

Australia's Proposed Resources Super Profits Tax

May 2010

KEY POINTS

- The Federal Government is firmly committed to introducing a 40% “super” tax on mining profits to be known as Resources Super Profits Tax (**RSPT**).
- The Opposition has indicated it will strongly oppose the introduction of the legislation.
- However, it appears to be generally accepted that the current royalty system is unsatisfactory and inefficient, and we believe it is likely there will be a compromise regarding the new tax.

INITIAL REACTION TO 40% RSPT PROPOSAL

Tax reform has always been controversial.

However, very few people would have anticipated that the release on May 2, 2010 of the Henry Committee Report on Australia's Future Tax System – and the Federal Government's response – would have generated such hostility.

The Government's proposal to impose an additional 40% tax on mining profits, by way of the RSPT, has led to a significant backlash that will likely continue until the Federal Election later this year.

It is no surprise the mining industry has reacted strongly against the RSPT proposal and claimed it will adversely affect the “engine room” of the Australian economy, or that there have been suggestions the new tax will delay or scuttle a number of billion dollar projects. It is also perhaps not surprising that one leading mining figure has described the tax as the “*nationalisation of 40% of the mining industry*”.

Most recently, BHP Billiton has warned that dividend payments to over 540,000 shareholders could be affected by the new tax.

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ARGUMENTS IN FAVOUR OF RSPT

The Government argues, however, that there is a sound theoretical basis for the Henry Committee's suggestion that a profits-based tax should be introduced to replace the large number of inefficient state-based royalties.

In addition, the Henry Committee has emphasised that while mining profits have increased by \$80 billion over the last decade, state royalties have only increased by \$9 billion (although this figure does not take into account the industry's contribution to federal tax revenues).

The Government has appealed to voter sentiment by referring to the fact that the “*fair go*” principle requires the Australian population to share in the profits derived from the extraction of Australia's mineral wealth; and has indicated it proposes to use the RSPT revenues to support superannuation (pensions) and infrastructure, and to reduce the corporate tax rate.

It is also worth recalling that when the 40% Petroleum Resources Rental Tax (*PRRT*) was introduced in the 1980s, there were strong protests to the effect the tax would cripple Australia's offshore petroleum industry. That clearly has not occurred, although it should be noted both the North West Shelf and the Timor Sea Joint Production Development Area are exempt from PRRT.

ISSUES THAT NEED TO BE ADDRESSED

As would be expected, the “devil is in the detail” and the implementation of the RSPT raises a large number of significant technical and substantive commercial issues that need to be addressed urgently, and carefully, including:

- The RSPT is not a tax on “super” or “excessive” profits: it is simply a tax on profits uplifted by the long-term (riskless) Government bond rate (currently 6%). In comparison, the PRRT, which applies to offshore petroleum profits, generally involves a greater percentage uplift (Government bond rate + 5%).¹

¹ In fact, the PRRT has a number of uplift percentages, the highest being 15% for exploration expenditure.

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There is a strong case, however, for arguing that RSPT should only be payable on profits reduced by a rate that reflects the inherent risks of carrying out mining exploration and production. There also needs to be recognition of the fact that the offshore petroleum exploration industry involves very different companies to those involved with onshore petroleum and minerals production operations.

- The payment of RSPT will not give rise to dividend franking (imputation) credits, and the fact RSPT is deductible when calculating a company's income tax liability will reduce the amount of franking credits available to frank dividends payable to shareholders. Those shareholders therefore won't obtain the benefit of any RSPT paid by the company.² It has been suggested this may result in Australian investors (in particular, individuals and superannuation funds) moving from mining shares into other Australian equities, and the Australian mining sector may become owned, to a greater extent, by foreign investors.
- The RSPT will apply to proposed *and existing* mining projects, with existing projects being transitioned into the new RSPT tax system on – in very broad terms – a historical cost basis. *This potentially has significantly adverse implications for existing projects.*
- The complexity of upstream and downstream operations may have implications in determining the amount of tax payable where a miner extracts and processes minerals for sale. Although the Government has stated the taxing point will be as close as possible to the well head or mine gate, the value of the minerals at that point may not necessarily be clear; and it is understood a number of companies are concerned RSPT may have the effect of “*disincentivising*” value-adding operations.

² Foreign (non-Australian) shareholders are not entitled to franking credits in respect of RSPT or income tax. However, depending on the tax rules applying in a foreign shareholder's jurisdiction, and any double taxation treaty between that jurisdiction and Australia, a foreign shareholder that owns 10% or more of the shares in an Australian company may be entitled to an indirect foreign tax credit for tax payable by the Australian company.

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- Under the RSPT, the Government guarantees to give resource firms the benefit of 40% of their extraction costs on the equivalent of a cash-flow basis (with the RSPT allowance preserving the real value of the benefit). That is, the Government guarantees to provide relief for expenditures and losses – including the possibility of a cash refund – in return for 40% of the resource super profits. Nevertheless, it is understood a number of companies would prefer to give away the possibility of such a refund in return for higher “hurdle rates”.
- As a political expedient, state-based royalties remain payable, although are creditable against a company's RSPT liability. As a result, one of the main complaints with the existing system – the payment of inefficient royalties – is *not* addressed.³

RESOURCE EXPLORATION REBATE

One important “trade off” for the RSPT is the proposed introduction of a refundable tax offset (the resource exploration rebate) for Australian exploration expenditure incurred on or after 1 July 2011.

The offset will also apply to expenditure incurred in exploring for geothermal energy, and will be available to all companies irrespective of their size.

However, the rebate is considered less satisfactory than the “*flow-through*” shares proposal preferred by the mining industry, which would allow unused deductions to flow to shareholders as an “exploration tax credit”.

WILL RSPT BE ENACTED IN ITS CURRENT FORM (OR AT ALL)?

The Government is clearly ideologically wedded to the RSPT proposal and needs the projected revenues to fund its other tax reform proposals.

³ Note: royalties are payable by reference to the amount physically produced by a mine, irrespective of whether the mine is profitable or loss-making, whereas RSPT would only be payable on profits.

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The Federal Opposition has described the proposal as “*economic vandalism*” and indicated it will strongly oppose its introduction and will drop the tax if it wins the election later this year.

It is worth noting, however, that the Minerals Council agrees the current output-based royalty regime should be abolished and is prepared to accept a profits-based regime that is:

- applied prospectively (i.e. only to new projects with voluntary “opt in” provisions);
- internationally competitive;
- differentiated by resource commodities;
- levied on primary resource value only; and
- equitable and efficient.

Accordingly, we believe there is likely to be a compromise between the Government, the Opposition and the industry before RSPT is introduced.

The Government has scheduled an extensive Consultation Process leading to the release of an Issues Paper and a Final Design Paper.

We strongly believe all mining companies should participate in the Consultation Process (which will take place in Adelaide on Friday, June 11, 2010) and, if possible, make Written Submissions regarding the issues that specifically affect their operations. This may be one of the most effective ways for the industry to influence the proposed legislation.

If you would like to discuss any aspects of the RSPT, or the Resource Exploration Rebate, or would like assistance preparing Submissions to the Government's Issues and Design Papers, please do not hesitate to contact:

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