The Minerals Resource Rent Tax—selected concepts and issues

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Economics Section

Contents

Introduction ........................................................................................................................................... 1
The policy basis of the MRRT—economic rent .................................................................................. 2
  Quasi-rents ............................................................................................................................................... 3
  Ricardian and differential rents ............................................................................................................. 3
  Monopoly rents ....................................................................................................................................... 3
  Economic rents as a basis for taxation .................................................................................................. 4
Coverage and features of the Bills ....................................................................................................... 6
  Is the MRRT a true resource rent tax? .................................................................................................. 7
Associated expenditure (including forgone revenue) .......................................................................... 8
Stakeholders’ views ............................................................................................................................... 10
Global iron ore and black coal markets and competing countries ..................................................... 15
  Global trade and pricing ....................................................................................................................... 15
  Competitors to Australia in global iron ore and coal markets ................................................................. 15
  Iron ore .................................................................................................................................................. 16
  Black coal ............................................................................................................................................... 17
  Coal prices and China ............................................................................................................................ 18
State resource taxation arrangements and the MRRT ....................................................................... 18
  New South Wales ............................................................................................................................... 20
  Western Australia ............................................................................................................................... 21
  Queensland ............................................................................................................................................ 22
<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tasmania</td>
<td>23</td>
</tr>
<tr>
<td>Historical Commonwealth resource taxation arrangements</td>
<td>24</td>
</tr>
<tr>
<td>Crude oil excise and the Petroleum Resources Rent Tax (PRRT)</td>
<td>24</td>
</tr>
<tr>
<td>Gold Tax</td>
<td>25</td>
</tr>
<tr>
<td>Longer-term implications of the MRRT for the Commonwealth Budget — cyclicity of revenues and associated expenditures</td>
<td>26</td>
</tr>
<tr>
<td>Appendix A: International mining taxation regimes</td>
<td>28</td>
</tr>
<tr>
<td>Brazil</td>
<td>28</td>
</tr>
<tr>
<td>India</td>
<td>28</td>
</tr>
<tr>
<td>South Africa</td>
<td>29</td>
</tr>
<tr>
<td>Canada</td>
<td>30</td>
</tr>
<tr>
<td>Russia</td>
<td>30</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>31</td>
</tr>
<tr>
<td>Argentina</td>
<td>31</td>
</tr>
<tr>
<td>Chile</td>
<td>32</td>
</tr>
<tr>
<td>Indonesia</td>
<td>32</td>
</tr>
</tbody>
</table>
Introduction

The Minerals Resource Rent Tax (MRRT) was announced in July 2010 as a replacement for the previously proposed Resources Super Profits Tax (RSPT). The RSPT proposal arose from the report in December 2009 of the Australia’s Future Taxation System review of the tax and transfer system (the Henry Review). The RSPT was announced as part of the Government’s initial response to the final report just prior to the handing down of the 2010-11 Commonwealth Budget.

The MRRT legislation is based on the deliberations of the Policy Transition Group (PTG) which was established on 3 August 2010 and chaired by former chairman of the board of BHP Billiton, Mr Don Argus, AC. The PTG undertook wide ranging consultation with industry and provided two reports to the Government on 21 December 2010; the first making 94 recommendations regarding the technical design of the new MRRT and the extension to the Petroleum Resource Rent Tax (PRRT), and the second making four recommendations on mineral and petroleum exploration.

On 24 March 2011, the Government accepted all 94 recommendations of the PTG. The recommendations were the basis of the design of Australia’s new resource taxation arrangements, as reflected in draft legislation released on 10 June 2011.

The Government also accepted the recommendations of the report on Minerals and Petroleum Exploration and the PTG’s advice to incorporate geothermal exploration into the wider definition of exploration.

The Resource Tax Implementation Group, another consulting body set up by the Government, comprising representatives of industry and the tax profession as well as government officials, is supposed to ensure close consultation with the resource sector until the legislation is finalised.

This Background Note has a number of aims. First, a discussion of the concept of rent and its use as a justification for imposing such a tax is presented. Second, the coverage and some key features of

1. For details of the announcement of the replacement of the RSPT with the MRRT, see: J Gillard (Prime Minister), Breakthrough agreement with industry on improvements to resource taxation, media release, 2 July 2010, viewed 4 November 2011, http://www.pm.gov.au/press-office/breakthrough-agreement-industry-resources-taxation
both the RSPT and the MRRT proposals are examined. Related expenditure (and forgone revenue) measures associated with the RSPT and MRRT are described briefly. Third, information on global coal and iron ore markets and competitor nations (in terms of their mineral exports) is presented. Current state and territory resource taxation arrangements and historical Commonwealth resource taxation arrangements are considered. Fourth, the positions of various interest groups and individual companies are presented. Finally, some attention is paid to issues surrounding the implications for the Commonwealth Budget of the MRRT and associated expenditures (including non-MRRT revenues forgone). Resource taxation arrangements in other selected countries are briefly outlined in Appendix A.

The policy basis of the MRRT—economic rent

Both the RSPT and MRRT are versions of resource rent taxes. The prime justification for these taxes is the existence of ‘economic rent’. ‘Economic rent’ is a concept which was developed and refined by a range of classical economists including David Ricardo, Johann von Thünen and Karl Marx. According to Emeritus Professor Armen Alchian of the University of California, Los Angeles (UCLA), economic rent is defined in theory as:

... the payment for a resource where the availability of the resource is insensitive to the size of the payment received for its use...[That payment] is named ‘economic rent’ or ‘quasi-rent’ depending on whether the insensitivity to price is permanent or temporary.

The fact that supply does not change with price means that rents are potentially a good source of taxation because the tax does not distort economic activity. Alchian continues:

To early economists, ‘rent’ meant payments for use of land; [David] Ricardo, in particular, called it the payment for the ‘uses of the original and indestructible powers of the soil’ (Ricardo, [Principles of Political Economy and Taxation], 1821, p.33). Subsequently, in recognition that a distinctive feature of what was called ‘land’ was its presumed indestructibility (i.e. insensitivity of amount supplied to its price), the adjective ‘economic’ was applied to the word ‘rent’ for any resource the supply of which is indestructible (maintainable for ever at no cost) and non-augmentable, and hence invariant to its price. In the jargon of economics, the quantity of present and future available supply is completely inelastic with respect to price, a situation graphically represented by a vertical supply line in the usual ‘Marshallian’ price-quantity graphs.

It is the characteristic of ‘inelasticity of supply’, or the invariability of the supply of a commodity to its own price, that makes economic rents a possibility. Alchian goes on to describe various different types of economic rent and closely related concepts, including:

• quasi-rents
• ‘Ricardian’ rents
• differential rents and

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7. Ibid., p. 90
• monopoly rents.

**Quasi-rents**

The concept of quasi-rent was elucidated by Alfred Marshall in 1920. Quasi-rent is a temporary phenomenon that occurs because ‘inelasticity of supply’ is observed for just about every commodity or good for some period of time. Quasi-rents are bid away over time by new entrants into the production of those commodities or the development of substitutes. Quasi-rents are a signal to entrepreneurs to devote their efforts to entering a particular industry and so are not very sound bases for imposing taxation.

**Ricardian and differential rents**

Ricardian rents and differential rents are related but are, conceptually, slightly different to one another. They were initially explored by David Ricardo and expanded upon by Johann von Thünen in the 1820s.

Ricardian rents occur where a particular commodity has differing use values in some dimension, say location/proximity to markets or energy content. Also, the value of any by-products (such as can occur in the extraction of mineral resources) is important in determining the level of Ricardian rents.

Differential rents occur because of the existence of different ‘qualities’ of a particular resource that yield an identical end commodity. In the case of petroleum resources, Ricardian rents can exist where, say, crude oil with lower sulphur content is more desirable than crude oil with higher sulphur content because it lowers refining costs. The rents accruing to the producers of crude oil with lower sulphur content would be higher than those accruing to producers of crude oil with higher sulphur content. In the case of mineral resources, differential rents occur because ore bodies yield different amounts of a commodity given the application of the same quantities of factors of production, such as capital and labour. Said another way, two different ore bodies may require different ‘effort’ to extract a given amount of the end commodity. The ore body that requires less effort to extract a given amount of ore would earn higher rents. These notions of rent are implicitly acknowledged in the MRRT Bills because mining profits are calculated on a project by project basis (although the low profit offset is based on a miner’s ‘mining group profits’).

**Monopoly rents**

Monopoly rents are rents that arise as a result of the artificial restriction of supply of a commodity, often due to legal or other barriers preventing entry into an industry. Activities devoted to gaining or maintaining monopoly privileges are commonly referred to in modern economic theory as ‘rent-seeking’. Rent-seeking is a cost to society, as it diverts resources away from productive activity. Rather than taxation, these types of rents are best dealt with by removing barriers to entry to an industry.
Economic rents as a basis for taxation

Economic rents are superficially seen as a good basis for taxation because taxing them supposedly does not have any effect on the effort that goes into producing the product with which they are associated. If that is the case, then behaviour would not be distorted and such a tax would have no, or only very small, ‘deadweight losses’. Economic rents are seen by some as ‘unearned income’ without any real social purpose. In both the final report of the Henry Review and the explanatory memorandum (EM) for the MRRT Bills, there is an implicit assumption made about non-renewable resources. This is that they are in finite supply or ‘non-augmentable’ and that this property is the basis for believing that rents can persist over time, rather than be bid away by the development of new mines, new extraction techniques or new uses for existing mineral resources. For this to be completely accurate, there must be no activity that would produce more of the commodity to be taxed. This is the justification used to suggest that economic rents in the mining sector are a sound basis for taxation. They would just tax away pure rent (that is, Ricardian/differential rents), and this supposedly would not have any effect on the application of factors of production and effort into extracting mineral resources. But this assumption is debatable.

In one sense, it is true. That is, on a global scale, the amounts of mineral resources are finite and, on any timescale relevant to human life, they are non-renewable. However, the notion that rents could persist is premised on some implicit assumptions:

- that all mineral deposits are known and that there will be no technological or other developments that can lead to substitution away from the commodities that the mineral resources yield
- that those commodities can only be profitably extracted using the set of minerals that are currently utilised or
- that the processes already in existence are the only ones that can be used to profitably extract commodities.

According to Alchian, this line of reasoning is fallacious. Economic rents do serve a social purpose. He discusses the relationship between prices of land that result from bidding at auction and therefore the rents associated with that land. He concludes that high rents are the result of high prices for land and not the cause. His reasoning can also be applied to mineral resources. This is important because it implies that it is the high value that can be achieved for the end commodity that enables pure rents to exist and be captured by the person or organisation best able to discover the most valuable use for that resource. Alchian states:

In principle, a 100 per cent tax on the land rent would not alter its supply...This would be correct if in this case the ‘owner’ of the land had any incentive left to heed the highest bidder where the highest bid determines the rent. The assertion assumes however that somehow the highest
valued use can be known and that amount of tax be levied without genuine bona fide
competitive bids for its use, a dubious if not plainly false proposition. 8

The key message here is that the highest value use of a particular tract of land or ore body is not
known in advance, but rather needs to be discovered and this is where entrepreneurial activity
comes in. Entrepreneurial activity is a process of discovery and it is the prospect of earning a
bonanza from economic rents that drives this discovery process. Uncertainty is pervasive and
discovery of new resources, extraction techniques and uses for existing resources do not occur
automatically or smoothly.

The International Bank for Reconstruction and Development (IBRD, also known as the World Bank)
released a study of mining royalties in 2006, undertaken by Otto, et al. It is worth quoting the
authors at length:

Those who advocate taxing economic rent usually have in mind the pure rents associated with
mining. They reflect the benefits created by the country’s geologic legacy, and unlike quasi-rent,
persist in the long run. No operating mine should close down even in the long run because the
government taxes away the pure rent.

This argument, while true, overlooks an important consideration. Creating pure rent in the
mineral sector requires not just the mining of valuable mineral deposits, but also either their
discovery through exploration or their creation by innovation and new technology from
previously known but uneconomic deposits. Prior to discovery and the development of
profitable production technologies, mineral resources cannot be exploited. It is the quest to
create and capture pure rent that provides the incentives for exploration. Geologists scouring
the hills for new ore bodies are not looking for marginal deposits; they are searching for
bonanzas with all the associated pure rent. Similarly, the search for new technologies that
convert uneconomic mineral deposits into valuable ore is driven by the hope of capturing the
pure rent such successful innovations create.

Thus, taxing away the pure rent will affect economic behavior, and so distort the economy in the
very long run. A country that taxes the pure rent associated with mining has to be prepared to
subsidize new exploration or conduct exploration itself. Otherwise, it is destined to watch its
mining sector decline over time as its known mines are depleted and not replaced.

One of the dangers for public policy is that the decline may take some years. The large economic
rent associated with mining in the short run (the quasi-rent, other rent, and pure rent) means
that higher tax rates on mining almost inevitably raise government revenues at first. The
negative effects on mine output, and in turn revenues, may take years to become apparent;
likewise, they take many years to reverse. Fortunately, there is an earlier indicator that mining
taxes are too onerous. A decline in exploration expenditures relative to other countries often
provides the first indication that a country is losing its competitiveness in attracting investment into its mineral sector.9

Thus, even taxing pure rents can have an impact on behaviour in the very long run by deterring both exploration for potential new mining projects and the development and utilisation of different types of minerals and extraction processes. This could potentially damage innovation and entrepreneurial activity in the minerals sector and therefore productivity. These impacts would take a very long time to manifest themselves, but as Otto et al. suggest, a decline in exploration expenditure relative to other countries would be an early warning indicator that the tax was too onerous—the ‘canary in the coal mine’, so to speak.

Coverage and features of the Bills

The MRRT differs in significant ways from the RSPT as it was originally proposed. The RSPT was to apply to a broad range of non-renewable mineral resources, including (but not necessarily limited to):

- petroleum and gas (excluding those already subject to the existing Petroleum Resources Rent Tax or PRRT)
- uranium
- bulk commodities (iron ore and black coal)
- base metals (gold, silver, copper, lead, nickel, tin, zinc, bauxite) and
- mineral sands.

The RSPT was designed to replace the system of royalties that are collected by state and territory governments via a full refund of state and territory royalties. The refund was capped at the level of royalties imposed before the announcement of the RSPT (along with any prior scheduled increases and an allowance for inflation). The refund was able to be transferred between mining projects and was able to be used to offset against other taxable income.

A rebate for resource exploration was also included. If the ‘mining expenditure’ on a particular project exceeded the ‘mining revenue’ then the resulting loss was able to be carried forward for offset against future liabilities. The definitions of ‘mining revenue’ and ‘mining expenditure’ are complex.

The loss offset under the RSPT was subject to an ‘uplift factor’ equal to the long-term (that is, 10 year) government bond rate. Under the MRRT, the ‘uplift factor’ is the long term bond rate plus seven percent.

Is the MRRT a true resource rent tax?

Under the MRRT the coverage of minerals is reduced to coal and iron ore (including commodities that are also extracted or produced in association with them such as coal seam gas). The MRRT is structured so as to tax a resource before any significant ‘downstream’ processing or ‘beneficiation’ occurs. In other words, taxable resources are to be valued in the form that they were extracted before any ‘value adding’ occurs. In this respect the MRRT is in accordance with the concept of a resource rent tax, in that it aims to tax the resource at an early stage of extraction/production, where little or no value adding has occurred. However, the inclusion of all types of coal presents some unique issues. Firstly, black coal is traded on world markets and so, theoretically, is easy to value at various points of sale. This contrasts with brown coal, which is not traded on world markets. Rather, brown coal reserves in Australia are predominantly owned, extracted and used directly by vertically-integrated electricity generators as an input into the production of electricity. Vertical integration is where a firm performs multiple stages of production and/or distribution of their end product rather than procuring those intermediate goods and/or services via the market. Thus, the valuation of brown coal is problematic as the resource is transferred within a single firm and such ‘transactions’ are not done openly through exchanges or formal contracts between independent parties. The transactions are privately held information. The question in this case is then, how can the government accurately ‘value’ brown coal before it is processed? Alternative valuation methods based on cost of production and return on capital are provided for in the Bill, but this adds significant complexity to the legislation. The Henry Review did not make any specific recommendations about the treatment of brown coal in a resource rent tax regime; rather, the issue was left as an open question which merited further consideration.

Also, as part of the MRRT package, the Government decided that instead of a full refund for state and territory royalties (according to the royalty schedules already in place or scheduled to occur) as was proposed under the RSPT, a rebate against MRRT liabilities for royalties paid would be granted. Under the MRRT, the rebates are able to be carried forward and offset against future liabilities using the relevant uplift factor. The decision to offer a tax rebate rather than a full refund has a number of effects. First, the MRRT can no longer be considered a replacement for state and territory royalties, but rather is layered on top of royalties for which miners will only be partially compensated (to the extent that their MRRT liabilities exceed royalty payments over time). This adds significantly to the compliance burden. Second, to the extent that the RSPT was ‘neutral’ in respect of production and investment decisions, the decision to rebate, rather than fully refund, state and territory royalties destroys any such claims to neutrality. Thus, even if the case for taxing ‘pure rents’ is accepted and it is taken as given that a government can capture them without distorting production and investment decisions, the MRRT cannot achieve this because it is levied in conjunction with a tax that is not a rent tax.

Onshore petroleum and gas will not be covered by the MRRT. The existing Petroleum Resource Rent Tax (PRRT) is to be extended to cover those projects.

Under the RSPT there was to have been an exploration rebate. This has been scrapped and a profit threshold of $75 million. The MRRT legislation details how the $75 million low profit offset is to be
tapered out, so that for mining profits between $75 million and $125 million, a partial offset is available, while for mining profits in excess of $125 million, no offset is available.\textsuperscript{10} The rate of the MRRT is 30 per cent, although this is reduced to an effective 22.5 per cent through the application of a 25 per cent extraction factor—that is, the effective tax rate is reduced by 25 per cent to allow for the application of specialist skills and expertise being applied to the extraction of minerals. This extraction factor is rather arbitrary and fails to account for heterogeneity amongst miners in terms of their technical and entrepreneurial expertise (although this heterogeneity is nigh on impossible to quantify).

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.

The MRRT introduces three main potential distortions to decisions to invest and produce:

- miners may choose to invest and develop mines in different countries
- miners may choose to delay investment and development of Australian mines of varying quality through time and
- miners may choose to invest and develop Australian mines that yield different commodities to the ones that are subject to the tax.
- Whether any of these happens will depend on a number of unpredictable variables, including global demand and the internal affairs of competing nations—including their own tax arrangements, which are dealt with in Appendix A.

**Associated expenditure (including forgone revenue)**

After announcing that the MRRT would replace the RSPT, the government established a Policy Transition Group to advise on the implementation and technical design elements of the tax reforms, with the aim of minimising compliance costs and enabling a smooth transition to the new arrangements.

The proposal of the Policy Transition Group which was accepted by the government was for an MRRT which they thought would be broadly revenue neutral.\textsuperscript{11} Receipts from the tax are to a great extent offset by state royalties and generous treatment of losses; some revenue is also devoted to recommended preferential treatment of exploration expenditure.

The treatment of losses is clearly explained in Chapter 2 of the EM for the MRRT bills and is not dealt with further here.

In its original proposal, in addition to the RSPT itself, the Government proposed to initiate other changes to the taxation and superannuation systems. These were:

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\textsuperscript{10} The thresholds were $50 million and $100 million in the original version of the Bill.

The Minerals Resource Rent Tax—selected concepts and issues

- phasing down the company tax rate from 30 per cent to 28 per cent in two stages (1 percentage point reductions in 2013–14 and 2014–15 respectively)—small business companies were to face a company tax rate of 28 per cent in 2012–13;

- allowing small businesses to instantly write off assets worth up to $5000 and simplifying depreciation arrangements (the instant write off amount was later increased to $6500)

- increasing the superannuation guarantee in stages from the current 9 per cent to 12 per cent in 2019–20

- establishing an infrastructure fund for the states, with $5.6 billion worth of funds to 2019–20 contingent on the passage of the RSPT ($1.435 billion was committed in 2012–13 and 2013–14 in the 2010–11 Budget) and

- increasing superannuation concessions—specifically:
  - additional superannuation co-contributions for low income earners from 1 July 2012
  - increasing concessional contributions caps for people aged over 50 with low superannuation balances from 1 July 2012 and
  - raising the superannuation guarantee age limit from 70 to 75 from 1 July 2013.

When the RSPT was replaced with the MRRT, the company tax rate was to be lowered to 29 per cent in 2013–14 but the second phase of the reduction was scrapped. Small business companies would still get an early start, facing a 29 per cent company tax rate from 2012–13. The $5.6 billion allocated to the infrastructure fund was still contingent upon passage of the MRRT legislation. The superannuation measures were retained.

The net revenue from the MRRT (allowing for offsetting reductions in company tax (through deductibility) and interactions with other taxes but before associated measures have been taken into account) is estimated at $3.7 billion in 2012–13, $4.0 billion in 2013–14, and $3.4 billion in 2014–15. Expenditure on proposals which have been linked to the tax out to 2014-15 is set out in Table 1. Please note however, that these figures have been derived from a variety of sources. They are based on information contained in a number of different budget and other documents reflecting different assumptions about the estimated/projected state of the economy into the future. Note: these figures are included only to suggest orders of magnitude and the reader should exercise caution in drawing conclusions.
The Minerals Resource Rent Tax—selected concepts and issues

Table 1: Revenue and expenditure associated with the MRRT

<table>
<thead>
<tr>
<th></th>
<th>2011–12 $m</th>
<th>2012–13 $m</th>
<th>2013–14 $m</th>
<th>2014–15 $m</th>
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<tr>
<td><strong>Net revenue from MRRT</strong></td>
<td>3700</td>
<td>4000</td>
<td>3400</td>
<td>3400</td>
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<tr>
<td><strong>Superannuation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Increase superannuation guarantee and increase age limit</td>
<td></td>
<td></td>
<td>-240</td>
<td>-500</td>
</tr>
<tr>
<td>Increase cap on contributions for age ≥50 with small balances (linked in announcement but not included in MRRT package of Bills)</td>
<td></td>
<td></td>
<td>-545</td>
<td>-785</td>
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<tr>
<td>Low income superannuation contribution</td>
<td>-1</td>
<td>-20</td>
<td>-892</td>
<td>-976</td>
</tr>
<tr>
<td><strong>Company tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduce rate (incl. early start for small business and growth dividend)</td>
<td>-54.7</td>
<td>-331.6</td>
<td>-1310.2</td>
<td>N/A</td>
</tr>
<tr>
<td>Increase instant small business asset writeoff</td>
<td></td>
<td></td>
<td>-1160</td>
<td>-1140</td>
</tr>
<tr>
<td><strong>Regional Infrastructure Fund</strong></td>
<td>-42.4</td>
<td>-704.3</td>
<td>-866.8</td>
<td>-665</td>
</tr>
<tr>
<td>Expanding the definition of exploration to include geothermal energy</td>
<td></td>
<td></td>
<td>-5</td>
<td>-5</td>
</tr>
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</table>

Sources: Various Budget and other Australian Government documents.  

Later in this note, we discuss the longer term implications for the Commonwealth Budget over time of this combination of revenues and expenditures.

**Stakeholders’ views**

Envisaging a difference of viewpoints between stakeholders in the interpretation and implementation of the MRRT legislation, the Taxation Committee of the Business Law Section of the Law Council of Australia (the Committee) submitted its views on the MRRT through its representation on the Resource Tax Implementation Group (RTIG). The Committee raised a number of issues on the second exposure draft of the proposed MRRT Bill:

- Need for clarity in the law—the Committee has a general concern with the use of the explanatory material and sought to remedy possible deficiencies in the draft
- Starting base—the starting base is a critical element of the transition of existing projects into the MRRT. By definition, the economics of such projects would not have taken account of the MRRT and the recognition of the starting base is important to ameliorate the impact of the tax in such projects. The Commissioner of Taxation is given a discretion to allow further time for an entity to make a valid choice in selecting the starting base. Experience suggests that the Commissioner will only exercise this power in a limited range of circumstances
- Mining expenditure—the Committee is not convinced that transfer of MRRT allowances between entities is only permitted for those entities that are ‘closely associated’

• Interaction with the depreciation regime—given the wide variety of joint venture and other commercial arrangements in the coal and iron ore sectors, the Committee anticipates that this will lead to potential complications because entitlements recognised for MRRT purposes may not align with the commercial realities or economic position of the parties.

• Joint and several liability—it is proposed that through amendments to section 721-10 of the *Income Tax Assessment Act 1997*, members of a MRRT consolidated group will prima facie be made jointly and severally liable for the MRRT liabilities of that group if the head company defaults, in the absence of a valid tax sharing agreement addressing those liabilities. The Committee can foresee this giving rise to challenges where relevant group members are participants in joint ventures with third parties and

• Anti-profit shifting rules—the Committee notes that proposed section 205-15(1)(d) requires regard to be had to the OECD transfer pricing guidelines in working out the amount that would, or could reasonably be expected to have been, received or incurred by an entity if ‘independent conditions’ had operated between the miner and others that it is dealing with. The Committee observes that the guidelines were developed in the context of the application of income tax law to international dealings, and developed through negotiations among the revenue authorities of the member nations of the OECD. It is not clear to the Committee why it is considered appropriate to apply those guidelines in the context of domestic legislation and a different tax regime.  

In alerting its clients on the likely implications of the MRRT, Finlaysons, a legal consulting firm, observed that:

The draft MRRT Bill introduces a number of important new legal concepts and raises a raft of legal issues that will need to be considered carefully by miners and their advisors. Unless those legal concepts and issues are taken into account, miners run the very real risk of unnecessarily paying too much MRRT (or paying too little and being penalised on audit)...

OECD transfer pricing methodologies: The draft EM refers to the framework for the application of arm’s length methodologies developed by the OECD, in relation to international transfer pricing, in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Comment: The use of OECD transfer pricing methodologies for calculating MRRT liability has significant potential implications for the practical operation of the new tax. The recent Federal Court decisions in *Roche Products v FCT* and *SNF Australia v FCT*—and similar cases overseas—have demonstrated the difficulties of setting transfer prices that are acceptable to the ATO (indeed, revenue authorities worldwide).

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If one thing is for certain, MRRT will be a complex tax and not simply a tax accounting exercise! Miners and their advisors will have to skill-up in entirely new technical areas.  

In analysing the basic framework of the MRRT and alerting its clients, KPMG Australia raised the following issues:

- **Market value approach:** The MRRT provides an allowance for pre-mining losses resulting from pre-mining expenditure. One of the requirements for a pre-mining loss allowance is that the pre-mining loss must relate to a pre-mining project interest, which is defined to be ‘an interest in an exploration right’, that an entity ‘holds’. A common arrangement in exploration projects is for an entity that does not hold the exploration right to ‘farm-in’ to the project whereby the entity only obtains their interest in the exploration right after they have met certain expenditure commitments. Where the farm-in party does not hold an interest in an exploration right, the net expenditure incurred would not seem to give rise to pre-mining losses.

- **Consolidated groups:** While the consolidation rules are intended to treat all mining project interests and pre-mining project interests of group members as being interests of a single entity (the head company), practically, the head company will still be required to maintain separate records (e.g. details of allowance components) for each of the project interests, as such information will be relevant in the event of a transfer of a project interest to a non-group entity.

Mallesons Stephen Jacques, another legal consulting firm, also made reference to the anti-avoidance and consolidated group provisions:

... anti-avoidance rules may be considered particularly stringent having regard to the overall complexity of the regime.

... (m)iners who are consolidated for tax purposes are also to have the election to consolidate for the purposes of the mining tax. In that case the members of the tax consolidated ‘mining’ group will be subject to the joint and several tax liability regimes. The consolidation of MRRT liabilities and the transfer of a ‘mining interest’ between entities will introduce a range of issues for M&A and project financing activity.

Ernst & Young, an international business consulting group, has identified similar concerns and pointed out:

- **Anti-avoidance:** The concern for miners is that the threshold for application of these provisions only requires a more than incidental purpose of obtaining an MRRT benefit. This is in contrast to the general anti-avoidance rules for income tax which require a sole or dominant purpose of obtaining a tax benefit.

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• Derivation of mining revenue: A concern is that miners will find these provisions too prescriptive and not necessarily aligned with the concept of determining a true arm’s length value of the resource at the taxing point.

• Starting base treatment of improvements to land: Miners have natural cause to question the issue of why other improvements such as benches, berms, catch berms and batters are not afforded separate treatment; or more generally why any improvements to land should not be treated separately if the miner is able and willing to value them.17

Legal consulting firm, Johnson Winter and Slattery, made similar observations:
• General anti-avoidance rule (GAAR): The GAAR can also apply where the scheme was entered into before 2 May 2010 if:
  – The scheme is an avoidance scheme—that is, the general anti-avoidance provision in any of the ITAA (that is, Part IVA), the A New Tax System (Goods And Services Tax) Act 1999, the Fringe Benefits Tax Assessment Act 1986 or the Petroleum Resource Rent Tax Assessment Act 1987 applies to the scheme; and
  – had the MRRT law been in force at the time the scheme was entered into, an entity would obtain an MRRT benefit from the scheme and it would be reasonable to conclude that an entity entered into the scheme for the requisite purpose of obtaining the MRRT benefit. In relation to the latter, the EM says that regard should be had to nature of the other tax avoidance benefit or benefits (e.g. under Part IVA) obtained under the scheme.

• Importantly, unlike Part IVA, the purpose of entering into or carrying out the scheme only has to be a more than incidental purpose and not the sole or dominant purpose (emphasis original).18

Small miners—those with less than the $50 million MRRT profit threshold—will be allowed exemptions from the MRRT liability. Those miners will be able to choose to avoid any MRRT liability for a particular year if either:

• their earnings before interest and tax and that of the entities connected to or affiliated with them, total less than $50 million for that year or

• their earnings before interest and tax (and those of related entities) total less than $250 million, and every mining project interest of those entities has royalties amounting to at least 25 per cent of the interest’s earnings before interest and tax.

Thomson Reuters Australia pointed out that those miners availing themselves of the options to use the simplified MRRT method will lose any starting base, starting base losses, mining losses, pre-mining losses, and royalty credits for all their mining project interests and pre-mining project

interests. They would begin to generate new losses and royalty credits after they stop using the simplified MRRT method.¹⁹

During the negotiations between the Government and the three big mining companies about the scope and design of the MRRT, the small miners were mostly excluded from the consultation process. However, since the consultation process to finalise the draft MRRT Bill, the Government consulted widely to alleviate any misgivings about the integrity of the concept behind the MRRT. Yet, since they were not included in the original discussions, small miners now doubt the MRRT as an equitable approach to tax reform.

Although one professional mining services association has already factored in the passing of the MRRT legislation this year, they are still continuing the debate over whether small miners were given a ‘fair go’.

Recently one such view got mention in the press:

With the release of the draft mineral resource rent tax (MRRT) legislation in June (2011), debate continues over the merits of the commodity tax and the effect it will have on Australia’s booming mining industry.

Reg Howard-Smith, chief executive for the Chamber of Minerals Energy of Western Australia, whose membership includes the big three miners as well as smaller ones, admits it wasn’t involved in the negotiations, nor was it involved in the creation of the PTG. He says that the chamber ‘understands the concerns of some of our members who were excluded from this part of the process’.

Fortescue Metals executive director Andrew Forrest, a very vocal proponent of the abolition or redesign of the MRRT, has not been so polite. ‘It’s a precedent that should not be supported. Taxation policy should be broad-ranging, it should be fair and it should be based on the constitution of being equal among states and equal among companies. That hasn’t happened. BHP has literally written a tax for everyone else to pay.’

Why then the negative discourse among small miners? ‘There are significant points of difference between emerging mining companies and the large multinational, multi-commodity conglomerates that “negotiated” the MRRT framework with the Gillard government,’ says Simon Bennison, CEO of AMEC (Association of Mining and Exploration Companies). ²⁰

Magnetite Network (also known as MagNet), representing Australia’s magnetite iron ore extracting companies, put a submission to the Treasury asking for the industry to be exempted from the MRRT.

They argued that:

Application of the MRRT to magnetite is likely to generate little or no revenue for the Commonwealth yet it is impacting negatively on the development of a new important industry for Australia.

The Federal Government has assessed a very low level of taxation to be likely to be paid on the basis that the ore will be valued as close as possible to the point of extraction.

This valuation methodology is unclear given that there is no trade in magnetite ore currently. It is only saleable as concentrate or pellets.

Australia’s national interest is best served by excluding magnetite from the MRRT.21

In responding to the MRRT draft legislation, the Minerals Council of Australia (MCA) raised a number of issues, mainly on the issue of practicality of using the concepts of terms in the Bill in consonance with other legislation and international covenants.

Their broad argument is:

- The MRRT is a complex tax requiring the application of concepts from income tax and goods and services tax (GST) legislation, together with the simultaneous use of the Organisation for Economic Co-operation and Development (OECD) transfer pricing guidelines, mining law, accounting concepts and legal principles of market valuation. Whilst the [exposure draft] legislation has been drafted to be very prescriptive in its operation, the integration of the different concepts and principles will inevitably mean that miners will be faced with difficulty and uncertainty in calculating their MRRT liabilities.22

There is some uncertainty around these issues as there exist some terms which are supposedly well-known in the mining industry, but are not defined in the Bills. These are terms such as ‘run-of-mine stockpile’, ‘beneficiation’ and ‘wellhead’. These concepts are crucial to the valuation point for the MRRT. Any uncertainty over the meaning of these terms, among others, could give rise to legal disputation and to the extent that occurs, add risk to mining projects.

**Global iron ore and black coal markets and competing countries**

**Global trade and pricing**

**Competitors to Australia in global iron ore and coal markets**

Australian companies compete on global iron ore and coal markets. Companies in the following countries will remain competitors for the foreseeable future:

- Brazil (iron ore)
- India (iron ore)
- South Africa (iron ore and coal)
- Canada (iron ore and coal)
- Russia (iron ore and coal)


The Minerals Resource Rent Tax—selected concepts and issues

- Kazakhstan (iron ore and coal)
- Indonesia (coal)
- Potential competitor regimes for global investment in mining (in general) are:
  - Argentina
  - Chile

**Iron ore**

Australia and Brazil dominate the global iron ore export market. China dominates global iron ore imports. Global iron ore exports increased from 966 million tonnes in 2009 to 1,081 million tonnes in 2010, an increase of 12 per cent.\(^{23}\)

Companies in Australia are mainly competing against companies in Brazil, India, South Africa, Canada, Russia and Kazakhstan in iron ore trade. Of total exports, companies in Australia exported 427 million tonnes (about 40 per cent), followed by Brazil 311 million tonnes (29 percent), India 104 million tonnes (about 10 per cent) and South Africa 48 million tonnes (4 per cent).\(^{24}\)

The average export price of iron ore in early 2005 was around $US30 per tonne. It increased until the Global Financial Crisis (GFC). Due to the severe scaling down of international trade associated with the GFC, average prices fell in mid-2008 until the middle of 2009, before increasing again in early 2010 and since then they have increased substantially. By mid-2011, the average price peaked at $US145 per tonne, before declining slightly.

In 2009, Australia mostly exported at prices around $US60 per tonne, which was at the higher price end of the market. Brazil mostly exported around $US40 per tonne. In 2009, India’s exports prices were around $US60 per tonne. In the first seven months of 2011, most of Australia’s exports were priced between $US140 and $US160 per tonne. Brazil’s export prices were around $US130 per tonne, while India’s export prices were between $US120 and $US140 per tonne. Thus, prices have more than doubled in the past few years for iron ore, associated with increased demand from China. The price differential among countries is based on the quality of the iron ore being produced in each country.\(^{25}\)

On the demand side of the global iron ore market, of the total of 1,412 million tonnes of steel produced by the top manufacturers in the world in 2010, companies in China accounted for 44 per cent of global production (626 million tonnes), followed by the European Union 12 per cent (172 million tonnes), Japan 8 per cent (109 million tonnes), the US 6 per cent (80 million tonnes), and Russia and India 5 per cent each (67 million tonnes).\(^{26}\) It is worth noting that although China became a significant player in global steel production and trade, it became a net importer of steel in

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24. International Steel Statistics Bureau (ISSB), 'Trade in Steel', viewed 9 November 2011, [http://www.issb.co.uk/asia.html](http://www.issb.co.uk/asia.html)
25. TDN, op. cit.
26. ISSB, op. cit.
2009. Chinese exports of steel products fell by 61 per cent in 2009 while imports rose by 43 per cent leaving China a small net importer of steel for the year compared with net exports of 48 million tonnes in 2007 and 41 million tonnes in 2008. The first half of 2010 saw Chinese exports up sharply but they peaked in June and fell sharply thereafter with a variety of export tax rebates having been cancelled in July, and China recorded net exports of 22 million tonnes for 2010. 27

China’s annual steel demand is expected to peak at between 770 million and 820 million tonnes between 2015 and 2020, according to a five year plan. 28

Black coal

On the supply side of the global coal market, companies in Australia are mainly competing against companies in Indonesia, Russia, Colombia, South Africa and Kazakhstan. Of total exports of 1,090 million short tons in 2009, companies in Australia exported 289 million short tons (about 27 per cent), followed by Indonesia 261 million short tons (about 24 per cent), Russia 140 million short tons (about 12 per cent), Colombia 78 million short tons (about 7 per cent) and South Africa 48 million short tons (about 7 per cent) (Table 2). 29

Table 2: Coal exports by country

<table>
<thead>
<tr>
<th>Coal exports by country and year, million short tons (1 Short ton = 970.2 kg)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Share in 2009 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>255.0</td>
<td>255.0</td>
<td>268.5</td>
<td>278.0</td>
<td>288.5</td>
<td>26.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>142.0</td>
<td>192.2</td>
<td>221.9</td>
<td>231.5</td>
<td>261.4</td>
<td>24.0</td>
</tr>
<tr>
<td>Russia</td>
<td>98.6</td>
<td>103.4</td>
<td>112.2</td>
<td>111.5</td>
<td>130.9</td>
<td>12.0</td>
</tr>
<tr>
<td>Colombia</td>
<td>59.1</td>
<td>68.3</td>
<td>71.2</td>
<td>74.7</td>
<td>75.7</td>
<td>6.9</td>
</tr>
<tr>
<td>South Africa</td>
<td>78.8</td>
<td>75.8</td>
<td>72.6</td>
<td>66.1</td>
<td>73.8</td>
<td>6.8</td>
</tr>
<tr>
<td>United States</td>
<td>51.7</td>
<td>51.3</td>
<td>60.6</td>
<td>83.5</td>
<td>60.4</td>
<td>5.5</td>
</tr>
<tr>
<td>China</td>
<td>93.1</td>
<td>85.6</td>
<td>75.4</td>
<td>63.4</td>
<td>38.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Canada</td>
<td>31.4</td>
<td>31.2</td>
<td>34.1</td>
<td>36.5</td>
<td>31.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Vietnam</td>
<td>19.8</td>
<td>23.5</td>
<td>35.1</td>
<td>21.3</td>
<td>28.2</td>
<td>2.6</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>28.3</td>
<td>30.5</td>
<td>32.8</td>
<td>47.6</td>
<td>25.7</td>
<td>2.4</td>
</tr>
<tr>
<td>Others</td>
<td>78.4</td>
<td>84.1</td>
<td>85.5</td>
<td>79.2</td>
<td>75.9</td>
<td>7.0</td>
</tr>
<tr>
<td>World</td>
<td>936.2</td>
<td>1000.9</td>
<td>1070.0</td>
<td>1093.4</td>
<td>1090.8</td>
<td>100.0</td>
</tr>
</tbody>
</table>


27. Ibid.
In the market for coal imports, in 2009, Japan remained the top destination for coal with 18 per cent of global imports of coal, followed by China (15 per cent), South Korea (11 per cent), and India (7 per cent) (Table 3).³⁰

About two-thirds of global coal imports are driven by the seven major markets. The top five are in Asia. The demand for coal imports has been expanding in China and India.

Table 3: Coal imports by country

<table>
<thead>
<tr>
<th>Coal imports by country and year, million short tons (1 short ton = 907.2 kg)</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Share in 2009 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>199.7</td>
<td>209.0</td>
<td>206.0</td>
<td>182.1</td>
<td>17.5</td>
</tr>
<tr>
<td>China</td>
<td>42.0</td>
<td>56.2</td>
<td>44.5</td>
<td>151.9</td>
<td>14.6</td>
</tr>
<tr>
<td>South Korea</td>
<td>84.1</td>
<td>94.1</td>
<td>107.1</td>
<td>109.9</td>
<td>10.6</td>
</tr>
<tr>
<td>India</td>
<td>52.7</td>
<td>29.6</td>
<td>70.9</td>
<td>76.7</td>
<td>7.4</td>
</tr>
<tr>
<td>Taiwan</td>
<td>69.1</td>
<td>72.5</td>
<td>70.9</td>
<td>64.6</td>
<td>6.2</td>
</tr>
<tr>
<td>Germany</td>
<td>50.6</td>
<td>56.2</td>
<td>55.7</td>
<td>45.9</td>
<td>4.4</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>56.8</td>
<td>48.9</td>
<td>49.2</td>
<td>42.2</td>
<td>4.1</td>
</tr>
<tr>
<td>Others</td>
<td>436.8</td>
<td>490.0</td>
<td>458.9</td>
<td>366.5</td>
<td>35.2</td>
</tr>
<tr>
<td>Total</td>
<td><strong>991.8</strong></td>
<td><strong>1,056.5</strong></td>
<td><strong>1,063.2</strong></td>
<td><strong>1,039.8</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Note: This information is revised in 2009 updates

Coal prices and China

World coal prices were volatile in the wake of global uncertainty. However, with increased demand from China, the average price of thermal coal in October 2011 was 14 percent higher from a year earlier reaching a record high of US$134 per tonne following eight consecutive weeks of increases, according to China’s government agency. The expectation of a coal supply shortage and surging demand is expected to push up prices further. As the world’s largest coal consumer, China consumed 2.28 billion tonnes of coal in the first nine months of 2011, up 10.3 percent year-on-year. China became a net importer of coal in the first nine months of 2011, with net imports of 111 million tonnes. During the month of September (2011), the country imported 19.12 million tonnes, up 25 percent year-on-year.³¹

State resource taxation arrangements and the MRRT

The current royalty rates on coal and iron ore by states and territories are presented in the following table (Table 4).

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³⁰ Ibid.
Table 4: Royalty rates of coal and iron ore, States and Territories, as of November 2011\(^{32}\)

<table>
<thead>
<tr>
<th>Mineral</th>
<th>State</th>
<th>Royalty Rate</th>
<th>Basis of Calculation</th>
<th>Last review/change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>QLD</td>
<td>7% where the value of the coal produced does not exceed $100/tonne 10% on the value of the coal exceeding $100/tonne</td>
<td>Ad valorem</td>
<td>2008 – Mines and Energy Legislation Amendment Regulation (No 2) 2008</td>
</tr>
<tr>
<td></td>
<td>NSW</td>
<td>Open cut mining 8.2%</td>
<td>Ad valorem</td>
<td>2008 – State Revenue and Other Legislation Amendment (Budget Measures) Act 2008</td>
</tr>
<tr>
<td></td>
<td>VIC</td>
<td>Brown Coal</td>
<td>Ad valorem with quantum rate for brown coal</td>
<td>2006 – Mineral Resources Development (Amendment) Regulations 2006</td>
</tr>
<tr>
<td></td>
<td>WA</td>
<td>If exported 7.5%</td>
<td>Ad valorem and quantum rate</td>
<td>2000 – Mining Amendment Regulations (No. 4) 2000</td>
</tr>
<tr>
<td></td>
<td>SA</td>
<td>3.5%</td>
<td>Ad valorem</td>
<td>2005 – Mining (Royalty No 2) Amendment Act 2005</td>
</tr>
<tr>
<td>Iron Ore</td>
<td>QLD</td>
<td>2.70%</td>
<td>Ad valorem</td>
<td>2005 – Mining (Royalty No 2) Amendment Act 2005</td>
</tr>
<tr>
<td></td>
<td>NSW</td>
<td>4.00%</td>
<td>Ad valorem</td>
<td>2008 – Mines and Energy Legislation Amendment Regulation (No 2) 2008</td>
</tr>
</tbody>
</table>

The Minerals Resource Rent Tax—selected concepts and issues

<table>
<thead>
<tr>
<th>Mineral</th>
<th>State</th>
<th>Royalty Rate</th>
<th>Basis of Calculation</th>
<th>Last review/change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>VIC</td>
<td>2.75%</td>
<td></td>
<td>No change since the introduction of the Mining Regulation 2003</td>
</tr>
<tr>
<td>WA Beneficiated Ore 5%</td>
<td>Ad valorem</td>
<td>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.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fine Ore 5.625%</td>
<td>Ad valorem</td>
<td>No recent change.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lump Ore 7.5%</td>
<td>Ad valorem</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SA</td>
<td>5.00%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: State and Territory governments (see footnote)

With the advent of the MRRT regime, governments in New South Wales (NSW) and Western Australia (WA) introduced a revised schedule for royalties in their 2011–12 state budgets. The original decision by the Government of Western Australia to raise the royalty rates on iron ore provided momentum for other states to take similar initiatives. This generated some controversy with the Commonwealth Government about the extent of state and territory governments’ capacity to generate their own revenue and at the same time, obtain a fair share of the federal GST distribution.

Subsequent to the finalisation of the MRRT by the Commonwealth Government in May 2011, only the NSW and WA governments had announced increased royalty rates for coal and iron ore, and the Tasmanian government repackaged their own. Due to the commitment in the MRRT package that the federal government would credit all royalties back to the MRRT payers, these moves by some state governments made the projected revenue for the forward estimates period on the Commonwealth Budget a little more uncertain.

In NSW, the increased rate will be progressively implemented, while in WA the rates are a result of gradual withdrawal of concessions to big mining companies allowed previously.

**New South Wales**

From 1 January 2009 the NSW Government introduced a new ad valorem coal royalty regime. Under this regime, royalty is charged as a percentage of the value of production (total revenue less allowable deductions). The new coal ad valorem royalty rates are 6.2 per cent for deep underground mines (coal extracted below 400 metres), 7.2 per cent for underground mines and 8.2 per cent for open cut mines.

Around 95 per cent of royalty revenue in NSW has been derived from coal. The key determinants of coal royalties are the volume of coal exports, international coal prices, and the exchange rate.

---

According the NSW Budget 2011–12 Statement, average annual revenue growth from mineral royalties is expected to be 17.3 per cent in the four years to 2014–15. The growth in 2011–12 reflects higher export volumes and higher prices than in 2010–11. The average Australian-US dollar exchange rate in 2011–12 is expected to remain around its 2010–11 average value, with a depreciating trend over the forward estimates (Table 5).  

According the NSW 2011–12 Budget Papers, the New South Wales Government was concerned about the Federal Government’s proposed carbon tax on emissions of carbon dioxide and other greenhouse gases. The NSW Government indicated that it would have a significant negative impact on state finances and increase the cost of providing a broad range of government services.  

The forecasts take account of changes to royalties for companies paying the Australian Government’s MRRT from 2012–13 intended to offset net revenue effects of the Australian Government’s carbon tax.  

Table 5: Revenue impact from the increased royalty rates on coal, NSW, $ million  

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase coal royalties for firms liable to the Australian Government’s Minerals Resource Rent Tax</td>
<td>235</td>
<td>244</td>
<td>465</td>
<td>944</td>
</tr>
</tbody>
</table>


The NSW government estimates the rates will need to be adjusted to produce revenue increases from $235 million in 2012–13 to $244 million in 2013–14 and $465 million in 2014–15. This would equal $944 million in extra royalty revenue between 2012 and 2015.

NSW legislation to implement the royalty supplement is expected to be finalised after the Commonwealth Government finalises its carbon tax and MRRT legislation. According to the NSW government, the royalty supplement is intended to protect NSW revenue from Australian Government changes, while minimising the financial impact on NSW coal mining.

**Western Australia**

The WA Government made a projection of $1.9 billion of extra revenue due to the increased rate of royalty on iron ore ‘fines’ during the forward estimates period (Table 6).
Table 6: Revenue impact from the increased royalty rates on iron ore, WA

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalty income ($m)</td>
<td>5.625</td>
<td>5.625</td>
<td>6.5</td>
<td>7.5</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>GST impact</td>
<td></td>
<td></td>
<td>-</td>
<td>-</td>
<td>-95</td>
<td>-96</td>
</tr>
<tr>
<td>Net revenue impact ($m)</td>
<td></td>
<td></td>
<td>378</td>
<td>824</td>
<td>817</td>
<td>2,019</td>
</tr>
</tbody>
</table>


In describing such an outcome, the WA Government reported that:

The revenue projections in this budget incorporate the State Government’s decision to further reform iron ore royalty rates. This follows an agreement between the Government and major iron ore producers in June 2010 to lift the iron ore ‘fines’ royalty rate in relevant State Agreement Acts from 3.75 per cent to 5.625 per cent, with effect from 1 July 2013.

Accordingly, the State government sought to increase the royalty rate for iron ore ‘fines’ to 6.5 per cent from 1 July 2012, and to 7.5 per cent from 1 July 2013, in both the Mining Act and relevant State Agreement Acts. This will ultimately align the ‘fines’ royalty rate with the existing 7.5 per cent rate for ‘lump’ ore and other ‘crushed and screened’ ores under the Mining Act.

This change also reflects the fact that iron ore fines account for the majority of the State’s iron ore shipments, and are no longer considered an inferior product in the global market. This reform is expected to increase royalty income by $378 million in 2012-13 and by over $800 million per annum in both 2013-14 and 2014-15. However, this will be accompanied by an ongoing reduction in the State’s GST revenue, commencing from 2014-15. The net impact of these changes is an additional $1.9 billion in revenue over the budget period.

Queensland

In a media report in the Brisbane Times, on 21 May 2011 the reporter indicated that Andrew Fraser, the Treasurer, has ruled out lifting mining royalties.

"We have absolutely no plans to further change Queensland's royalty regime," Mr Fraser said.

"Queensland overhauled its royalty regime in 2008. These reforms removed the discounts put in place decades ago to facilitate the growth of the coal industry."  


However, some earlier comments reportedly made by Anna Bligh, the Premier of Queensland, suggest that the Queensland Government would not sign up to an agreement with the Commonwealth Government that binds a future Queensland Government. She expressed her views:

> 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 as consequences for federal arrangements that would be something that needs to be negotiated frankly between the mining companies and the federal government. 40

**Tasmania**

The Tasmanian Government has quietly transformed its royalty regime without much obvious debate with the Commonwealth Government.

In its 2011–12 Budget, the Tasmanian Government projected an increase in its minerals royalty from $36.2 million in 2010–11 to $52.3 million in 2014–15. 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. 41

The actual and projected royalty revenues of the states and territories suggest a strong growth of the revenue in the forward estimates period (Table 7):

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The Minerals Resource Rent Tax — selected concepts and issues

Table 7: Revenues from mining royalty for each State and Territory Government, $ million

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>1,768</td>
<td>1,240</td>
<td>1,768</td>
<td>2,128</td>
<td>2,215</td>
<td>2,351</td>
</tr>
<tr>
<td>Victoria</td>
<td>47</td>
<td>46</td>
<td>47</td>
<td>48</td>
<td>49</td>
<td>50</td>
</tr>
<tr>
<td>Queensland</td>
<td>3,243</td>
<td>2,791</td>
<td>3,445</td>
<td>3,651</td>
<td>3,436</td>
<td>3,674</td>
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<td>Western Australia</td>
<td>2,324</td>
<td>4,159</td>
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<td>203</td>
<td>232</td>
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<tr>
<td>Tasmania</td>
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<td>-</td>
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<td>-</td>
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<td>-</td>
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</tr>
</tbody>
</table>

Source: Budget papers 2011–12, State and Territory governments

ACT: NIL

Historical Commonwealth resource taxation arrangements

Crude oil excise and the Petroleum Resources Rent Tax (PRRT)

The PRRT was introduced to replace a host of different crude oil excise rates. In 1975, the Whitlam Government introduced crude oil (and LPG) production excise to ensure that the community reaped some of the benefits of increased world oil prices. In short, the crude oil excise functioned as a de facto royalty.

The Whitlam Government introduced the crude oil excise in August 1975 to redistribute to the community some of the gains producers received from increased world prices. Subsequent determination of the level of excise sought to balance the return to the community against the need to ensure incentives remained for companies to explore for and produce oil in Australia. To ensure adequate incentives, excise rates were adjusted from time to time. For example, on 23 October 1984, the government announced that it would introduce arrangements to encourage development of fields that had not been developed because of inadequate returns under the 'old' oil excise scale. These fields became eligible for concessional treatment under the new 'intermediate' excise scale. The following table shows current crude oil excise rates (Table 8).
The PRRT was introduced to replace the crude oil excise system. The PRRT thus replaced a complicated system. The PRRT, being a profits-based tax, meant that oil producers did not pay tax until such time as they became profitable. The fact that producers paid excise before they were profitable may have discouraged exploration (a similar argument was mounted in the context of the Rudd Government’s proposed RSPT and now the Gillard Government’s MRRT). It could be argued that the PRRT is, strictly speaking, not a tax on ‘rent’ but rather a de facto profits-based royalty.

Gold Tax

Between 1924 and 1990, income from gold mining was declared tax-exempt in Australia. With the volatile pricing in the global gold market after the US policy of relinquishing the gold standard, and the oil embargo in the 1970s, Australian gold-mining industry experienced a boom in the 1980s. This was mainly a result of the devaluation of the Australian currency against the US dollar in 1976 and significant increases in the gold price in 1979 and 1980.

During the mid and late 1980s, the gold-mining industry experienced a robust rise in earnings, production, export, industry membership and expenditure on gold exploration. The resulting boom and prosperity in the gold-mining industry prompted a political debate on the legitimacy of its tax-exempt status. This has been mainly because the community was exerting pressure as to reap the dividend out of this boom.

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Table 8: Crude oil excises

<table>
<thead>
<tr>
<th>Annual sales</th>
<th>Old oil* %</th>
<th>Intermediate** %</th>
<th>New oil*** %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mega litres#</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0 to 50</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over 50 to 100</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over 100 to 200</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over 200 to 300</td>
<td>20</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over 300 to 400</td>
<td>30</td>
<td>15</td>
<td>0</td>
</tr>
<tr>
<td>Over 400 to 500</td>
<td>40</td>
<td>30</td>
<td>0</td>
</tr>
<tr>
<td>Over 500 to 600</td>
<td>55</td>
<td>50</td>
<td>10</td>
</tr>
<tr>
<td>Over 600 to 700</td>
<td>55</td>
<td>55</td>
<td>15</td>
</tr>
<tr>
<td>Over 700 to 800</td>
<td>55</td>
<td>55</td>
<td>20</td>
</tr>
<tr>
<td>Over 800</td>
<td>55</td>
<td>55</td>
<td>30</td>
</tr>
</tbody>
</table>

Source: Commonwealth Department of Resources, Energy and Tourism, Crude Oil Excise Rates

* Oil discovered before 18 September 1975.

** Oil discovered before 18 September 1975 but not developed as of 23 October 1984.

*** Oil produced from naturally-occurring discrete accumulations discovered on or after 18 September 1975.

# A megalitre is a million litres.

As a consequence, the Parliament approved a law to remove the tax-exempt status of the industry and imposed income tax on gold mining (gold tax) from 1 January 1991. Since 1924, Australia was the only OECD country in which the income of an entire industry was exempt from tax.  

**Longer-term implications of the MRRT for the Commonwealth Budget—cyclicality of revenues and associated expenditures**

The revenue derived from the MRRT will be heavily dependent upon (Australian dollar) commodity prices. In particular, movements in exchange rates and world prices for iron ore and coal will be fundamental in determining the revenue raised by the MRRT. The revenue flows will be highly procyclical. That is, MRRT revenues will vary significantly with nominal GDP growth. In addition, the design features of the tax in terms of how mining profits and losses are defined and deductibility of certain types of expenditures mean that there will be significant lags in MRRT collections in the event of significant rises or falls in commodity prices. This is similar to the way in which company tax revenues fluctuate with nominal GDP growth. In short, significant volatility will be a feature of the tax. Chart 1 shows receipts from the petroleum resource rent tax (PRRT) superimposed on the value of crude oil and liquid natural gas (LNG) exports. This serves to show how a resource rent tax varies with the value of underlying commodity exports.

**Chart 1: Value of crude oil and LNG exports; resource rent tax receipts, $ million**

![Chart 1](image)


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However, the MRRT revenue will not be sequestered from Commonwealth consolidated revenue. Tax revenue, like all forms of money, is fungible—in the absence of a dedicated fund which sequesters MRRT revenue, the revenue raised by the MRRT is indistinguishable from other Commonwealth revenue. So the ‘associated measures’ are, in reality, functionally separate from the MRRT. Indeed, they are being implemented in separate legislation.

Nevertheless, if we take the measures as being ‘tied’ to the MRRT, then the overall package of the measures’ impact on the Commonwealth Budget will depend on how the flow of MRRT revenue compares to the flows of expenditure and other revenues forgone over time. There are some risks here. The expenditures are bound at least to stay roughly the same, and they will have to be paid even if the mining revenue falls. The company tax rate reduction will result in revenue forgone in perpetuity (that is, notwithstanding any increased economic activity that partially offsets the direct effect on company tax revenue attributable to the company tax reduction). The superannuation concessions are permanent as well, as are the small business asset depreciation provisions. The cost to revenue of the increase to the superannuation guarantee rate is only $740 million over the forward estimates, but it increases to $3.6 billion a year by 2019–20. It is not certain whether the regional infrastructure fund will continue to receive contributions from the government.

To some extent this kind of uncertainty is just the uncertainty that is inherent in economics. To the extent that the expenditures and revenue forgone are applied in areas that will promote growth, they may in the end pay for themselves, at least partially. The superannuation measures (if they promote additional saving, rather than displace voluntary private saving or result in additional private borrowings) and the infrastructure funding might be put in this category.

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Appendix A: International mining taxation regimes

The following sections describe the mining tax regimes of selected competitor countries (as of December 2010). It is difficult to directly compare resource taxation regimes, however, the following is intended to place the Australian system in some sort of context.

For comparative purposes, it should be noted that the Australian corporate tax rate is 30 per cent.

**Brazil**

The general corporate tax rate is 15 per cent plus 10 per cent extra. The additional 10 per cent tax is levied on income exceeding R$240,000 (USD 110,000 approximately) bringing the rate to 25 per cent. A social contribution of nine per cent is based on net profit. This contribution is levied on a taxable base similar to their income tax.

The rate of specific mining tax varies according to the type of mineral, from 0.2 per cent to 3 per cent: (i) 3 per cent is levied on aluminium, manganese, halite and potassium; (ii) 2 per cent is levied on iron, fertilizers, coal and other mineral substances; (iii) 1 per cent is levied on gold and (iv) 0.2 per cent is levied on precious stones, coloured cuttable stones, carbonates and noble metals.

Taxation of dividend payments by companies in Brazil was eliminated in 1996. Additionally, any payment, credit or remittance for royalties, or technical or administrative services paid to non-residents will have a 10 per cent impact on the ‘economic domain intervention contribution’ (CIDE), except for dividend payments.

**India**

The corporate tax rate for Indian companies is 30.9 per cent (or 33.22 per cent, if income exceeds INR 10 million). For foreign companies the rate is 41.2 per cent (or 42.23 per cent, if income exceeds INR 10 million). Mineral tax depends on the type of mineral and ranges from 0.2 per cent to 20 per cent.

Any dividend remitted overseas attracts a remittance tax of 21.115 per cent (20 per cent basic rate, plus a 2.5 per cent surcharge on the basic rate and a 3 per cent on basic and surcharge rates)

Mining royalty payable to the state governments (Central Government in the case of Union Territory) depends on the type of mineral. The royalty rates for many minerals are on an ad valorem basis (ranging from 0.2 per cent to 20 per cent) whereas for some others, the rate is fixed on a tonnage basis.

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Mining carried out in a Special Economic Zone is eligible for a tax holiday for a certain number of years subject to the fulfilment of conditions, including that the minerals so extracted are exported from India.

Expenditure on prospecting for minerals incurred by Indian companies, including prior to the commencement of commercial production, is allowable on an amortization basis subject to certain limits. Goods required for coal mining projects attract a concessional customs (import) duty rate of 5 per cent against the normal rate of 12.5 per cent.

Indian Mining Laws prevent the Central Government from increasing the rate of royalty for any mineral more than once during any period of three years. Tax losses can be carried forward up to eight consecutive assessment years immediately succeeding the assessment year for which the loss was first computed.

**South Africa**

In addition to the normal corporate tax of 28 per cent, mining companies are also liable for the Secondary Tax on Companies (STC) which is a tax of 10 per cent on net dividends distributed. The effective tax rate for companies is therefore a combination of the normal tax and the STC and is variable depending on the amount of the dividend declared. Capital gains tax is also applicable at an effective rate of 14 per cent.

South Africa does not currently levy a withholding tax on dividends. However, plans are well under way to introduce a 10 per cent tax. The new tax will also qualify for treaty relief.

The *Income Tax Act* provides for a 12 per cent withholding tax to be deducted from royalties paid to non-residents. Where South Africa has a double tax treaty agreement with the country in which the recipient resides, the withholding tax on the royalty may be reduced to zero per cent, 5 per cent or 10 per cent depending on the agreement.

The total effective nominal tax rate on distributed profits is 36.89 per cent. Gold mining companies can elect whether or not to pay the STC. If they elect to pay the STC, then there is a formula for the calculation of the rate at which gold mines must be taxed. In addition, mining companies are also liable for VAT, customs, and excise and a skill development levy.

Royalties are payable on minerals classified as either refined or unrefined. The payments are calculated in terms of a formula for the respective mineral conditions (unrefined/refined) and are payable on a company’s earnings before interest and tax, and rise with profitability. The royalty rates vary by the level of refinement, and are currently for unrefined materials a maximum 7 per cent, and for refined materials a maximum 12 per cent.\(^{46}\)

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Canada

The federal corporate tax rate was 18 per cent in 2010, and will drop to 15 per cent by 2012. Provincial income tax rates vary between 10 per cent and 16 per cent.

Each province in Canada imposes its own mining tax under systems that vary significantly. Applicable tax rates vary between 10 per cent and 16 per cent. The mining tax base is typically revenue less most expenses except financing and property acquisition costs.

A non-refundable investment tax credit (ITC) of 10 per cent applies to grassroots exploration and mine development costs, but only for base and precious metals and diamonds. It is available only to corporations. ITCs of 20 per cent (35 per cent for certain private corporations) are available for expenditures in qualified scientific research incurred anywhere in Canada. A temporary non-refundable 15 per cent Mineral Exploration Tax Credit is available to individuals who invest in flow-through shares. Certain provinces provide additional credits for flow-through shares.

Certain buildings, machinery and equipment acquired before the commencement of production or for the purpose of a major expansion may qualify for accelerated tax depreciation at a rate of up to 100 per cent.

Russia

The corporate income tax rate is 20 per cent, of which 2 per cent is payable to the federal budget and 18 per cent to the regional budget. The regional portion of the tax may be reduced by a maximum 4.5 per cent maximum subject to regional authorities’ decisions.

Companies are subject to a mineral resources extraction tax (MRET), levied at rates ranging between 3.8 per cent and 8 per cent (rates depend on the type of mineral) based on the value of extracted mineral. Tax base is calculated on the quantity of the minerals extracted multiplied by their sales price or cost price (where extracted minerals were not sold but further processed or used for own needs).

The rates are:

- 4.0 per cent for peat, coal, lignite, anthracite and shale oil, apatite-nepheline, apatite ores
- 4.8 per cent for conditioned ferrous metal ore
- 5.5 per cent for bauxites
- 6.0 per cent for concentrates and other intermediate products containing gold

6.5 per cent for concentrates and other intermediate products containing precious metals (except for gold), precious metals which are useful components of multi component complex ore (except for gold) and

8.0 per cent for conditioned non-ferrous metal ores (safe for nephelines and bauxites), rare metals either occurring in their own deposits or presented in ores with other mineral resources, multi-component complex ores, as well as useful components of complex ores, except for precious metals, natural diamonds and other precious and semi-precious stones.

Generally, at the exploration stage mining companies incur significant expenses, do not generate any income and therefore their net assets may be less than the companies’ charter capital (‘negative net assets’). In this case, in accordance with existing corporate law practices, starting from the second financial year the company may be forced into liquidation if it does not resolve their negative net assets issue.

Geological exploration and development of strategic mining deposits (for example, uranium, diamonds, nickel, cobalt, mine fields with reserves of gold equal to or more than 50 tonnes, copper 500 000 tonnes) with a participation of foreign investors requires approval by the Russian authorities.

Kazakhstan

The corporate rate of tax is 20 per cent. The net after tax profit of branches of foreign legal entities is subject to a 15 per cent branch profit tax. (Reduction or elimination of this tax may be available under the appropriate tax treaty).

The Kazakh mining tax has a bonus system: minimum bonus for exploration and production contracts equals approximately USD 27 000 and USD 29 000, respectively; commercial discovery bonus is 0.1 per cent of the world market value of the volume of the recoverable reserves.

A Mineral Extraction Tax is levied upon the cost of produced volumes of minerals. The current rates for minerals are fixed depending on the type of mineral. The Mineral Extraction Tax is applied to the value of the produced mineral where value is based on world price of minerals.

There is also an Excess Profit Tax (EPT)—the portion of net income exceeding 25 per cent of deductions for EPT purposes is subject to tax at progressive rates from 0 per cent to 60 per cent.

Argentina

The corporate tax rate is 35 per cent. There is no specific mining tax. There is a provincial royalty. The rate varies depending on the province where the mine is located.

A specific law titled ‘Law 24,196’ set down a special mining regime for Argentina. Mining projects within the purview of that law have the following rights: (i) double deduction of exploration expenses; (ii) accelerated depreciation of assets; (iii) exemption from import duties; (iv) a limit of 3 per cent on mining royalties; (v) forecast expenditure for environmental conservation deductible from income tax; (viii) fiscal stability for a period of 30 years. This latter means that a mining investor
will not experience any increase in their total tax burden determined on the date the corresponding feasibility study is presented, for the period of 30 years. There is currently a ‘presumed minimum gains’ tax levied at a rate of 1 per cent on the net value of assets; companies within the purview of Law 24,196 on mining investments are exempt from the imposition of this tax.

Chile

The rate of corporate tax was 17 per cent in 2010, increasing to 20 per cent for profits accrued or received in 2011, before dropping back to 18.5 per cent in 2012 and to 17 per cent from 2013 onwards.

New mining tax initiatives are as follows:

• Annual sales of less than 12,000 tonnes of fine copper are exempted from a Mining Industry Tax; for annual sales between 12,000 and 50,000 tonnes of fine copper, a marginal rate ranging from 0.5 per cent to 4.5 per cent is applied over the taxable operational mining income (equivalent to an effective tax burden of 0.04 per cent to 1.93 per cent);

• Annual sales over 50,000 tonnes of fine copper are subject to an effective tax burden ranging from 5 per cent to 14 per cent over the taxable operational mining income. This new specific mining tax regime may not apply to foreign investors that had signed foreign investment contracts with the Chilean Government under Decree Law 600 including a mining tax invariability. However, such foreign investors may voluntarily be subject to the new regime being subject during calendar years 2010, 2011 and 2012 to an effective tax burden ranging from 4 per cent to 9 per cent over the mining operational margin.

Indonesia

The prevailing corporate tax rate for 2010 onwards is a flat rate of 25 per cent of net taxable profit. A five per cent income tax reduction is applicable for a company listed on the Indonesian Stock Exchange, subject to meeting certain requirements.

Royalties are payable quarterly to the Government based on the actual volume of production or sales price, according to details set out in the Contract and or prevailing regulations for Mining Business Licence (IUP) and Special Mining Business Licence (IUPK) holders. The royalty is deductible for corporate income tax purposes. Mining royalty applies on coal (between 2 per cent and 7 per cent), copper 4 per cent; iron ore 3 per cent; and gold and silver 3.75 per cent and 3.25 per cent respectively.
