MINERALS COUNCIL OF AUSTRALIA

SUBMISSION TO TREASURY

Minerals Resource Rent Tax Repeal and Other Measures Bill 2013

31 OCTOBER 2013

EXECUTIVE SUMMARY

The Minerals Council of Australia (MCA) welcomes the Government's commitment to consult on the exposure draft *Minerals Resource Rent Tax Repeal and Other Measures Bill 2013*.

The MCA has consistently stated that the MRRT was unnecessary to ensure all Australians benefited from the Millennium mining boom. Coal and iron ore were among the highest taxed industries in Australia before the introduction of the MRRT with an average tax ratio in excess of 40 per cent over the five years from 2006-07. Even with repeal of the MRRT, Australia will remain a relatively high tax jurisdiction for coal and iron ore mining.

While the MRRT removed some of the more serious flaws in the original Resource Super Profits Tax (RSPT), the industry has never accepted the core propositions that underpinned the MRRT:

i) that the industry was not paying a fair share; and
ii) that the MRRT was necessary for all Australians to share in the benefits of the Millennium boom.

Repeal of the MRRT would boost industry confidence and send a powerful signal that Australia is not about to relinquish its place as a premier destination for investment and a cost competitive supplier of minerals resources.

The MRRT is an extra layer of tax on top of company tax and royalties. The mining industry has contributed $117 billion in company tax and royalty revenues since 2006-07. This does not include a range of other taxes. Additional taxes impact investment decisions and make Australian projects less attractive relative to projects in competitor nations. This in turn threatens investment, jobs and, ultimately, future taxation revenues.

The challenges facing coal and iron ore mining are of a different nature to those of mid-2010. The coal and iron ore industries confront the challenge of maintaining competeviness and profitability in the face of lower prices and high costs.

The debate and misguided rhetoric surrounding the RSPT and MRRT over the last three and a half years has undermined Australia's sovereign risk standing in a highly competitive global market for resources development.

By removing an additional and unnecessary layer of tax, repeal of the MRRT will help restore industry confidence, reduce tax system complexity and improve Australia's sovereign risk reputation. Australia can return to a focus on a competitive, stable tax system focused on the most pressing challenges to future growth in the industry which is to improve industry competitiveness and encourage investment.

Issues arising *Minerals Resource Rent Tax Repeal and Other Measures Bill 2013*

The MCA offers suggestions on the draft legislation and explanatory memorandum to ensure the legislation achieves its aim of repealing the MRRT from 1 July 2014 in an administratively simple way, while retaining appropriate levels of tax integrity. The MCA suggests amendments in relation to the PRRT changes and transitional provisions to ensure:

- compliance costs are minimised in the transition of CSG incidental to coal mining into the PRRT regime; and
- MRRT deductions for mining expenditure incurred in 2013-14 are appropriately recognised in a way that minimises compliance costs.

These suggestions will help to ensure certainty, as well as to minimise complexity and the potential for future disputes over interpretation.

THE MINERALS RESOURCE RENT TAX

Commercial context

Australia's minerals resources industry competes in a global industry characterised by volatile commodity prices and footloose capital. Coal and iron ore projects are capital intensive with large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. A stable, competitive tax system is vital to attracting investment in the industry, particularly in a period of heightened market volatility.

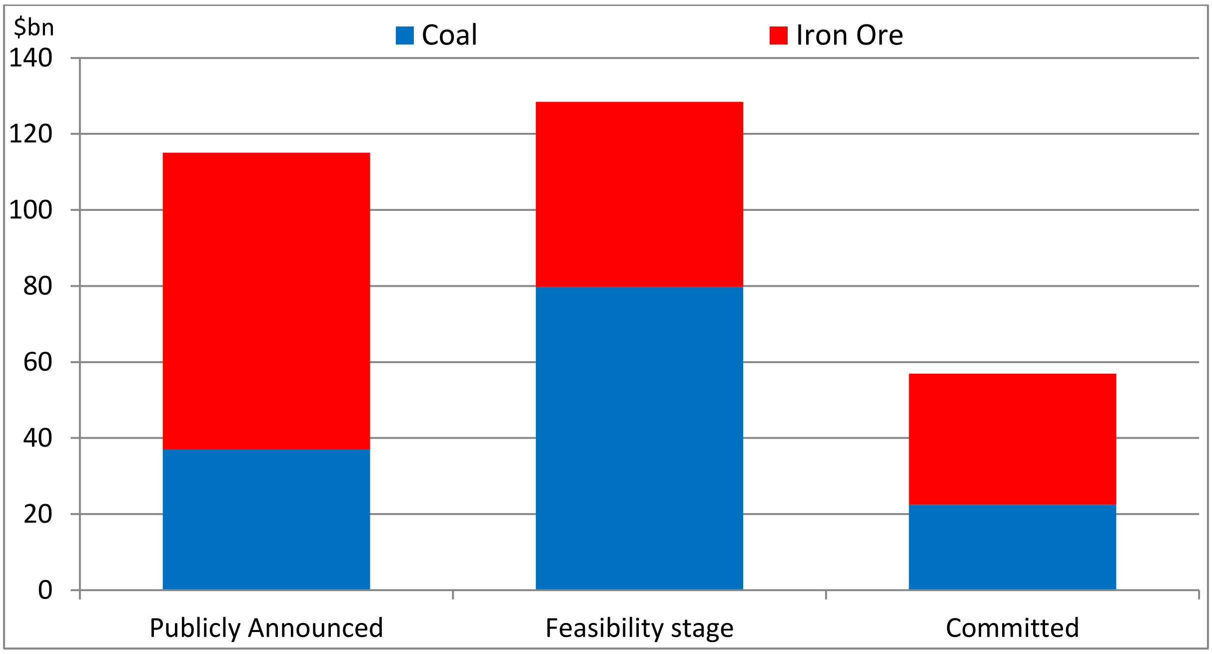
The minerals resources industry has long been a key pillar of Australia's economy, never more so than in recent years. Recent research by the Reserve Bank of Australia (RBA) confirmed the significance of the mining industry to the economy particularly over the last decade. It found that the resources sector has accounted directly for around 8 per cent of GDP (around 18 per cent of GDP including direct flow on benefits to mining-related activities) and almost 10 per cent of employment.

The industry accounts for almost half the value of Australia's exports of goods and services with the sectors covered by the MRRT – iron ore and coal – accounting for the majority of this contributing $96 billion to exports in 2012-13. Together, the iron ore and coal sectors employ more than 90,000 Australians directly and hundreds of thousands more indirectly, the majority in regional and remote Australia. The recent expansion of iron ore and coal through the "investment boom" will ensure that as supply ramps up securing more jobs in future decades.

Both industries have entered a phase of heightened uncertainty in the last two years with lower commodity prices, a persistently high exchange rate and rising costs combining to reduce profit margins and contributing to cancelled or delayed capital expenditure plans. In the 12 months to April 2013, iron ore and coal mining projects worth $29 billion were cancelled or delayed (excluding associated infrastructure such as rail and port).

At the end of April 2013, the Bureau of Resource and Energy Economics (BREE) reported "committed" iron ore and coal projects worth almost $57 billion. Demonstrating the potential for a "pipeline" of projects, there are uncommitted projects in the two industries worth more than $243 billion. Securing a solid pipeline of investment in Australia's two largest export earners will help soften the expected sharp fall-off in capital expenditure in coming years with economy wide impacts.

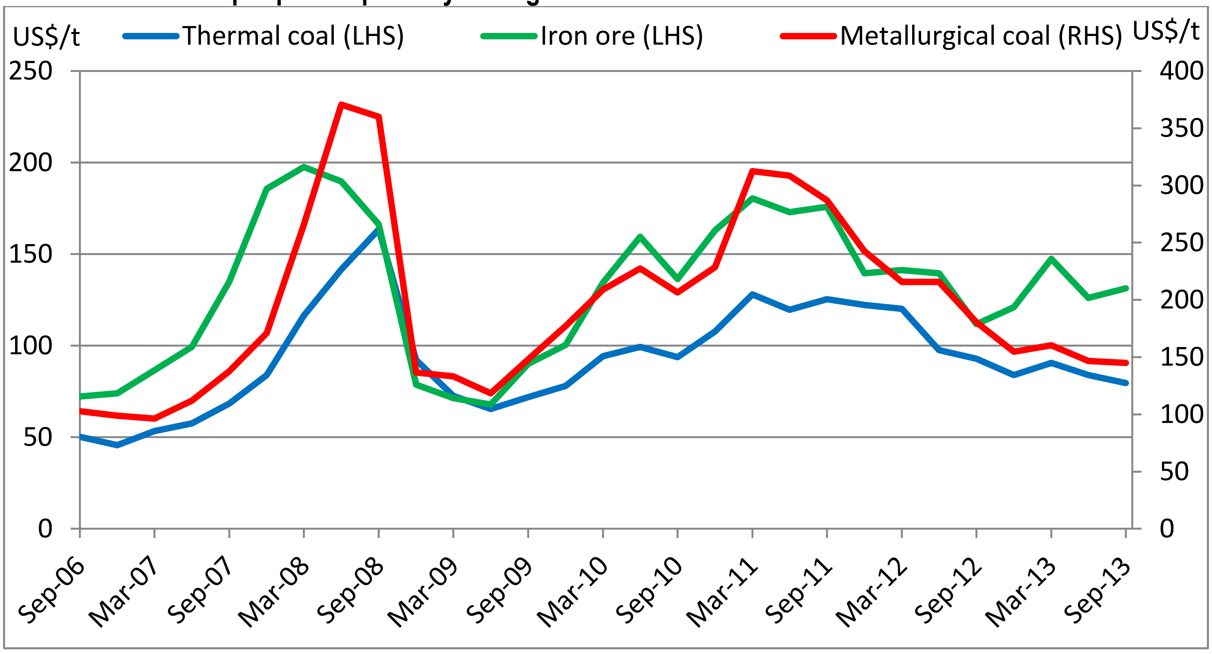
Major mining projects – potential and committed as at April 2013



The challenges facing coal and iron ore mining are of a different nature to those of mid-2010 during the rent tax debate. The focus then was on overcoming capacity constraints and maximising returns from high commodity prices. Today, the coal and iron ore industries confront the challenge of maintaining competiveness and profitability in the face of lower prices.

Based on quarterly averages, prices for key commodities in September 2013 are between 35 and 50 per cent down on peak 2011 levels. Iron ore spot prices in 2012 averaged 16 per cent below 2011 prices. Despite a recovery in late 2012 and early 2013, prices have trended down towards levels of a year earlier. Average prices for high-quality metallurgical coal dropped 35 per cent in 2012 and have continued to ease through 2013. The average spot price for thermal coal fell by one third in the September quarter of 2012 and prices have continued to ease in 2013.

Bulk commodities spot prices quarterly averages



The challenge for Australia's mining industry lies in arresting operating and capital costs and improving Australia's sovereign risk profile. Australia's overall tax burden is an important component of costs and the assessment of Australia's sovereign risk for future investment. A competitive, stable tax system is critical to attracting investment in the iron ore and coal industries to secure a future pipeline of investments vital to Australia's future economic prosperity.

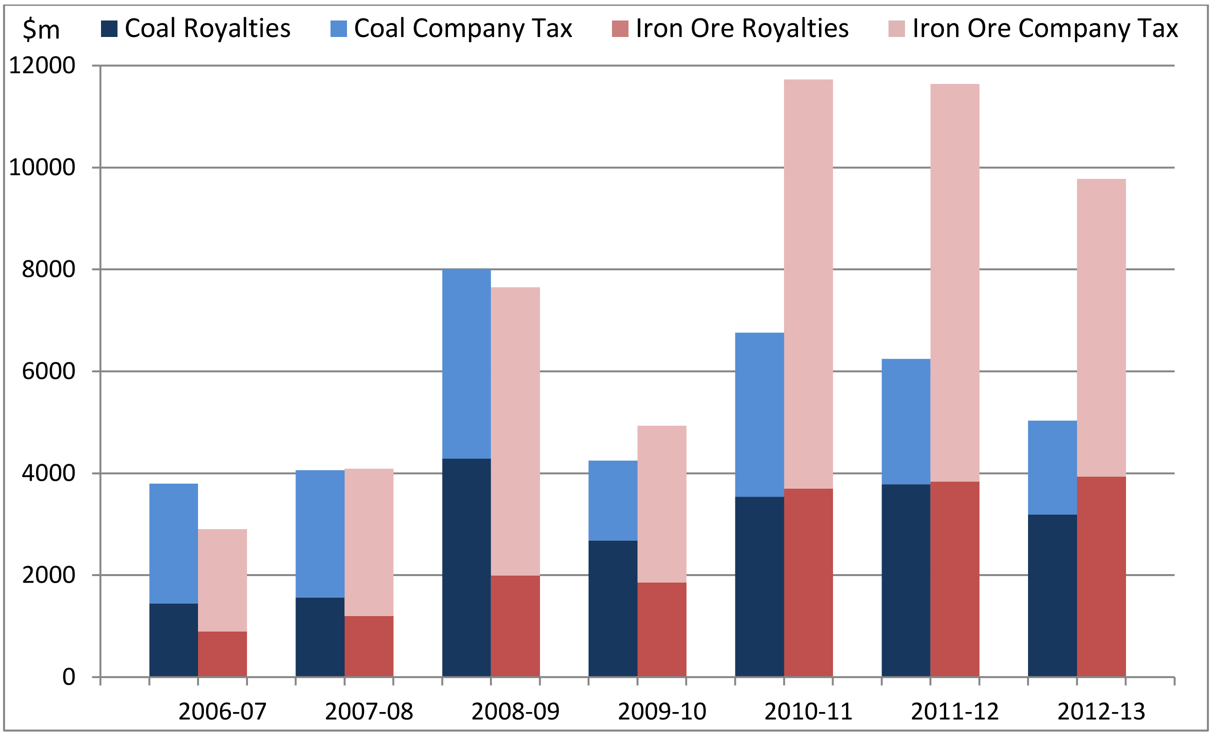
Industry tax contribution

The MRRT was not necessary to ensure all Australians benefited from the mining sector. Minerals resource companies have been Australia's largest taxpayers in recent years and the mining of iron ore and coal were among the highest taxed industries in Australia, even before the introduction of the MRRT.

Analysis by Deloitte Access Economics (DAE) shows that Australia's minerals industry has paid almost $117 billion in company tax and royalties since 2006-07. Coal and iron ore have contributed the majority of minerals tax receipts, estimated at almost $18.5 billion (82 per cent of total minerals) in company tax and royalties in 2010-11 (the last year of available official data).

Despite claims made during the 2010 tax debate, over the past five years the overall tax contribution of the minerals industry has been high and stable averaging in excess of 41 per cent and the small year to year volatility in the total tax contribution has been predominately driven by cyclical factors, rather than a persistent downward trend.

Iron ore and coal tax contribution



The minerals industry therefore strongly contests the argument that it does not pay its "fair share" of taxes in Australia or that Australians do not capture an appropriate return from the profits of industry at the peak of the resources cycle.

The MRRT added a third mechanism to company tax and royalties to tax resource profits derived from the extraction of coal and iron ore. As company tax is linked directly to profitability, revenues have been more volatile than royalties, but very substantial in years when commodity prices were high. The majority of royalties are based on the value of mineral production with relatively high royalty rates applying to coal and lump iron ore.

Even with repeal of the MRRT, Australia will remain a relatively high tax jurisdiction for coal and iron ore mining with an effective rate of 41 per cent in 2011-12 according to the MCA's 2012 tax Survey. Analysis by Goldman Sachs released in January 2013 has confirmed that, even without the MRRT, Australian iron ore and coal producers are at the upper end of global resource royalty and tax scales. Australia was found to be in the top quartile of countries based on a total tax take of 44 per cent compared with a global average of around 39 per cent.

The policy development process

The policy debate over the MRRT and original RSPT has been characterised by a significant failure of process and policy. While the Policy Transition Group (PTG) MRRT process was a demonstration of good policy implementation, based on a set of policy principles, it did not come about until after an initial poorly thought out and damaging proposal in the form of the RSPT.

The minerals industry adopted a constructive, principles-based approach to the reform of royalty and taxation arrangements as part of Australia's Future Tax System (Henry Review).

The principles put forward by the MCA prior to and through the development of the MRRT were as follows:

- **Internationally competitive**: the overall tax burden on the industry should be competitive with tax burdens in other countries
- **Prospective**: tax changes should not undermine the basis upon which past investments have been made
- **Differentiated**: reforms should recognise that capital investment and financial return characteristics differ across resources commodities such that different minerals can sustain different tax burdens;
- **Resource-based**: a resource-based tax should be limited to the value of the resource; and
- **Equitable and efficient**: Reform of taxation and royalty arrangements should promote economic activity and improve the efficiency, simplicity and fairness of the tax system without compromising competitive neutrality.

The lack of consultation with industry and State Governments on resource taxation reforms announced in May 2010 led to the deep flaws in the original Resource Super Profits Tax (RSPT). Although the MRRT was an improvement on the RSPT, it pushed Australia's tax rates to the upper boundary of international tax rates and added new complexity to Australia's tax system. The acrimonious debate since the RSPT was first proposed in May 2010 has created a high degree of uncertainty over the taxation of Australia's resources over the last three and a half years.

Tax stability crucial to future investment and growth

With the backdrop of lower prices, high cost structures, increasing royalties and a diminishing pipeline of investment projects, Australia's minerals industry faces challenges in securing the next phase of growth. Repeal of the MRRT will help boost industry confidence and signal Australia's determination to remain a premier destination for investment.

The perpetual uncertainty that has characterised Australia's resources and broader business tax regime over recent years threatens investment, jobs, growth and, ultimately, future taxation revenues. Repeal of the MRRT is a clear step to Australia strengthening its reputation as an investment destination with stable and competitive taxation arrangements which will help secure future economic prosperity.

ISSUES ARISING - DRAFT MINERALS RESOURCE RENT TAX REPEAL BILL

The MCA supports the repeal of the MRRT Act and MRRT Imposition Acts. The MCA offers suggestions on consequential amendments to the *Petroleum Resource Rent Tax Act 1987* and the MRRT transitional provisions relating to the bringing forward of MRRT expenditure contained in schedule 1 of the exposure draft legislation. The MCA's recommendations are informed by the following high level principles for legislative drafting:

- Ensure taxpayer certainty;
- Minimise administrative complexity and compliance burdens on industry in alignment with existing business practices; and
- Limit the potential for future disputes over tax interpretation.

PRRT changes

The Bill proposes to amend the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRTAA 1987) to include all coal seam gas (CSG) within the onshore PRRT regime. The Bill 'carves-out' CSG from PRRT liability where it is incidental to coal production. Correspondingly, the provisions also ensure that exploration expenditure that relates only to excluded 'incidental' CSG production is not deductible against a PRRT liability.

The policy intent to exclude CSG from PRRT liability avoids imposing unnecessary compliance costs on coal seam gas of underground coal operations where CSG production is purely incidental to coal operations and recovered for safety, not commercial reasons. As the EM states at page 6 "some entities only recover coal seam gas as an unavoidable incident of coal mining activities. Imposing PRRT on these entities would involve excessive compliance costs for no real benefit."

The MCA agrees that CSG extracted as a necessary incident of mining coal should be excluded; however, the legislation as currently drafted does not fully meet the policy intent. The exclusion does not capture all gas extraction activities that are incidental to coal mining. As a consequence compliance and administrative costs would be imposed on industry and the ATO for no revenue outcome.

Issue

The 'carve-out' included in section 2AB is narrowly defined and does not fit all gas extraction activities that are incidental to coal operations from the PRRT regime.

The extraction of CSG is a necessary and incidental part of underground coal mining for safety reasons. There are a range of methods and arrangements in place by various underground coal mines to extract CSG produced as part of the operation. This can range from flaring the gas, utilising it on site, or selling it to gas companies or into the electricity grid.

The wording of the provision proposes a two limb test effectively excluding from PRRT certain CSG that is necessary to recover from coal mining operations, including for safety reasons, and all of the CSG must be used onsite by the mining operation. The test does not cover the relatively common situation whereby underground coal operations sell excess CSG to gas companies or generate power for transfer to the electricity grid. This is despite the fact that where excess CSG is sold or transformed and then sold it is not undertaken for a commercial, profit making purpose. The cost of extraction is usually materially higher than the sale price (in most cases the extraction costs are many multiples higher than the incidental revenue derived).

Bringing these sales of CSG (or electricity generated from CSG) within the scope of the PRRT regime would result in loss making CSG operations incidental to coal mines being subject to the PRRT compliance costs for little or no revenue.

The carve-out appears to be modelled on mining licences rules which may not work in practice for a number of existing operations. The draft excludes a 'production licence' which only permits the recovery of CSG as a necessary result of coal mining. This appears to be modelled on the 'incidental CSG rules' in the QLD Mineral Resources Act which do not give a coal miner a right to extract CSG, other than 'incidental CSG'. In such situations separate production licences are held by gas companies for CSG production over the same area as the coal mine. However, such a neat licence delineation between CSG production and 'incidental CSG' does not exist for most mining licences. Most mining licences, including 'old' mining licences in Queensland provide the right to extract both coal and CSG rendering the section 2AB carve-out of little use to exclude incidental CSG production. That is, such mining licences will never meet the conditions of the carve-out, because those tenements do not impose the restriction required in limb 1 of the test, even if it were the case that the relevant mining company only used the CSG for the purposes outlined in limb 2.

By way of example:

> Xco is an underground coal miner which produces and 'sells' CSG under a mining licence which contains the right to extract CSG. CSG produced as part of the operation is used to power on site facilities at the mine such as lighting and excess amounts of CSG are sold to a neighbouring power station for a small return. The cost of capital and operating expenses in extracting the gas to the power station is materially more than the sale price. State royalties are paid on the sales revenue. The CSG extraction is done for safe mining practice, not to make a profit or derive a 'resource rent'.

There is also at least one instance where a CSG business has bought the right to enter a coal miners mining licence to extract gas by way of a lump sum payment (it was not possible to sell the mining licence as it was still being used for coal mining). The coal operator does not earn any ongoing money from the extraction and sale of gas. It is unclear in this situation whether the coal miner with ownership of the mining licence or alternatively the CSG business which holds the contractual right to extract and sell the gas would be liable for PRRT.

Not including such operations within the PRRT exemption would result in significant compliance costs associated with PRRT even though it is unlikely that there will be any PRRT liability. Resources would need to be put in place to prepare returns, develop systems to implement the PRRT, and undertake new valuations to determine starting bases for PRRT purposes. The ATO would also need to administer these rules.

Recommendation

To ensure the legislation meets the Government's policy intent to reduce compliance costs associated with the transition of all CSG to the PRRT regime, the MCA recommends:

- **that 2AB be amended to remove the restriction that the production licence must contain conditions which only allow the holder to mine incidental CSG (as many coal licences do not contain such restrictions);**
- **that 2AB be amended to include CSG sold, or CSG that is used to generate electricity and the electricity is then sold, where the CSG has been produced as a necessary incident of mining coal;**
- **paragraph 1.17 of the EM be amended to reflect these changes to cover incidental CSG production; and**
- **if necessary, the detail of what CSG production sold is incidental to coal mining and is not for a commercial purpose could be dealt with by way of regulation, for which there is precedent under the PRRT regime.**

Such amendments would ensure that gas extracted from a coal mine, or a proposed coal mine for mine safety reasons, engineering requirements and environmental conditions would be excluded from the PRRT regime. Gas extracted as part of an independent commercial operation would be subject to taxation under the PRRT regime.

Alternatively, inclusion of a broader incidental CSG exclusion provision in the proposed legislation – for instance using the existing wording in the MRRT Act – and then separately consider whether restrictions to that broad exemption are appropriate by way of a process of review of compliance costs associated with the recent extension of the PRRT to onshore oil and gas. Consideration as part of onshore administration of the PRRT regime would have the advantage of allowing more time to adequately address the issue in the broader context of the Government's deregulation agenda.

Application and transitional provisions

Integrity provisions to prevent bringing forward of tax losses

The draft Bill includes an integrity provision in Schedule 1, item 131 to prevent taxpayers from bringing forward MRRT deductible expenditure into 2013-14 that relates to anything to be done, or to be omitted to be done, on or after 1 July 2014.

Issue

Whilst we recognise the policy basis for raising this issue, the draft provision is not specifically targeted at expenditure that is incurred for the purpose of reducing or eliminating MRRT. The approach adopted in the draft imposes unnecessary compliance costs on taxpayers as well as creating uncertainty.

The proposed apportionment approach would require taxpayers to examine expenditure incurred in the normal course of business to check whether it could relate to anything to be done post 1 July 2014. For example, if a taxpayer acquires in the ordinary course of business a haul truck for use in pit (i.e. upstream) which is delivered in June 2014 and used that month, but will clearly be used post 1 July 2014, is that expenditure excluded by the draft provision? In our view it should be mining expenditure and claimable as a deduction. The haul truck was not purchased for the purpose of reducing MRRT, but rather it was acquired in the ordinary course of the mining business. Similarly if a taxpayer incurs an insurance bill in relation to the same truck that is paid in June 2014 for 12 months cover, the draft provision would seem to require apportionment when there is no requisite purpose of avoiding MRRT.

The MCA recommends that the focus be on expenditure incurred for the purpose of reducing or removing an MRRT liability and not on expenditure incurred in the normal course. The MRRT Act includes Integrity Measures in Part 4-6 which can adequately address this risk to the revenue. Those integrity measures are aimed at addressing actions that are done for the purpose of obtaining an MRRT benefit. In our view there is no need for a separate integrity provision to address the issue raised in the draft EM.

Recommendation

- **The MCA is of the view that Part 4-6 of the MRRT Act operates as an integrity measure to target any tax mischief without imposing compliance costs on taxpayers. The additional integrity provision in Schedule 1 is not necessary.**