.1.

79 Freedom of Information disclosure. Department of the Treasury website: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936 (accessed 11 May 2011), Australian Government Solicitor legal advice, 27 April 2010, p.5

6.113 The Australian Government Solicitor's advice, under the above text, was deleted as part of the Freedom of Information response from the Department of the Treasury.

6.114 The other mechanism considered as part of the advice, and also redacted in parts, was a cap on the credit/refund arrangement as part of the RSPT. The advice found that:

> There is a risk that this proposal, specifically the proposal to cap the amount of refund available based on the State in which the expenditure was incurred, constitutes discrimination between States for the purposes of s51(ii) of the Constitution and a preference between the States for the purposes of s99 of the Constitution. To avoid this risk, one possibility would be to impose a cap on the total refund/credit which is consistent across all States.[80]

The Mineral Resources Rent Tax and the Petroleum Resources Rent Tax

6.115 In recognition of the importance of the constitutionality of the MRRT, the then Secretary of the Treasury was asked whether legal advice had been sought specifically regarding the proposed new MRRT separate from the RSPT:

> Dr Henry—Tell me if I am wrong fellas, but so far as I know we have not sought external legal advice on the constitutionality of the government's MRRT proposal.
>
> CHAIR—But you did so for the RSPT?
>
> Mr Parker—We did have it for the RSPT. Insofar as the taxing point is concerned—that is, the first saleable form under the MRRT—it is not, in my understanding, in any degree of substance different to the RSPT design.
>
> CHAIR—But it is, isn't it? We have already had this discussion. The RSPT was a pure profits based tax, whereas the MRRT—even with the name—is a minerals resource rent tax which is applied at the point of extraction rather than as part of a pure assessment of the profits of the particular mining venture concerned. What I am trying to get at is where the line in the sand is that the Commonwealth will not cross. Is there one? Have you legal advice that has defined that line in the sand for you?
>
> Dr Henry—Yes.
>
> Mr Parker—Yes. I do not think that the purity of the tax, as you have framed it, goes in any degree of essence to the limits of the Commonwealth's constitutional taxation power.
>
> CHAIR—The taxing point is what I am looking at.
>
> Dr Henry—I wish it did. It would be rather nice if the Constitution obliged us to levy taxes only on pure profit.

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80 Freedom of Information disclosure. Department of the Treasury website: http://www.treasury.gov.au/contentitem.asp?NavId=087&ContentID=1936 (accessed 11 May 2011), Australian Government Solicitor legal advice, 27 April 2010, p. 2.

> CHAIR—But you have not sought any further legal advice as to whether the MRRT is in fact constitutional, based on your assumption that there is no difference between the RSPT and the MRRT on that front.
>
> Mr Parker—That is right.[81]

6.116 During the course of the hearing into the MRRT and expanded PRRT, the issue of constitutionality of these taxes arose. The evidence before the Committee revolved around two key matters. The first matter can be described in the context of the MRRT and expanded PRRT as:

> MR PAPE - The terms of reference for this inquiry seem to inextricably link the topics of resource taxation and fiscal federalism. My interest in this proposed minerals resource rent bill... is whether the parliament is overreaching its powers under section 114 of the Constitution. Relevantly, section 114 states that the Commonwealth shall not:
>
> … impose any tax on property of any kind belonging to a State. [82]

6.117 As there is no agreement about royalty arrangements in the context of the MRRT and expanded PRRT either between the Commonwealth and the states and territories or between states and territories themselves, the second key issue revolves around the interaction between the MRRT/expanded PRRT and state and territory royalties:

> MR PAPE - As presently advised, I doubt if a rebate or credit for state royalties, if it were to be allowed against the proposed tax, would be seen as discriminatory so as to offend section 51(ii) or section 99 of the Constitution. But, of course, the difficulty we have in all of this is that the so called bill is nonexistent and we are speculating as to what in fact the Commonwealth might do.[83]

6.118 However others have suggested that such discrimination may exist, for instance, Andrew Forrest has signalled that he believes the proposed taxation arrangements are discriminatory. It has been reported that:

> Claiming that the mining tax being pushed by Prime Minister Julia Gillard is discriminatory, Fortescue Minerals Group (FMG) chief executive Andrew Forrest said on Tuesday that he is prepared to challenge the measure's legality in the Australian High Court.
>
> ... Forrest stressed that the minerals resource rent tax (MRRT) proposed by the Gillard government heavily favors the country's giant mining firms such

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81 Senator Mathias Cormann, Chair Fuel and Energy Committee, Dr Ken Henry, Secretary, Department of the Treasurer, Mr David Parker, Executive Director, Department of the Treasury, *Fuel and Energy Committee Hansard*, 5 July 2010, pp. 41 – 42.

82 Mr Bryan Pape, Senior Lecturer, School of Law, University of New England, *Committee Hansard*, 13 December, p. 1.

83 Mr Bryan Pape, Senior Lecturer, School of Law, University of New England, *Committee Hansard*, 13 December, p. 1.

> as BHP Billiton, Rio Tinto and Xstrata, which he insisted should not have been the case as the three companies can very well afford to cover the additional expenses entailed in the new tax initiative.[84]

6.119 Given the legal matters that have been drawn to the Inquiry's attention and the absence of a draft Bill, the Commonwealth Parliament and the High Court may play an important role in settling the final form and legality of the legislation that deals with the MRRT, the PRRT and state and territory royalties:

> CHAIR—What sanctions are there against the federal parliament passing legislation which is unconstitutional?
>
> Mr Pape—Until the High Court declares it unconstitutional, it is valid.
>
> CHAIR—Essentially, the parliament can pass whatever unconstitutional law it likes. If nobody objects to it, it will stand.
>
> Mr Pape—That is right.
>
> CHAIR—So there is nothing that can be done before a law is passed to test its constitutional validity?
>
> Mr Pape—It may well be that a senator might say, 'My view is that this law is unconstitutional. I believe it would have standing to go to the High Court to run the case that it is unconstitutional.'[85]

6.120 Senator's are not able to seek the advisory opinion of the High Court of Australia on Bills. According to advice provided by the Acting Clerk of the Department of the Senate on 15 December 2010:

> ... [i]t is not possible for the High Court to give an advisory opinion on the constitutionality of a bill; the court does however have jurisdiction to consider the constitutionality of any Act where there is a dispute between parties on a matter arising under the Act.[86]

6.121 Advice from the Acting Clerk of the Senate, Mr Elliott did note that while the High Court had no jurisdiction to offer an advisory opinion, it was open to Senators to privately seek their own legal opinions, question the government on the matter on or pursue the issue through the Senate inquiry process.[87]

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84 Unknown author, 'FMG's Andrew Forrest hints of challenging MRRT in court', *International Business Times Australia*,14 June 2011, http://au.ibtimes.com/articles/162159/20110613/fmg-s-andrew-forrest-hints-of-likely-legal-challenge-against-mrrt.htm (accessed 21 June 2011)

85 Senator Mathias Cormann, Chair, Senate Select Committee on New Taxes and Mr Bryan Pape, Senior Lecturer, School of Law, University of New England, *Committee Hansard*, 13 December, p. 3.

86 Mr Cleaver Elliott, Acting Clerk, Department of the Senate, Formal email: Seeking advisory opinions from the High Court on the Constitutionality of bills, 15 December 2010.

87 Mr Cleaver Elliott, Acting Clerk, Department of the Senate, Formal email: Seeking advisory opinions from the High Court on the Constitutionality of bills, 15 December 2010.

6.122 In these circumstances, the Committee members will continue to carefully scrutinise the relevant legislation when it comes before the Parliament.

6.123 The Senate will not be the only interested party following the developments of the MRRT, it has been reported in The Australian that:

> ... [the] likelihood of Fortescue supporting a High Court challenge to the proposed MRRT, Mr Forrest said it was not possible to say at this stage, given the legislation was in draft form and "totally unfinished".
>
> But should the draft legislation remain unchanged, Mr Forrest said he was keen to test the constitutionality of the proposed tax.
>
> "As it stands now, any Australian who has a tax which allows multinationals to pay less per dollar of profit than what they do, that should be challenged, that is totally against the constitution," Mr Forrest said.
>
> "If that is what finally appears, you may be assured that Fortescue and others will challenge a precedent so dangerous that it gives multinationals a major advantage over Australia home grown companies.[88]

6.124 The Western Australian Government is also assessing its legal options in relation to the draft MRRT legislation, it was reported in the *The Australian* that:

> THE Barnett government and the West Australian resources industry were last night weighing up a High Court challenge to the Gillard government's planned $11.1 billion mining tax after the release of draft laws failed to silence miners who claim the impost is unjust.
>
> A spokesman for West Australian Attorney-General Christian Porter said the 176-page draft legislation had been sent immediately to the State Solicitor's Office, which would assess its constitutionality.
>
> Mr Porter has argued that the High Court could strike down the tax because it would discriminate between the states by allowing a miner in one state to receive a different royalty credit to a company mining the same resource in another state. The tax could also be unconstitutional because WA's mineral resources remain the property of the state rather than the commonwealth.[89]

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88 AAP, 'Fortescue may challenge resources rent tax of constitutional grounds, says Forrest', *The Australian*, 13 June 2011, http://www.theaustralian.com.au/business/mining-energy/fortescue-may-challenge-resources-rent-tax-on-constitutional-grounds-says-forrest/story-e6frg9df-1226074326165 (accessed 21 June 2011)

89 Andrew Burrell, 'Colin Barnett and miners eye high court challenge to Julia Gillard's tax', *The Australian*, 11 June, http://www.theaustralian.com.au/business/mining-energy/colin-barnett-and-miners-eye-high-court-challenge-to-julia-gillards-new-carbon-tax/story-e6frg9df-1226073303486 (accessed 21 June 2011)

Committee comment

6.125 The committee considers that there are still way too many unresolved issues and uncertainties for the Parliament to allow this legislation to proceed.

6.126 Whether the proposed MRRT and expanded PRRT are constitutional remains unresolved. It is entirely unsatisfactory for the government to ask the Parliament to pass legislation which may well breach the prohibition against imposing a tax on state property.

6.127 The interaction between the proposed MRRT, expanded PRRT, state and territory royalties and GST sharing arrangements remain unresolved.

6.128 The Parliament should not pass legislation which is likely to have a significant impact on investment and activity in an important sector of the economy, when such constitutional and other uncertainties remain. In particular, given the Government has consciously chosen not to remove these uncertainties through genuine consultation and negotiation with the states and other stakeholders.

6.129 The clearest demonstration of the problems caused by the Commonwealth Government stubbornly refusing to engage the states was illustrated when the Western Australian government decided to remove royalty concessions on iron ore fines, increasing the rate over time to the standard rate for iron ore of 7.5 percent.

6.130 As a direct result of the government's mining tax deal negotiated exclusively and in secret with the three biggest mining companies that Western Australian Government decision blew a $2 billion black hole into the federal budget. Why? because the Prime Minister and the Treasurer had committed the Commonwealth to crediting all state and territory royalties against any national mining tax liability. They did so without first checking what the state and territory intentions were in relation to mining royalties into the future.

6.131 Much of the debate recently centred on what Wayne Swan knew and when about Western Australian plans to remove royalty concessions on iron ore fines. He had pleaded ignorance and surprise about the move to align royalty rates for iron ore fines and lumps.

6.132 The evidence presented above is that Treasurer Swan had indeed been told about those plans on several occasions over a period of more than a year. Whatever developments may have happened later, there is no doubt that the Treasurer knew about those plans at the time he recommended to the Prime Minister that she sign off on the promise to credit all state and territory royalties.

6.133 Even leaving that aside, the committee considers that surely any competent Australian Government about to commit to credit all state and territory royalties against any new national tax liability would make it its business to find out. Surely a competent government would discuss and reach agreement about royalty rates into the future before pressing ahead. The committee considers that the government should

have been awake to the fact that the Commonwealth has no legal authority over royalty rates in the states and territories. The government should have realised that in the circumstances a promise to credit those royalties without having reached agreement with the states about what would happen to them in the future was reckless, irresponsible and incompetent.

6.134 Through its refusal to genuinely engage and consult with the states as the constitutional 'owners' of mineral royalties, the Commonwealth has exposed its own Budget to the decisions of the states to an extraordinary degree. This exposure of the Commonwealth budget to the activity of other levels of governments, in this case the states, has no precedent in recent Australian history.

6.135 The Gillard Government never sought any assurance from the states and territories in relation to its royalty arrangements. Instead it just asserted without legal authority that states and territories would not increase royalties into the future.

6.136 In the shadow of a difficult 2010 election, the government was too desperate to get a deal which would get the big miners off their back and let them put the mining tax revenue towards the budget bottom line and to create the illusion of an early surplus by 2012/13. A surplus, which under the Gillard Government version of the mining tax is exposed to decisions about royalty rates in six different states and the Northern Territory.

6.137 The committee agrees that the appropriate level of royalties is a matter for the states as the appropriate level of income tax on mining company profits is a matter for the federal government.

6.138 The committee also considers that there is no need for a multi-billion dollar new tax on top of the existing taxation framework to ensure an appropriate return for the community.

6.139 Royalties are the price paid by mining companies for the value of the non-renewable resource which is owned by the states.

6.140 The suggestion by the Treasurer a few weeks ago that somehow state and territory governments must get his approval before making decisions about royalty rates was rightly condemned by state leaders on both sides of politics.

6.141 There is no constitutional basis for his assertion and no state Premier is a signatory to Labor's mining tax deal with the three big miners.

6.142 The government has made a complete mess of the mining tax process. In the committee's view the Parliament should demonstrate its opposition to both the tax and the flawed process which led to the tax by voting against any legislation seeking to implement it.

Recommendation 8

6.143 The committee recommends that the Parliament insist on the government tabling an agreement with the states and territories about the interaction between the proposed MRRT/expanded PRRT, royalties, GST sharing arrangements and any other related federal-state financial relations issues before considering any mining tax related legislation.

Chapter 7

Australia needs genuine tax reform not lazy tax grabs

7.1 This inquiry has given detailed consideration to the development of the RSPT, the MRRT and expanded PRRT. The committee has found a significant number of shortcomings in the design of those new taxes. The government's proposed new national mining tax arrangements are more complex, less efficient and less fair than the status quo. The committee considers that the process for the development of the MRRT and expanded PRRT was inappropriately secretive and exclusive.

7.2 Genuine tax reform is best delivered through an open, transparent and inclusive process not by negotiation behind closed doors with a chosen few given the privileged opportunity to pursue their particular interests.

7.3 Taxation reform must be an ongoing process. It should not be targeted at one industry in isolation as is the case with the MRRT and expanded PRRT. Australia needs genuine taxation reform focused on delivering lower, simpler and fairer taxes. In order to achieve that more needs to be done including on the spending side of the budget. Australia needs tax reform aimed at improving our productivity and international competitiveness, to encourage increased workforce participation, enterprise and to attract investment. Future tax reforms must also focus on making the system more user friendly, efficient and on reducing red tape for households and business instead of increasing it. Finally, any genuine tax reform will include a focus on Federal-State financial relations.

7.4 Taxation is one of the most complex and delicate policy areas entrusted to lawmakers and administrators. One misaligned lever can cause chaos elsewhere in the system. Reform must occur in an ordered way that addresses known structural problems without creating unwanted or unforseen new ones. This chapter outlines the committee's views on why a single, more strategic, coordinated and coherent framework for taxation reform is needed and how such reform should be conducted.

A lack of strategic, coordinated and coherent framework for tax reform

7.5 Since coming to office, the government has rapidly increased government spending and initiated four major reviews focussed on reforming Australia's taxation system. The first major review was the Henry Tax Review process. At the time this report was prepared the government had only taken on board a mere handful of the 138 recommendations. This process remains incomplete. The Henry Review still provides an important reform roadmap, but following through on genuine tax reform will require the kind of steely political resolve that is sorely lacking in this government.

7.6 While the Henry Tax Review was supposed to be a once in a generation opportunity for 'root and branch reform' of our tax system delivering simpler and

fairer taxes all the government is proposing is a massive new tax on a single industry which is manifestly more complex and less fair.

7.7 The Henry Review noted that ten out of Australia's 125 taxes raised 90 per cent of overall revenue. That means there are more than 100 taxes that are doing very little other than adding huge complexity. The Henry Tax Review suggested that reliance on fewer efficient taxes would be preferable. Yet, since that report was delivered to the government, they have proposed at least five ad hoc new taxes – the student tax, the flood tax, the minerals resource rent tax, the expanded petroleum resource rent tax and the carbon tax. In fact over the past four budgets the current government has introduced new or increased taxes to the tune of more than $45 billion.

7.8 The government did not do the hard yards required for genuine tax reform. Genuine tax reform requires engagement through an open, transparent and inclusive process involving all stakeholders, in particular state and territory governments. Any genuine tax reform absolutely needs to be based on active engagement and negotiations with the states and territories – as was recommended incidentally by the Henry Tax Review. It is time the government embraced the Council of Australian Governments (COAG) process to achieve agreement on genuine tax reform.

7.9 In particular, proposals related to resource taxation should have involved state and territory governments in the process given the implications for their budgets and their capacity to fund ongoing services in areas like health, law and order, education and transport.

7.10 Treasury's 'Red Book' briefing to the incoming government described State taxes and levies as some of Australia's worst designed and inefficient taxes. That was pretty strong language by Treasury. However, the states do have an historical problem with raising their own revenue. In 1942, the Commonwealth established a national uniform income tax system, effectively stopping the states from continuing to raise their own income taxes. Under the Constitution, excise duties are the exclusive domain of the Commonwealth as well. So this leaves the states with a very limited ability to impose a variety of taxes to fund their responsibilities to the community. In Western Australia, revenue from mining royalties represents about 20 per cent of its own-source revenue. How can any federal government which asserts it is pursuing tax reform refuse to communicate with a state like Western Australia when its tax proposals seek to further restrict their capacity to raise their own revenue?

7.11 Since the Henry Tax Review, the government has announced a review of the distribution of revenue from the Goods and Services Tax to the states and territories. While this Review is welcome it is conducted in isolation and has some time to go.

7.12 Later in the year there will be a tax 'forum' (instead of a tax 'summit') which is supposed to consider personal tax, transfer payments, business tax, state taxes, environmental and social taxes and tax system governance. The time for that forum is about three months away, yet the Treasurer still has not released any discussion papers

to inform debate in the lead-up to the forum. Instead, what we have is a promise to allow reform ideas to be uploaded to a website ahead of the tax forum. This is pure window dressing without a thorough process to actively engage experts in a structured approach to reform.

7.13 Both the government's mining tax and the carbon tax have been excluded from consideration by the tax forum. These are significant tax changes with significant implications for the Australian economy, the federal budget, international competitiveness, investment and jobs. They should be on the table for consideration by the tax forum in late 2011.

A framework to get taxation reform right

7.14 At present, the current formulation of taxation policy is taking place in an environment of high government spending, through a series of uncoordinated and incoherent tax reviews. There is a serious need to streamline and improve the development of taxation policy. There is also an opportunity to better use the considerable work that has already been undertaken to formulate a more strategic taxation policy for the nation.

7.15 The government should scrap its mining tax and carbon tax proposals and start again by engaging in a genuine taxation reform agenda. The current ad-hoc nature of taxation reform should be consolidated into one single, coordinated and coherent strategic framework, and should also incorporate spending reform. Under that framework, the MRRT and the PRRT would be scrapped and reconsidered. The work of the Henry Tax Review would be re-considered and the framework would also include active engagement with state and territory governments about the related Federal-State financial relations implications.

Building on the Henry Tax Review

7.16 The foundation documents for the framework would draw upon the work of the Henry Tax Review and would be accompanied by the release of the data that underpinned the work of that project. Increased transparency surrounding tax policy and its development should provide the necessary stimulus to encourage more fully informed and considered tax arrangements for the nation.

Better transparency

7.17 The development of the RSPT, MRRT and the PRRT has highlighted the need for transparency in the development of policy. The development of the MRRT and the PRRT was characterised by a lack of transparency and an exclusive agreement amongst a select group of insiders. Chapters 2 and 3 outlined these matters in detail.

Better consultation

7.18 In addition to ensuring that sufficient information is disclosed to ensure an informed consideration of taxation options, a traditional model of consultation with

stakeholders would be adopted. This would entail the release of an initial discussion document, followed by a draft and then final set of recommendations for government. The policy development would entail the traditional White Paper and Green Paper process that accompanies the development of important policies. Chapter 3 provided an overview of the deficient consultation.

7.19 The committee calls for a genuine Australian Tax Summit to position Australia to meet its taxation challenges. A detailed and genuine discussion on developing a better taxation framework for Australia would be a precursor to obtaining the judgement of the Australian people on the need for reform. This approach to developing tax policy is more akin to the process that surrounded the design and implementation of A New Tax System, (which included the Goods and Services Tax) under the Howard Government.

The Importance of Spending Reform

7.20 An important goal of tax reform should be to reduce the overall tax burden for the Australian community. Tax reform should focus on both the level and mix of taxes as well as the design of individual tax arrangements and the tax system as a whole. Ideally, then, genuine tax reform should be accompanied by a serious effort to curtail the blow-out in government spending and waste that has taken place since the election of the current government.

The Importance of actively engaging with the States and Territories

7.21 There can be no genuine taxation reform in Australia without active engagement between the Commonwealth and state and territory governments. This is particularly true in the area of resource taxation given the implications for state and territory royalty and GST sharing arrangements.

Committee comment: Another missed opportunity

7.22 The committee is of the view that the government is unlikely to opt for a strategic, coordinated and coherent framework to review and address the challenges in taxation policy. While a genuine Tax Summit could provide a vehicle for addressing the shortcomings of the process that surrounded the development of the MRRT and the PRRT, the government appears unwilling to re-evaluate its policy.

7.23 The committee is disappointed that the government will not allow the Tax Forum to consider those Henry Tax Review recommendations relating to the introduction of the RSPT and its proposed successors the MRRT and expanded PRRT.

7.24 If the tax forum and the Henry Tax Review recommendations are to form the basis of future policy development and eventual implementation, the committee recommends that such proposals be based on an open, transparent and inclusive process.

Recommendation 9

7.25 The committee recommends that the current uncoordinated, incoherent and ad hoc taxation processes currently underway be replaced by one genuine tax reform process focused on delivering lower, simpler and fairer taxes, through an open, transparent and inclusive process.

Senator Mathias Cormann

Chair

Government Senators Dissenting Report

Introduction

Senator Hutchins and Senator Cameron do not agree with the recommendations in the Coalition Senators' report.

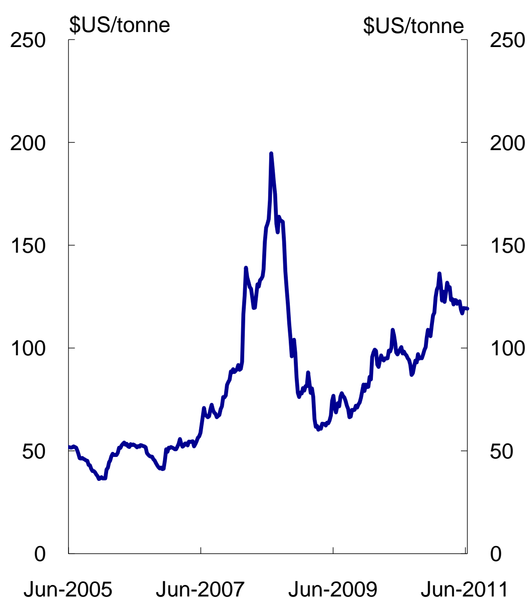
Government Senators find that the Mineral Resource Rent Tax and the extension of the Petroleum Resource Rent Tax onshore will deliver significant positive and beneficial returns to Australia, particularly the regions.

Current mining boom

Australia is going through a mining boom that by almost any economic indicator is unprecedented.

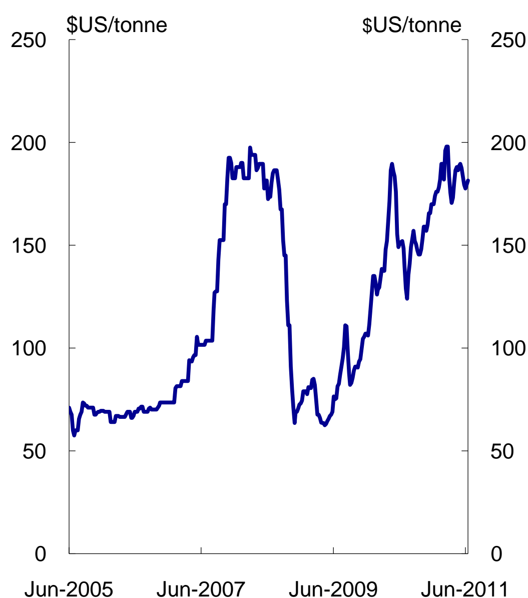
Commodity prices have increased significantly, especially in iron ore.

Thermal Coal (Newcastle, FOB)



Source: Global Coal

Iron Ore (CFR)



Source: Bloomberg

These commodity prices have in turn spurred a mining investment boom. Since the Government announced its mining tax reforms, mining investment has skyrocketed from $35 billion last year (09-10), to $51 billion this year (10-11), to an expected $83 billion in 2011-12. Mining employment has also grown substantially by 19.4 per cent – that's 35,200 mining jobs - compared to 2.3 per cent for the whole economy over the same period.

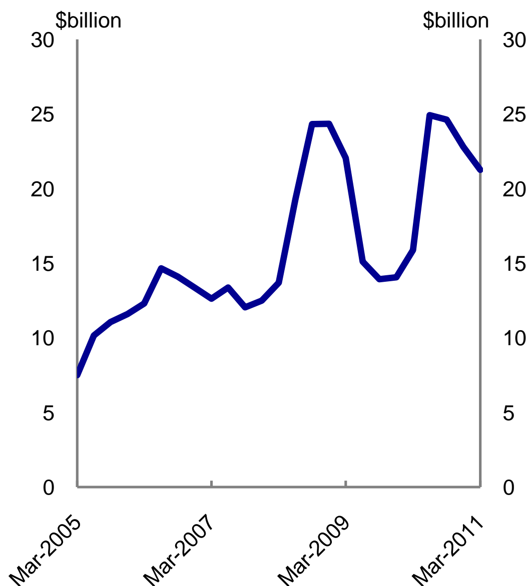
The latest ABARES quarterly commodities report shows that Australian energy and minerals export earnings are forecast to increase by 33 per cent to around $186 billion in 2010-11, before increasing by a further 16 per cent to $215 billion in 2011-12.

Exploration is also growing. Junior exploration companies also continue to get lots of interest – in December 2010 they made up 88 per cent of all resource sector initial public offerings.

The resources of all Australians

It is clear that the current mining boom is delivering record profits to miners. Mining profits were $25 billion in the September quarter.

Mining profits



Source: ABS cat no. 5676.0

Much of these profits travel off-shore to foreign owners, yet a lot of it has little to do with the investment in labour or capital by mining companies. Mining can be a difficult and specialised industry that requires high returns to workers and investors. But the kinds of returns mining interests are sometimes currently accruing can be out of all proportion to these costs. Instead, much of their profit can be due to the inherent underlying and finite value of the resources owned by Australians. It is an inescapable fact that when these minerals are dug up and sent overseas they are gone forever.

The Government's tax reforms

The Government's tax reforms respond to these pressures by returning a fairer share of nation's wealth to Australians.

The 2011-12 Budget includes net revenue from the MRRT is $3.7 billion in 2012-13, $4 billion in 2013-14, and $3.4 billion in 2014-15, which represents the net impact on

revenue across several different revenue heads. This includes the offsetting reductions in company tax (through deductibility) and interactions with other taxes.

The MRRT revenue is being used to fund important tax and superannuation reforms, including

- a company tax cut for all companies to 29 per cent on 1 July 2013; and
- a new tax break for up to 2.7 million small businesses, from 1 July 2012
- investment in our regions, through a Regional Infrastructure Fund
- simplifying personal tax for 6.4 million Australians with a $500 standard deduction from 1 July 2012 and a $1,000 deduction from 1 July 2013;
- rewarding personal saving of over 5 million Australians, with a 50% tax discount on up to $500 of interest income from 1 July 2012, increasing to up to $1,000 of interest income from 1 July 2013;
- a boost to superannuation for 8.4 million Australians, with the first increase on 1 July 2013; and
- expanded superannuation concessions for 3.5 million low income earners and about 275,000 over 50s from 1 July 2012.

The Government's mining tax means lower taxes, more infrastructure and greatly increased personal savings for ordinary Australians.

The Coalition Senators' report recommends the MRRT revenue be used to repay debt or be devoted to the Future Fund. This would mean foregoing all of the important investments in more competitive business taxes, tax relief for small business, simplified personal taxes with bigger tax returns, new regional infrastructure, and greater savings through superannuation. These initiatives are important investments in the growth of Australia's entire economy, and will see Australia save more of the gains through the 8.4 million superannuation accounts of Australian workers.

The MRRT

The MRRT will apply to all new and existing iron ore and coal projects and will apply at a rate of 30 per cent. An extraction allowance of 25 per cent reduces the effective rate of the MRRT to 22.5 per cent.

Under the MRRT, the government taxes positive cash flows, or mining profits, and allows miners to carry forward and uplift losses (unused deductions) for use in later years. The tax applies to profits attributable to the resource close to the point of extraction and therefore avoids taxing the value adding of the miner such as processing and transportation of the resource. As such it is a tax on a limited portion of mining profits, unlike company income tax, which applies to all income.

Under the MRRT, upstream capital expenditure is immediately deductible. Unlike income tax, capital assets do not have to be depreciated over their effective lives. The MRRT will be fully deductible for company income tax purposes.

Small miners

There are a number of features of the MRRT which benefit smaller miners.

Small miners often have large start up costs of capital.

As new projects will be able to be immediately write-off investment and immediately deduct expenses, no MRRT will be payable until the project has made enough profit to pay off its upfront investment.

To the extent that expenses, including capital expenses, cannot be deducted immediately due to insufficient profit, those losses will be carried forward and uplifted at the government long term bond rate plus 7 per cent.

There is also a special concession for small miners.

Mining companies with an annual MRRT profit of $50 million or less, are entitled to a low-profit offset that will reduce their MRRT liability to nil. This offset phases out between $50 million and $100 million of MRRT profit. -

This concession and the inherent design of the MRRT provide significant advantages to smaller miners.

Royalties are a poor way of getting a return from the resources we own

It is clear that profits-based mining taxes such as the MRRT are fairer and encourage production compared to royalties. This is because royalties are either based on revenue or volume, so they hit mining production from the first tonne of mineral produced, regardless of how costly the resource is to produce. Also, as a mine approaches the end of its life, and the grade of iron ore gets worse, royalties continue to charge the same price.

A royalty system therefore can lead to fewer mines starting up and existing struggling mines to close too soon.

While a royalty system taxes less profitable mines too much, it also taxes highly profitable mines too little. A mine struggling with high costs of extraction, for example due to the particular characteristics of the mineral deposit, pays the same royalty as a mine with little costs and making lots of profit.

The MRRT will recognise the investment and operating costs involved in extracting non-renewable resources. For start up mines, it imposes a charge once the mine production starts making a profit. And for mines nearing the end of their life it recognises that margins fall as the grade of iron ore gets worse.

When mining prices are high, the MRRT delivers more revenue to Australians from selling the resources they own. When they are low, royalties discourage investment and jobs in mining.

The Australia's Future Tax System review found state-based royalty systems to be unfair and among the most inefficient taxes in Australia. It also found that profits based resource taxes are one of the most efficient taxes that can be levied in Australia. A profits-based system will get a better return for Australia from its non-renewable wealth, and do it in a better and more efficient way than state royalties.

Development of the MRRT and PRRT

The MRRT and extension of the PRRT to all offshore and onshore oil and gas projects have been subject to extensive consultations since they were announced on 2 July 2010.

The Government set up a Policy Transition Group (PTG), led by the Minister for Resources and Energy, the Hon Martin Ferguson and Mr Don Argus. The PTG was established to oversee the development of the detailed technical design of the MRRT and the transition of existing petroleum projects to the PRRT regime.

The PTG conducted a comprehensive and extensive program of face-to-face consultations with a range of stakeholders in Perth, Brisbane, Sydney, Adelaide and Melbourne. Participants included affected mining companies, relevant industry associations, major accounting firms and other tax professionals. The PTG consultations were overwhelmingly constructive, as were the 88 written submissions that were received.

On 24 March 2011, the Government accepted all recommendations of the PTG relating to the new arrangements. The PTG recommendations form the basis of the draft MRRT legislation and the PRRT extension.

One of these recommendations that the Government accepted is that a Resource Tax Implementation Group be convened to assist in the drafting of the MRRT legislation. The RTIG includes tax experts and representatives from the mining industry and has been assisting with the development of draft legislation for public consultation.

The Government released the draft MRRT Bill and Explanatory Memorandum on 10 June 2011 for public consultation. Consultation will run until 14 July 2011. The draft PRRT amendments will be released in the near future.

Legislation is expected to be introduced into the Parliament late in 2011 in order for the new resource tax arrangements to commence as planned on 1 July 2012.

Costings

Estimates of MRRT revenues have been published and regularly updated since the policy was announced. The 2011-12 Budget includes revised estimates on page 5-35 of Budget Paper No. 1.

Treasury's terms of trade forecasts and projections are published in the Budget, and were updated in the Economic Statement and the PEFO.

Treasury has explained that it does not publish forecasts of the commodity prices underlying the terms of trade forecast.

Conclusion and recommendation

Recommendation 1 - The MRRT should be implemented from 1 July 2012 so that the MRRT and the investments that will flow from it will be of lasting and enduring benefit to current and future generations of Australians.

Senator Steve Hutchins

Deputy Chair

Senator Doug Cameron

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Prosper Australia
2	Mr Grant Dinse
3	Association of Mining and Exploration Companies (AMEC)
4	Australian Bureau of Agricultural and Resource Economics; Bureau of Rural Sciences
	• Supplementary Submission
5	ANDEV
	• Supplementary Submission
6	DOMGAS ALLIANCE
7	National Institute of Economic and Industry Research
8	Business Council of Australia
9	Australian Council of Trade Unions
10	Mr John Passant, Faculty of Law, University of Canberra
11	Centre for Policy Development
12	Australian Petroleum Production and Exploration Association Ltd (APPEA)
13	Construction, Forestry, Mining and Energy Union
14	The Australia Institute
15	Institute of Public Affairs
	• Supplementary Submission
16	Oxfam Australia
17	Mr Bryan Pape
	• Supplementary Submission
18	Australian Workers' Union
19	Professor Ross Garnaut
20	Australian Council of Social Service
21	The Institute of Chartered Accountants in Australia
22	Mr Yuanyuan Jia
23	Mr Tony Hassell
24	Law Council of Australia
25	Magnetite Network (MagNet)

26	Northern Territory Government
27	Mr Andrew Oliver
28	Mr Marcus Webb
29	Dr George Fane
30	Professors H. Ergas, M. Harrison and J. Pincus
31	Hon Christian Porter MLA
32	Professor John Rolfe, Centre for Environmental Management, CQ University
33	Mr Philip Kirchlechner

Additional Information Received

- Mineral Resource Rent Tax Heads of Agreement
- Opening statement tabled by Henry Ergas and Jonathan Pincus at a public hearing in Melbourne on 30 March 2011.
- Received from Mr Alan Moran, Institute of Public Affairs, on 24 November 2010; answers to Questions on Notice taken at a public hearing in Melbourne on 19 November 2010.
- Received from Mr Tony Petersen, DomGas Alliance, on 25 November 2010; answers to Questions on Notice taken at a public hearing in Perth on 8 November 2010.
- Received from Mr Simon Bennison, Association of Mining and Exploration Companies, on 1 December 2010; answers to Questions on Notice taken at a public hearing in Perth on 8 November 2010.
- Received from Mr Timothy Marney, Department of Treasury and Finance, Government of Western Australia, on 26 November 2010; answers to Questions on Notice taken at a public hearing in Perth on 8 November 2010.
- Received from Mr John Nicolaou, Chamber of Commerce and Industry Western Australia, on 8 December 2010; answers to Questions on Notice taken at a public hearing in Perth on 8 November 2010.
- Received from Mr Bernie Delaney, BHP Billiton, on 14 January 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 8 December 2010.
- Received from Prof Ross Garnaut, on 24 January 2011; answer to Question on Notice taken at a public hearing in Melbourne on 19 November 2010.
- Received from the Department of the Treasury, on 2 February 2011; answers to Questions on Notice taken at a public hearing in Canberra on 22 November 2010.
- Received from Prof Henry Ergas and Prof Jonathan Pincus, on 13 April 2011; answers to Questions on Notice taken at a public hearing in Melbourne on 30 March 2011.

TABLED DOCUMENTS

PERTH, 8 November 2010

- Document tabled by BURU Energy Ltd; submission to the Policy Transition Group
- Document tabled by the Chamber of Commerce and Industry Western Australia; submission to the Policy Transition Group

MELBOURNE, 19 November 2010

- Document tabled by ABARE; 'Minerals and energy: Major development projects'

MELBOURNE, 8 December 2010

- Document tabled by Rio Tinto; Opening remarks
- Document tabled by BHP Billiton; testimony by company representatives Mr Gerard Bond and Mr Bernie Delaney
- Document tabled by the Minerals Council of Australia; a policy brief: Minerals resources, tax, and the prosperity of all Australians, June 2010.

APPENDIX 2

Public Hearings and Witnesses

PERTH, 8 November 2010

ANWYL, Ms Megan Irene, Executive Director, Magnetite Network

BALL, Mr Morgan Scott, Chief Finance Officer and Company Secretary, BC Iron Ltd

BENNISON, Mr Simon, Chief Executive Officer, Association of Mining and Exploration Companies

COURT, Mr Michael John Reginald, Executive Director Economic, Department of Treasury and Finance

EDWARDS, Mr James Rhys, Executive Officer, Economics and Tax, Chamber of Minerals and Energy of Western Australia

FLANAGAN, Mr David Nathan, Managing Director, Atlas Iron Ltd

FORREST, Mr John Andrew Henry, Chief Executive Officer, Fortescue Metals Group Ltd

HARRISON, Mr David, General Manager, Advocacy, Chamber of Commerce and Industry of Western Australia

HUGHES, Mr Marcus Paul, Group Tax Manager, Fortescue Metals Group Ltd

MACKENZIE, Mr William Ross (Bill), Chairman, Magnetite Network

MARNEY, Mr Timothy, Under Treasurer, Department of Treasury and Finance

NEWTON, Mr Robert Geoffrey, Executive Officer, Media and Public Affairs, Chamber of Minerals and Energy of Western Australia

NICOLAOU, Mr John, Chief Officer, Membership and Advocacy, Chamber of Commerce and Industry of Western Australia

PEARCE, Mr Stephen Thomas, Chief Financial Officer, Fortescue Metals Group Ltd

PETERSEN, Mr Anthony Edward, Chairman, DomGas Alliance

RICHARDS, Mr Noel, Senior Policy Adviser, Resources and Energy, Chamber of Commerce and Industry of Western Australia

SHORT, Mr Graham, National Policy Manager, Association of Mining and Exploration Companies

STREITBERG, Mr Eric Charles, Executive Director, Buru Energy Limited

TAPP, Mr Julian Robin Paul, Director, Strategy, Fortescue Metals Group Ltd

WILLMOTT, Ms Deidre Ellen, Group Manager, Approvals and Government Relations, Fortescue Metals Group Ltd

MELBOURNE, 19 November 2010

ARMSTRONG, Mr Graham T, Senior Associate, National Institute of Economic and Industry Research

GARNAUT, Professor Ross Gregory, Private capacity

HOGAN, Ms Lindsay, Senior Economist, Resource, Energy and Trade, Australian Bureau of Agricultural and Resource Economics, Bureau of Rural Sciences

MANNING, Dr Ian Geoffrey, Deputy Executive Director, National Institute of Economic and Industry Research

MORAN, Dr Alan John, Director, Deregulation Unit, Institute of Public Affairs

MORRIS, Mr Paul, Deputy Executive Director, Australian Bureau of Agricultural and Resource Economics, Bureau of Rural Sciences

CANBERRA, 22 November 2010

HENRY, Dr Ken, Secretary, Department of the Treasury

PARKER, Mr David John, Executive Director, Revenue Group, Department of the Treasury

MELBOURNE, 8 December 2010

BOND, Mr Gerard, Head of Group Human Resources, BHP Billiton

DELANEY, Mr Bernie, Vice President, Government Relations, BHP Billiton

LYONS, Mr Ross, General Manager, Taxation, Rio Tinto .

O'NEILL, Mr Mark, Chief Adviser, Government Relations, Rio Tinto

CANBERRA, 9 December 2010

CARLTON, Mr Tim, Director, Commonwealth Grants Commission

SPASOJEVIC, Mr John, Secretary, Commonwealth Grants Commission

SYDNEY, 13 December 2010

CHAIT, Mr Louis Alan, General Manager Business Analysis and Planning, Xstrata Coal

FREYBERG, Mr Peter, Chief Executive, Xstrata Coal

McCARTHY, Ms Cassandra, Group Manager Government Relations and Climate Change, Xstrata Coal

PAPE, Mr Bryan, Senior Lecturer, School of Law, University of New England

MELBOURNE, 30 March 2011

ERGAS, Professor Henry, Professor of Infrastructure Economics, University of Wollongong.

FANE, Adjunct Professor George, Australian National Universit

FREEBAIRN, Professor John William, Ritchie Professor, University of Melbourne

PINCUS, Professor Jonathan James, Visiting Professor, University of Adelaide

ROLFE, Professor John, Professor in Regional Development Economics, Central Queensland University

APPENDIX 3

Terms of Reference
Australia's future tax system[1]

Objectives and scope

1. The tax system serves an important role in funding the quality public services that benefit individual members of the community as well as the economy more broadly. Through its design it can have an important impact on the growth rate and allocation of resources in the economy.

2. Raising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and intergenerational), and minimise complexity for taxpayers and the community.

3. The comprehensive review of Australia's tax system will examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and enhance Australia's economic and social outcomes. The review will consider:

3.1. the appropriate balance between taxation of the returns from work, investment and savings, consumption (excluding the GST) and the role to be played by environmental taxes;

3.2. improvements to the tax and transfer payment system for individuals and working families, including those for retirees;

3.3. enhancing the taxation of savings, assets and investments, including the role and structure of company taxation;

3.4. enhancing the taxation arrangements on consumption (including excise taxes), property (including housing), and other forms of taxation collected primarily by the States;

3.5. simplifying the tax system, including consideration of appropriate administrative arrangements across the Australian Federation; and

3.6. the interrelationships between these systems as well as the proposed emissions trading system.

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1 Department of the Treasury, Australia's future tax system – Report to the Treasurer – Part One, December 2009, pp vii–ix.

4. The review should make coherent recommendations to enhance overall economic, social and environmental wellbeing, with a particular focus on ensuring there are appropriate incentives for:

4.1. workforce participation and skill formation;

4.2. individuals to save and provide for their future, including access to affordable housing;

4.3. investment and the promotion of efficient resource allocation to enhance productivity and international competitiveness; and

4.4. reducing tax system complexity and compliance costs.

5. The review will reflect the Government's policy not to increase the rate or broaden the base of the GST; preserve tax-free superannuation payments for the over 60s; and the announced aspirational personal income tax goals.

6. The review's recommendations should not presume a smaller general government sector and should be consistent with the Government's tax to GDP commitments.

7. The review should take into account the relationships of the tax system with the transfer payments system and other social support payments, rules and concessions, with a view to improving incentives to work, reducing complexity and maintaining cohesion.

8. The review should take into account recent international trends to lower headline rates of tax and apply them across a broader base, as well as domestic and global economic and social developments and their impact on the Australian economy.

9. The review will also incorporate consideration of all relevant tax expenditures.

Composition and consultation

10. The Review Panel will be chaired by the Secretary to the Treasury, Dr Ken Henry AC and will also comprise Mr Greg Smith (Australian Catholic University); Dr Jeff Harmer (Secretary of the Department of Families, Housing, Community Services and Indigenous Affairs), Mrs Heather Ridout (Australian Industry Group CEO); and Professor John Piggott (University of New South Wales).

11. The Review Panel will be supported by a working group from within the Treasury, with representation from the Department of Families, Housing, Community Services and Indigenous Affairs, and drawing on other Australian government and state agencies as appropriate.

12. The Chair may task members of the Review Panel to oversee programs of work related to their field of expertise.

13. The Review Panel will consult the public to allow for community and business input.

14. The review will also, where necessary, draw on external expertise and shall have the cooperation of state governments and their Treasuries as well as relevant COAG working groups.

15. The Minister for Families, Housing, Community Services and Indigenous Affairs will provide input on issues related to transfer payments, family assistance and retirement incomes.

Structure and timing

16. The review process will be conducted in several stages. These will follow the release of an initial discussion paper by Treasury on the architecture of the tax system and an examination of the existing tax rates and bases (excluding the GST). The paper will be released by the end of July 2008.

17. The Review Panel will provide a final report to the Treasurer by the end of 2009. The Government will respond in a timely way to the tax review's recommendations as they are released.

APPENDIX 4

Mineral Resource Rent Tax Heads of Agreement

The Design of the Minerals Resource Rent Tax

The new resource tax will apply from 1 July 2012 only to mined iron ore and coal. All other minerals are excluded.

The rate of tax will be 30% applied to the taxable profit at the resource.

Taxable profit is to be calculated by reference to:

- The value of the commodity, determined at its first saleable form (at mine gate) less all costs to that point
- An extraction allowance equal to 25% of the otherwise taxable profit will be deductible to recognise the profit attributable to the extraction process. (i.e. this to only tax the resource profit)
- Arms length principles on all transactions pre and post first saleable form.

MRRT is to be calculated on an individual taxpayer's direct ownership interest in the project.

There will be no MRRT liability for taxpayers with low levels of resource profits (i.e. $50m per annum).

All post 1 July 2012 expenditure is to be immediately deductible for MRRT on an incurred basis. Non-deductible expenditure will be broadly consistent with PRRT.

MRRT losses will be transferable to offset MRRT profits the taxpayer has on other iron ore and coal operations.

Carried-forward MRRT losses are to be indexed at the allowance rate equal to the LTBR plus 7 percent.

The MRRT will be an allowable deduction for income tax.

All State and Territory royalties will be creditable against the resources tax liability but not transferable or refundable. Any royalties paid and not claimed as a credit will be carried forward at the uplift rate of LTBR plus 7 percent.

Starting Base

The starting base for project assets is, at the election of the taxpayer, either:

- Book value (excluding the value of the resource) or
- Market value (as at 1 May 2010).

All capital expenditure incurred post 1 May 2010 will be added to the starting base and depreciated against mining operations from 1 July 2012.

"Project assets" for the purpose of the MRRT will be defined to include tangible assets, improvements to land and mining rights (using the Income Tax definition).

Where book value is used to calculate starting base, depreciation will be accelerated over the first 5 years. The undepreciated value will be uplifted at LTBR plus 7 percent.

Where market value is used to calculate starting base, there will be no uplift and depreciation will be based on an appropriate effective life of assets, not exceeding 25 years.

Any undepreciated starting base and carry forward MRRT losses are to be transferred to a new owner if the project interest is sold.

Implementation Committee

A mutually acceptable Committee comprising credible, respected industry leaders will oversee the development of more detailed technical design to ensure the agreed design principles become effective legislation. This will have the objective of ensuring the agreed principles are effected in line with their intent in a commercial, practical manner.

Signed on behalf of the Australian Government by:

Hon Julia Gillard MP Prime Minister	Hon Wayne Swan MP Deputy Prime Minister and Treasurer	Hon Martin Ferguson AM MP Minister for Resources, Energy and Tourism
Marius Kloppers BHP Billiton	David Peever Rio Tinto Australia	Peter Freyberg Xstrata Coal

Canberra, 1 July 2010

APPENDIX 5

Policy Transition Group
List of Recommendations

MRRT RECOMMENDATIONS

SCOPE OF THE MRRT

Resources subject to the MRRT

Recommendation 1: The MRRT should apply to all mining operations resulting in the depletion of naturally occurring coal or iron ore. For the avoidance of doubt, the following activities should be covered by the MRRT rather than the PRRT:

- coal mining operations involving the extraction of gas derived from the underground conversion of coal; and

- coal mine methane extracted as a necessary and integral part of a coal mining operation.

Recommendation 2: Where there is incidental production of coal or iron ore as part of a mining project, the proceeds from the sale of the coal or iron ore should be assessable under the MRRT, with allowance for a reasonable apportionment of mining costs.

Recommendation 3: Where there is incidental production of other minerals or products as part of an coal or iron ore project, the proceeds from the sale of the other minerals or products should not be assessable under the MRRT and the reasonable apportionment of mining costs associated with those minerals or products should not be deductible under the MRRT.

Recommendation 4: The terms ‘iron ore’ and ‘coal’ should take their ordinary meanings in the legislation, rather than being defined terms.

3.2 Who is the taxpayer

Recommendation 5: An income tax consolidated group should be permitted to elect to be treated as a single entity for MRRT purposes. Only such a group should be permitted to combine mining interests held by more than one entity into the same project.

Recommendation 6: The head company of a consolidated group that makes that election should be responsible for paying the MRRT of the group, but each entity in the group should be jointly and severally liable for the group’s unpaid MRRT.

4 DEFINITION OF A PROJECT

Defining a project

Recommendation 7: A project must consist of at least one production right. A project should commence when a production right is granted or acquired.

Recommendation 8: Where separate production rights that produce the same commodity exhibit a degree of integration in the extraction and processing operations, and other activities that occur prior to the taxing point, they should be considered a single project (a single mine).

Recommendation 9: The taxpayer should be allowed to elect to define a project as the aggregated interests in separate production rights that produce the same MRRT commodity and are managed as an integrated operation, demonstrated through the same downstream infrastructure being used or operated in an integrated manner in respect of production from the production rights. Where a taxpayer elects to aggregate production rights, the project must encompass the full extent provided by the criteria.

Recommendation 10: A project would need to be re defined to reflect changes in circumstances relating to the production rights in which the taxpayer holds an interest, such as where:

- an interest in a new production right is acquired, or an existing mining tenement in which the taxpayer has an interest becomes a production right, and is part of a project defined under Recommendations 8 or 9;
- an interest in a production right that is part of a project defined under Recommendations 8 or 9 is sold or relinquished; or
- the configuration of the taxpayer's mining operations change, such that one or more production rights satisfy, or no longer satisfy, the tests under Recommendations 8 or 9.

Applying the definition of a project

Recommendation 11: The taxpayer should be allowed to self-assess a project in accordance with the defining criteria. Decisions would be reviewable by the ATO and rulings available for those seeking certainty.

Recommendation 12: Entities that are consolidated for income tax purposes and elect to also be consolidated for MRRT purposes (see Recommendation 5) should apply Recommendations 8 and 9 to production rights held by members of the consolidated group under the single entity rule. In that case, the head company of the consolidated group will be the taxpayer for each aggregated project within the group.

Recommendation 13: Exploration for an MRRT commodity and pre-project expenditure relating to upstream activities, incurred on or after 1 July 2012, would be immediately deductible against assessable revenue generated by any project producing the same commodity held by a taxpayer who incurred the expenditure, in accordance with Recommendation 26.

Defining when a project ends

Recommendation 14: A project should be deemed to cease to exist when a production right is rescinded by or relinquished to the issuing authority, or 10 years after production of a commercial quantity of coal or iron ore from the mine ceases, or when the taxpayer elects to close the project, whichever occurs first.

Recommendation 15: Expenditure incurred in undertaking rehabilitation of a mine site after a project has ceased production should be deductible. To the extent that the rehabilitation costs cannot be offset against assessable revenue, or transferred to another project in the wholly-owned group, the taxpayer will be eligible for an immediate tax credit up to the amount of MRRT paid over the life of the project.

5 TAXING POINT

Recommendation 16: The taxing point is the point at which:

- the resource leaves the point at which it has been stockpiled after being extracted (the run of mine (ROM) stockpile) ready for the next unit of operation;
- where a ROM stockpile does not exist, or is by-passed, the point at which the resource is delivered to the first unit of operation after extractive mining activities have occurred (for example loading onto a conveyor belt to a processing unit or loading into an in-pit crusher); or
- a stand alone arm's length sale to a third party, where this occurs prior to the taxing point described in the points above.

Recommendation 17: The ATO should work with industry to develop acceptable administratively efficient approaches to allocating costs at the taxing point where existing accounting and administration systems are not aligned to that point.

6 TAXABLE REVENUE

6.1 Resource revenue

Recommendation 18: The value of the resource at the taxing point should be determined by:

- an arm’s length sale to a third party at the taxing point; or
- where there is not an arm’s length sale at the taxing point, the amount determined using the most appropriate and reliable arm’s length method.

Recommendation 19: The value of the resource should be determined at the time of supply of the resource, but no later than when the resource is loaded for export.

Recommendation 20: The explanatory memorandum should provide guidance as to the type of valuation methodologies that are suitable and be detailed enough to provide certainty to taxpayers and guidance to the ATO and the courts. In addition, draft ATO guidance on acceptable resource valuation methodologies and procedures should be developed, in parallel to the legislative process, to be available prior to the MRRT coming into effect.

Recommendation 21: A 'safe harbour' method to calculate the value of the resource at the taxing point where there is no arm's length supply to a third party at the taxing point should be available to:

- taxpayers with mining operations that, combined, produce fewer than 10 million tonnes per annum of saleable coal and iron ore in a tax year; and
- vertically integrated transformative operations in existence at 1 May 2010.

Recommendation 22: Taxpayers eligible to apply the 'safe harbour' method may calculate the value of the resource at the taxing point as the value derived from the first arm's length supply to a third party less:

- operating costs incurred between the taxing point and the point of sale;
- an allowance for capital employed between the taxing point and the point of supply, calculated as the depreciated optimal replacement cost of the capital employed multiplied by LTBR+7; and
- deductible and creditable amounts attributable to the use of the 'safe harbour' method should not be available to offset assessable receipts generated from other resource sales from the mining project or be transferable to other projects of the taxpayer.

6.2 Annual calculations

Recommendation 23: The MRRT should be assessed on an annual basis that includes MRRT deductions incurred throughout the year and all MRRT revenue receivable during the year.

Recommendation 24: The MRRT income should be deemed to be derived at the time of supply of the resource, but no later than when the resource is loaded for export.

Recommendation 25: The approach outlined in Recommendation 23 should apply from 1 July 2012, recognising that some resources supplied after that date will have been extracted prior to 1 July 2012.

6.3 Exploration and other pre-project expenditure

Recommendation 26: MRRT exploration and other pre-project upstream expenditure incurred in respect of mining tenements other than a production right should be:

- transferable to other projects producing the same MRRT commodity held by a taxpayer, subject to Recommendation 44; and
- transferable to projects producing the same MRRT commodity within an entity acquiring the tenement on which the expenditure is incurred, subject to Recommendation 47.

Recommendation 27: The uplift rate applying to eligible exploration and other pre-project expenditure incurred in respect of mining tenements other than a production right should reduce from the LTBR+7 to LTBR 10 years after the expenditure is incurred.

6.4 Other revenue and deductions

Recommendation 28: Project revenue and deductions should include other amounts relating to changes in the use of project assets and amounts previously assessed or deducted. These include:

- balancing adjustments when a project asset (whether in the starting base or acquired from 1 July 2012) leaves the project or the extent of its use in the project changes;
- compensation for the loss of an asset or an MRRT deductible expense (for example, an insurance payout);
- explicit or implicit reimbursements, reductions or subsidies of deductible expenditure; and
- amounts arising under a risk sharing arrangement embedded in a contract entered into by the taxpayer where the counterparty is the purchaser of the resource or supplier of a service or input to an upstream activity (for example, under a take or pay arrangement).

Recommendation 29: Amounts received from contract mining services which an MRRT entity provides to a third party, such as extraction services, should not be MRRT assessable receipts to the entity and the costs of providing those services should not be MRRT deductible to the entity.

7 DEDUCTIBLE EXPENSES

Recommendation 30: Payments of a revenue or capital nature should be deductible for MRRT purposes to the extent they are necessarily incurred by an entity in carrying on mining operations upstream of the taxing point, subject to the exclusions listed in Recommendation 31.

Recommendation 31: The following payments should be excluded for the purposes of Recommendation 30:

- Payments of interest or principal on a loan, and other borrowing costs, with hire purchase and finance lease arrangements treated as a debt financed asset purchase;

- Payments of dividends, the cost of issuing shares, and repayments of equity capital.

- Payments of resource royalties levied under State or Territory legislation;

- Payments to acquire, or to acquire an interest in, an exploration permit, retention lease, production licence, pipeline licence or access authority, otherwise than in respect of the grant of the right, or project profits, receipts or expenditures;

- Payments of private override royalties, other than those subject to Recommendation 33, noting that the market value starting base should be determined as if unencumbered by such royalties;

- Payments to the extent they represent hedging or foreign exchange losses relating to the resource, other than those arising under an agreement to sell the resource or acquire any service or input to an upstream activity;

- Payments of rehabilitation bonds or to a rehabilitation fund;

- Payments that represent a provision, reserve, sinking fund, insurance fund, or similar;

- Payments of a capital nature in respect of land or buildings for use in connection with administrative or accounting activities (for example, a head office), not being land or buildings located at, or adjacent to, mining operations upstream of the taxing point; and

- Payments of income tax or GST.

Recommendation 32: The Implementation Group should investigate the treatment of expenses associated with plant and equipment included in head office expenditure.

Recommendation 33: Private royalties payable in respect of a period after 30 June 2012 to a State or Territory body under an agreement entered into prior to 2 May 2010 should be deductible but otherwise treated in an equivalent manner to State and Territory royalties. Recommendation 31 would not apply in respect of such royalties.

Recommendation 34: The legislation should ensure that native title payments made pursuant to an agreement under the Native Title Act 1993 or a similar Act in settlement of an indigenous land use agreement, should be deductible to the extent they relate to upstream operations.

Recommendation 35: The definition of exploration under the MRRT should be aligned with that used for income tax.

Recommendation 36: The time of recognition of an expense should be aligned with that under income taxation.

8 TREATMENT OF DEDUCTIONS

8.1 Starting base losses and royalties

Recommendation 37: Losses arising from unused depreciation of the starting base (starting base losses) should not be transferable to other projects.

Recommendation 38: Starting base losses should be uplifted in the following manner:

- market value starting base – by the consumer price index to retain their real value; and
- book value starting base – by the MRRT uplift rate consistent with the design announced on 2 May 2010.

Recommendation 39: State and Territory mineral and gas royalties (including those raised on behalf of private land owners holding mineral rights) should be:

- creditable against MRRT liabilities;
- non-transferable and non-refundable; and
- carried forward and uplifted where they are unable to be used.

Recommendation 40: It is important to ensure that the taxation of Australia's resources preserves our international competitiveness and ensures Australians receive a greater benefit from mineral resources and that this is reflected in the treatment of royalties under the MRRT. The MRRT should not be used as a mechanism to enable States and Territories to increase inefficient royalties on MRRT taxable commodities. All current and future State and Territory royalties on coal and iron ore should, therefore, be credited and it is imperative that the Australian, State and Territory Governments put in place arrangements to ensure that the States and Territories do not have an incentive to increase royalties.

Recommendation 41: Private royalties imposed by the States and Territories on behalf of private land owners should be treated in the same manner as State and Territory royalties and therefore be creditable and uplifted but not transferable.

8.2 Deduction ordering rules

Recommendation 42: MRRT revenue should be reduced by deductions, losses and royalty credits in the following order:

1. Project deductions.
2. Royalty credits (current year and carried forward).
3. Carried forward losses of the project.
4. Starting base depreciation deductions and starting base losses.
5. Transferable exploration expenditure.
6. Transferred-in project losses.

9 TRANSFERS OF MRRT LOSSES

Recommendation 43: Losses should only be transferable between projects producing the same MRRT commodity.

Recommendation 44: Losses that can be transferred should be transferred at the appropriate point under the ordering rules, to the extent that they can be used.

Recommendation 45: Project losses should only be transferable if the transferring and transferee projects were owned by the same entity (or group) from when the losses were generated until they are transferred. Historical losses should otherwise be quarantined to the project from which they originated.

Recommendation 46: Notwithstanding Recommendation 45, the Implementation Group should consider whether there are administrative and/or alternative legislative approaches to loss transferability that could apply in situations where the holder of an interest in a joint venture acquires a further interest in that joint venture. (The Implementation Group is identified in Recommendation 61.)

Recommendation 47: MRRT exploration and pre-project losses acquired with a mining tenement should be transferable to projects with MRRT profits, whether or not any ownership condition is satisfied. To avoid the possibility that this free transfer of exploration losses leads to trading in exploration deductions that have a greater economic value than the underlying tenement:

- the unused exploration losses attributable to a tenement should go with the tenement when it is transferred; and
- the part of an exploration loss that an entity acquiring a mining tenement can use should be limited by reference to the amount paid for the tenement (or an equivalent amount where the entity that owns the tenement is acquired).

Recommendation 48: If the relevant tests are otherwise satisfied, losses should be transferable to projects owned by other entities within the same consolidatable group regardless of whether the group has chosen to consolidate.

10 STARTING BASE

Starting base

Recommendation 49: A starting base should be available for all interests in mining tenements in existence at 1 May 2010.

Starting base election

Recommendation 50: An entity must make an irrevocable election to use market value or book value as the method for determining a starting base for each interest the entity holds in a project or other mining tenement in existence at 1 May 2010, by the due date for the filing of the first MRRT tax return. Where an election is not made by the required date, the project or mining tenement should be taken to have a book value starting base. Where an appropriate book value does not exist or cannot be reliably reproduced, there should be no starting base.

Determining the market value starting base

Recommendation 51: An entity should determine a market value starting base comprising the market value of mining assets upstream of the taxing point as at 1 May 2010 on the basis of accepted market valuation principles.

- In determining how market valuation principles should be applied, the taxpayer should take into consideration their particular circumstances and the stage of development of the project or mining tenement.

- The derivation of the market value starting base should have regard to market expectations of future iron ore and coal prices, exchange rates, interest rates, inflation and other industry reference benchmarks as at 1 May 2010, and recognised methodologies for market valuation in the mining sector. The Treasury, ATO and RET should consult industry and professionals to identify suitable reference benchmarks to reduce compliance costs and provide greater certainty to taxpayers. The existence of such benchmarks would not constrain a taxpayer's choice of valuation methods or their ability to use alternative estimates.

- Guidance as to the application of valuation methodologies should be provided through examples within the explanatory memorandum. In addition, the ATO should provide early guidance to industry regarding the practical application of this aspect of the legislation.

- The approach used in deriving the starting base should be consistent with that used to value the resource at the taxing point.

- The starting base should include all tangible assets including improvements to land and mining rights (as defined by income tax – that is, mining, quarrying and prospecting), as well as relevant intangible assets such as mining information.

- Where a private override royalty existed in relation to the project or tenement at 2 May 2010, the starting base should be determined as if it were unencumbered by the private override royalty liability (Recommendation 31).

- As a proxy for the market value of tenements other than a production right, an entity could elect to use the sum of their expenditure over the previous 10 years.

Applying the market value starting base

Recommendation 52: The market value starting base of a mining project or other mining tenement should not start to be depreciated until an MRRT commodity is first produced from the tenement to which the starting base relates. Where a resource does not come into production by 30 June 2037 (25 years from the commencement of the MRRT), the starting base should be immediately deductible in the year production commences.

- Depreciation of the market value starting base should be on a straight-line basis.

- The mining right and mining information should be treated as one asset and depreciated over the lesser of the life of the mine or the period to 30 June 2037.

- Other assets should be written off over the lesser of their effective life, the life of the mine or the remainder of the period to 30 June 2037.

- The market value starting base should not be uplifted. Starting base deductions that have not been used within a project should be uplifted by the consumer price index to retain their real value (Recommendation 38).

- Any undepreciated starting base amounts attributable to an interest in a project or mining tenement are to be transferred to the new owner upon sale of the interest.

- The starting base is not to be reduced to reflect any depletion in the resource between 2 May 2010 and 30 June 2012. However, where starting base assets are disposed of between 2 May 2010 and 30 June 2012, the starting base should be reduced by the market value ascribed to the asset at 1 May 2010.

- Capital and mine development expenditure incurred between 2 May 2010 and 30 June 2012 should be added to the starting base.

Determining the book value starting base

Recommendation 53: A book value starting base should be the accounting book value of existing project assets (excluding the value of the resource) as at the most recent audited accounts available on 1 May 2010. Such accounts are to have been prepared in line with Australian Accounting Standards.

- Capital and mine development expenditure incurred after the date at which the audited accounts were prepared and before 1 July 2012 should be added to the starting base.

- The book value starting base should be uplifted at the MRRT uplift rate from the date at which the audited accounts were prepared until fully offset against project revenues.

- Further guidance as to the application of the book value starting base should be provided through examples within the explanatory memorandum.

Applying the book value starting base

Recommendation 54: The book value starting base of a mining project or other mining tenement should start to be depreciated from the later of the commencement of the MRRT (1 July 2012) and the date an MRRT commodity is first produced from the tenement to which the starting base relates.

- The starting base should be depreciated over five years with the following profile: 36 per cent, 24 per cent, 15 per cent, 15 per cent and 10 per cent.

- Undeducted book value starting base amounts should be uplifted and carried forward to be available as an offset against future project revenue.

- Any undepreciated starting base amounts should be transferred to a new owner if an interest in a project or mining tenement is sold.

- Where starting base assets are disposed of between the date at which the audited accounts were prepared and 30 June 2012, the starting base should be reduced by the book value ascribed to the asset at 1 May 2010.

11 COSTS OF COMPLIANCE FOR SMALL MINERS

11.1 $50 Million threshold offset

Recommendation 55: The $50 million threshold offset is intended to relieve a taxpayer of any MRRT liability arising in respect of an income year when their MRRT profit is below $50 million. The offset should have the following features:

- the profit threshold should apply annually to a taxpayer's MRRT profit (revenue less expenses);

- the profit threshold should apply at an aggregate taxpayer level, defined by the small business test in Subdivision 328-C of the Income Tax Assessment Act 1997;

- the offset should be phased-down between $50 million and $100 million, such that the maximum possible tax concession provided by the threshold ($11.25 million at $50 million), is reduced by $0.225 for every $1 of MRRT profit above $50 million; and

- the actual offset available to a taxpayer with an MRRT profit of between $50 million and $100 million should be the lesser of:
  - the maximum offset reduced by creditable royalties paid and the credit equivalent of other deductible amounts (carry-forward losses and starting base deductions); and
  - MRRT otherwise payable.

11.2 Simplified MRRT obligations

Recommendation 56: Taxpayers subject to MRRT, who are unlikely to have an MRRT liability for an extended period for example, due to their lack of MRRT profits or the relativity between gross MRRT profit and creditable royalty payment, should be provided the option to elect to comply with simplified MRRT obligations to reduce their compliance burden.

Recommendation 57: The Treasury and ATO should work with industry to develop and implement one or more tests that allow a taxpayer to evidence they will not be liable for MRRT for an extended period. The test, or tests, should be designed to work with readily available data and be applied at an aggregate taxpayer level, defined by the small business test in Subdivision 328-C of the Income Tax Assessment Act 1997.

The PTG observes that the following tests could achieve the required outcome:

- Earnings Before Interest and Tax (EBIT) on iron ore and coal extraction plus creditable royalties less than $50 million.
- EBIT on iron ore and coal extraction plus creditable royalties less than $250 million AND creditable royalties exceed 25 per cent of such earnings plus creditable royalties.

Recommendation 58: Where a taxpayer meets the relevant test, or tests, an annual election to opt into the simplified MRRT obligations should be available.

Recommendation 59: Where an entity no longer satisfies at least one of the relevant tests, or opts to withdraw from the simplified MRRT obligations, it would need to comply with the full MRRT obligations for that year. Such taxpayers should be treated as new MRRT taxpayers and only receive a deduction for expenditure incurred in the year they fail the tests or move to the full MRRT.

12 MRRT ADMINISTRATION

12.1 Transitional administration

Recommendation 60: The Treasury should engage with overseas jurisdictions as soon as possible, regarding the crediting of MRRT in their jurisdictions.

Recommendation 61: The Treasury and ATO should continue to engage with industry to progress the administrative design and implementation of the MRRT, including:

- establishing an Implementation Group involving industry representatives and relevant advisors and officials from RET, the Treasury and ATO;
- providing practical early guidance on the MRRT and taxpayer obligations; and
- establishing capability in both the ATO and key intermediaries to support industry in complying with the law.

Recommendation 62: The Government should ensure the ATO is appropriately funded to provide interpretive and administrative support to industry in their transition to the MRRT.

Recommendation 63: To ensure the MRRT achieves its intended purpose efficiently and equitably, with minimal compliance and administration costs, the Board of Tax should review the operation of the MRRT within five years of its implementation.

Recommendation 64: The ATO should provide guidance on circumstances that may warrant a remission of penalties by the ATO in cases of inadvertent errors, particularly in the first two years of the MRRT.

12.2 Ongoing administration

Recommendation 65: The MRRT legislation should provide for:

- the MRRT to be designed and implemented as a self-assessed tax;
- a July−June accounting period, with substituted accounting periods in place for taxpayers who use them for income taxation;
- an instalments regime that is responsive to the potential for significant within-year variability in mining profits and a final reconciliation period that fits within entities' tax calendars;
- acceptance of functional currencies where the company meets the criteria and uses them in accounting for income taxation; and
- the ability of the ATO to obtain MRRT relevant information from third parties such as project vendors or joint venture operators.

Recommendation 66: Division 25 of the Income Tax Assessment Act 1997 should be updated to specifically include expenditure related to management of MRRT tax affairs as an income tax deduction.

Recommendation 67: The administrative design of the MRRT should provide workable certainty to taxpayers and minimise the costs of complying with and administering the MRRT. These practices should include:

- providing for annual MRRT returns, including the option to lodge returns prior to the receipt of MRRT income to support the provision of certainty regarding historic expenditure; and
- guidelines for joint venture participants and operators, and the ATO, in relation to joint venture accounts and substantiation of expenditure.

PRRT RECOMMENDATIONS

14 DEFINITION OF THE PROJECT

Recommendation 68: The definition of a project transitioning into the PRRT should be based on the granting of a production licence and the definition of a production licence within the PRRT legislation should be extended to cover production licences granted under relevant State and Territory legislation.

Recommendation 69: The existing criteria for combining offshore projects should be applied to the combining of onshore projects. However, the criteria that the Minister has regard to should be expanded to include:

- the aggregated interests in separate production rights that exhibit a degree of integration in extraction and processing operations, and other activities that occur prior to the taxing point; and
- the aggregated interests in separate production rights that are managed as an integrated operation because the same downstream infrastructure is used or operated in an integrated manner in respect of production from the production rights.

Recommendation 70: Given the need to provide certainty to the North West Shelf (NWS) project, it should be specified in the legislation that the licence areas associated with the project can be considered one project, as was the case when the Bass Strait project transitioned to the PRRT.

Recommendation 71: The Minister for Resources and Energy should continue to issue combination certificates under Section 20 of the PRRT Assessment Act 1987 for both onshore and offshore projects.

15 RESOURCES SUBJECT TO THE EXTENSION

Recommendation 72: The PRRT should apply from 1 July 2012 to all Australian onshore and offshore oil and gas extraction projects, including coal seam methane and oil shale projects. It should not apply to:

- projects within the Joint Petroleum Development Area in the Timor Sea;
- coal mining operations involving the extraction of coal or gas derived from the underground combustion of coal; and

- the extraction of coal mine methane where it is a necessary and integral part of a coal mining operation.

16 TAXING POINT

Recommendation 73: The existing PRRT provisions determining the point at which petroleum, or products produced from petroleum, become taxable (the taxing point) are sufficient to accommodate all types of petroleum projects, onshore and offshore, conventional and unconventional, and should therefore be retained.

17 TAXABLE REVENUE

Recommendation 74: The existing PRRT provisions for valuing the resource at the taxing point should be applied to projects transitioning into the PRRT, subject to the following considerations:

- where a State or Commonwealth royalty determination that sets the value of the resource at the taxing point is in place the taxpayer should be able to seek a determination from the Minister for Resources and Energy to allow the taxpayer to elect that value in determining their PRRT receipts;

- taxpayers developing onshore gas resources within an integrated gas to liquids project, such as liquefied natural gas, should have the option of using the existing RPM as a default methodology for calculating the value of the resource at the taxing point;

- taxpayers with existing integrated gas to liquids projects, such as liquefied natural gas, at 1 May 2010 that are to transition to the PRRT should have access to a simplified RPM as a default methodology. This should provide a single agreed phase point and capital base determined by an agreed valuation methodology for existing assets; and

- existing RPM provisions within the PRRT should be amended to provide for integrated gas to electricity projects. Industry should be consulted in relation to the amendments required to ensure appropriate functionality of the methodology.

18 DEDUCTION ORDERING AND DEDUCTIBLE EXPENDITURE

18.1 Deduction ordering rules

Recommendation 75: The existing PRRT deductibility rules should apply to transitioning projects with amendments to accommodate starting base amounts and government resource tax credits.

18.2 Transition deductible expenditure

Recommendation 76: The legislation should ensure that native title payments made pursuant to an agreement under the Native Title Act 1993 or a similar Act in

settlement of an indigenous land use agreement should be deductible to the extent they relate to upstream operations.

Recommendation 77: The costs of water treatment processes and associated facilities integral to the production of coal seam methane should be treated as deductible expenditure.

Recommendation 78: The existing PRRT treatment of private override royalties as non-deductible/non-assessable amounts should be extended to projects transitioning into the PRRT. Where such royalties exist, the market value starting base should be determined as if unencumbered by the royalty.

18.3 Exploration for unconventional gas

Recommendation 79: The PTG recommends existing treatment of exploration expenditure under PRRT be extended to unconventional gas projects.

18.4 Deductible expenditure issues

Advice to Government 1: While it is not within the PTG's terms of reference to make recommendations in respect of the design of the PRRT, other than in relation to transitioning projects, the PTG advises that the test for deductibility could be amended to one of expenditure necessarily incurred in carrying on activities in relation to a petroleum project (upstream of the taxing point) from 1 July 2012.

18.5 Exploration deductions

Advice to Government 2: While it is not within the PTG's terms of reference to make recommendations in respect of the design of the PRRT, other than in relation to transitioning projects, the PTG advises aligning the definition of exploration under the PRRT to that under income tax.

19 STARTING BASE

Starting base election

Recommendation 80: An entity must make an irrevocable election to use either market value, book value or the look-back method for determining a starting base for each interest the entity holds in a project or other petroleum tenement in existence at 1 May 2010, by the due date for the filing of the first PRRT tax return. Where an election is not made by the required date, the project or petroleum tenement should be taken to have a look-back starting base. Where an appropriate look-back does not exist or cannot be reliably reproduced, there should be no starting base.

Determining the market value starting base

Recommendation 81: An entity should determine a market value starting base comprising the market value of petroleum assets upstream of the taxing point as at 1 May 2010 on the basis of accepted market valuation principles.

- In determining how market valuation principles should be applied, the taxpayer should take into consideration their particular circumstances and the stage of development of the project or petroleum tenement.

- The derivation of the market value starting base should have regard to market expectations of future petroleum prices, exchange rates, interest rates, inflation and other industry reference benchmarks as at 1 May 2010, and recognised methodologies for market valuation in the petroleum sector. The Treasury, ATO and RET should consult industry and professionals to identify suitable reference benchmarks to reduce compliance costs and provide greater certainty to taxpayers. The existence of such benchmarks would not constrain a taxpayer's choice of valuation methods or their ability to use alternative estimates.

- Guidance as to the application of valuation methodologies should be provided through examples within the explanatory memorandum. In addition, the ATO should provide early guidance to industry regarding the practical application of this aspect of the legislation.

- The approach used in deriving the starting base should be consistent with that used to value the resource at the taxing point.

- The starting base should include all tangible assets including improvements to land and mining rights (as defined by income tax – that is, mining, quarrying and prospecting), as well as relevant intangible assets such as petroleum information.

- Where a private override royalty existed in relation to the project or tenement at 2 May 2010, the starting base should be determined as if it were unencumbered by the private override royalty liability (Recommendation 78).

- The starting base is not to be reduced to reflect any depletion in the resource between 2 May 2010 and 30 June 2012. However, where starting base assets are disposed of between 2 May 2010 and 30 June 2012, the starting base should be reduced by the market value ascribed to the asset at 1 May 2010.

- Capital expenditure incurred between 2 May 2010 and 30 June 2012 should be added to the starting base.

Recommendation 82: A default methodology should be considered for taxpayers that acquired or disposed of a portion of an interest in a project or petroleum right with an identified coal seam methane resource in the 3 years to 1 May 2010. The default should determine a proxy for the market value starting base, based on known reserves as at 1 May 2010 and a value derived from a recent comparable market transaction or transactions.

Applying the market value starting base

Recommendation 83: The market value starting base should be immediately deductible for projects transitioning to the PRRT. For other petroleum tenements the starting base should be immediately deductible upon becoming part of a project.

- The market value starting base should be uplifted in line with the provisions provided for general project expenditure, with the expenditure deemed to be incurred on the 1 July 2012.

- Where eligible expenditure is incurred between 1 May 2010 and 1 July 2012, it will be added to the starting base.

- The starting base and losses generated from the starting base should not be transferable between projects.

- Any undeducted starting base amounts attributable to an interest in a project or petroleum tenement are to be transferred to the new owner upon acquisition of the interest.

Determining the book value starting base

Recommendation 84: A book value starting base should be the accounting book value of existing project assets (excluding the value of the resource) as at the most recent audited accounts available on 1 May 2010. Such accounts are to have been prepared in line with Australian Accounting Standards.

- Capital expenditure incurred after the date at which the audited accounts were prepared and before 1 July 2012 should be added to the starting base.

- Where starting base assets are disposed of between 2 May 2010 and 30 June 2012, the starting base should be reduced by the book value ascribed to the asset at 1 May 2010.

Applying the book value starting base

Recommendation 85: The starting base should be immediately deductible for projects transitioning to the PRRT. For other petroleum tenements the starting base should be immediately deductible upon becoming part of a project.

- The book value starting base should be uplifted in line with the provisions provided for general project expenditure, with the expenditure deemed to be incurred on the valuation date of 1 May 2010 or, where eligible expenditure is incurred between 1 May 2010 and 1 July 2012, the date when the expenditure is incurred.

- The starting base and losses generated from the starting base should not be transferable between projects.

- Any undeducted starting base amounts attributable to an interest in a project or petroleum tenement are to be transferred to the new owner upon acquisition of the interest.

- Further guidance as to the application of the book value starting base should be provided through examples within the Explanatory Memorandum.

Determining the look-back starting base

Recommendation 86: A look-back starting base should be available based on deductible expenditure incurred in the exploration and development of a project or other petroleum tenement between 1 July 2002 and 2 May 2010.

- Capital and exploration expenditure incurred after 1 May 2010 and prior to the commencement of the extension of the PRRT on 1 July 2012 should be added to the starting base.

- Where starting base assets are disposed of between the date at which the audited accounts were prepared and 30 June 2012, the starting base should be reduced by the book value ascribed to the asset at 1 May 2010.

Applying the look-back starting base

Recommendation 87: The starting base should be immediately deductible for projects transitioning to the PRRT. For other petroleum tenements the starting base should be immediately deductible upon becoming part of a project.

- The book value starting base should be uplifted in line with the provisions provided for general project expenditure, with the expenditure deemed to be incurred on the date at which the audited accounts were prepared or, where eligible expenditure is incurred between the date at which the audited accounts were prepared and 1 July 2012, the date when the expenditure is incurred.

- The starting base and losses generated from the starting base should not be transferable between projects.

- Consideration should be given to allowing the inclusion of relevant acquisition costs as they relate to project assets upstream of the taxing point. If acquisition costs are included:

o they should be allocated to the existing PRRT expenditure categories, with appropriate methods to apportion the starting base to be developed in consultation with industry; and

o the period of uplift at LTBR+15 on the portion allocated to exploration expenditure should be limited to 5 years.

- Further guidance as to the application of the look back value starting base should be provided through examples within the explanatory memorandum.

20 TREATMENT OF THE STARTING BASE AND CREDITS FOR GOVERNMENT RESOURCE TAXES

Recommendation 88: Starting base amounts should be treated in the same manner as general project expenditure, being immediately deductible, non-transferable and non-refundable, with undeducted amounts uplifted in accordance with the existing augmentation provisions. An exception would be the exploration expenditure component of a look back starting base, which should be treated in accordance with the existing provisions relating to exploration expenditure.

Recommendation 89: Government resource taxes should be creditable against PRRT liabilities and treated in the same manner as general project expenditure, being immediately creditable, non transferable and non-refundable, with unused amounts uplifted in accordance with the existing augmentation provisions.

Recommendation 90: It is important to ensure that the taxation of Australia's petroleum resources preserves our international competitiveness and ensures Australians receive a greater benefit from these resources and that this is reflected in the treatment of royalties under the PRRT. The extension of the PRRT should not be used as a mechanism to enable States and Territories to increase inefficient royalties on petroleum activities. All current and future resource taxes on petroleum should, therefore, be credited and it is imperative that the Australian, State and Territory Governments put in place arrangements to ensure that the States and Territories do not have an incentive to increase royalties.

21 PRRT ADMINISTRATION

21.1 Transitional administration

Recommendation 91: The Treasury and ATO continue to engage with industry to progress the administrative design and implementation of the extension of the PRRT to all petroleum projects, including:

- establishing an Implementation Group involving industry representatives, relevant advisors and officials from RET, the Treasury and ATO;
- providing practical early guidance on the extension of PRRT and taxpayer obligations; and
- establishing capability in both the ATO and key intermediaries to support industry in complying with the law.

Recommendation 92: That Government should ensure the ATO is appropriately funded to provide interpretive and administrative support to industry in their transition to the extended PRRT.

Recommendation 93: To ensure the extension of the PRRT achieves its intended purpose efficiently and equitably with minimal compliance and administration costs,

the Board of Tax should review the operation of the extended PRRT within five years of its implementation.

Recommendation 94: The ATO should provide guidance on circumstances that may warrant a remission of penalties by the ATO in cases of inadvertent errors, particularly in the first two years of the extended PRRT.

21.2 Ongoing administration

Advice to Government 3: As part of extending the PRRT, the Australian Government could consider amending the PRRT legislation to provide for:

- substituted accounting periods for taxpayers who use them for income taxation;
- an instalments regime that is responsive to the potential for significant within-year variability in petroleum profits and a final reconciliation period that fits within entities' tax calendars;
- the ability of ATO to obtain PRRT relevant information from third parties such as project vendors or joint venture operators.

Advice to Government 4: The ATO could consider adapting the administrative design of the PRRT, to provide workable certainty to taxpayers and minimise the costs of complying with and administering the extended PRRT. These practices should include:

- providing for annual PRRT returns, including the option to lodge returns prior to the receipt of PRRT income, to support the provision of certainty regarding historic expenditure; and
- guidelines for joint venture partners and operators, and the ATO in relation to joint venture accounts and substantiation of expenditure.