MINERALS COUNCIL OF AUSTRALIA

SUBMISSION ON THE AUSTRALIAN GOVERNMENT'S TAX DISCUSSION PAPER

JUNE 2015

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Policies to improve Australia's productivity performance, workforce participation and international competitiveness are needed to sustain future economic growth and increases in living standards. Tax reform is essential if Australia is to continue to grow and prosper.

The guiding objective of tax reform should be to increase Australia's growth potential through a more competitive tax system. This objective can and should be achieved in a way that supports fiscal repair over time and that maintains a high level of equity in the tax system.

With its heavy reliance on income taxes (on individuals and businesses), Australia's tax system is increasingly uncompetitive globally. Australia's corporate tax system is not 'broken', but our company tax rate is too high for a medium-sized, open, capital-hungry economy.

The MCA recommends that the Australian Government's forthcoming White Paper take as a starting point the need to move Australia's statutory corporate tax rate progressively towards the current OECD average of 25 per cent. With a staged process of tax reform and spending discipline, the Government should aim to reach this goal over a five year period.

Australia's capacity to capture the next wave of mining investment and to secure future export revenues depends critically on ensuring policy frameworks – not least our taxation system – become more internationally competitive.

Mining projects are highly capital intensive with considerable, high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. Securing the benefits of Australia's comparative advantage in mineral resources requires stable and globally competitive tax arrangements.

Australia is a relatively high tax mining jurisdiction, even after the abolition of the mining tax and the carbon tax. Mining tax ratios in Australia at or near longer term highs, while official company tax data show mining to be among the highest taxed industries in Australia.

An economy-wide corporate tax cut is the priority business tax reform to improve competiveness and economic growth prospects. Reforms to Australia's capital allowance rules would be second-best from a long-run competitiveness perspective.

Stable tax arrangements for exploration, R&D and business inputs such as fuel are vital to industry competitiveness and investor confidence.

Taxes that act as barriers to investment, including withholding taxes and stamp duties, should be progressively reduced as part of wider tax reform. Simplification of the capital allowances regime and FBT rules are priorities to reduce business and ATO administrative costs.

Any future reform of state tax and royalty regimes will require the agreement from all states and territories. More can be done to improved tax system consultation through early engagement with stakeholders on proposed policy and legislative changes.

The Australian mining industry is committed to meaningful and globally consistent tax transparency and will work with the Australian Government to progress the Extractives Industry Transparency Initiative and voluntary measures.

1. WHY TAX REFORM? THE ECONOMIC CONTEXT

- Policies to improve Australia's productivity performance, workforce participation and international competitiveness are needed to sustain future economic growth and increases in living standards. Tax reform is essential if Australia is to continue to grow and prosper.

- The guiding objective of tax reform should be to increase Australia's growth potential through a more competitive tax system. This objective can and should be achieved in a way that supports fiscal repair over time and that maintains a high level of equity in the tax system.

- With its heavy reliance on income taxes (on individuals and businesses), Australia's tax system is increasingly uncompetitive globally. Australia's corporate tax system is not 'broken', but our company tax rate is too high for a medium-sized, open, capital-hungry economy.

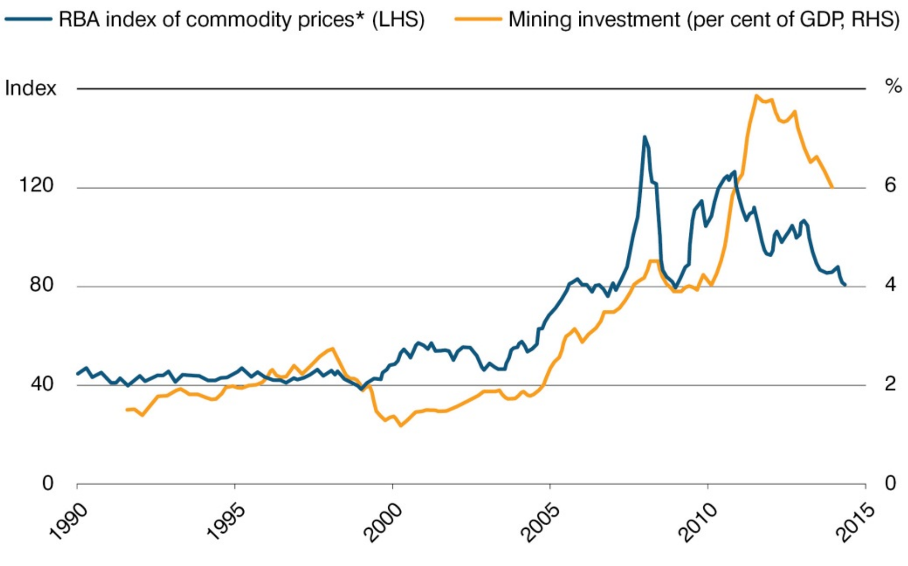
1.1 Sustaining Australian prosperity

Australian living standards rose strongly in the first decade of twenty-first century, continuing an unbroken period of growth since the early 1990s. Rapid industrial growth in China and other emerging economies, higher terms of trade and strong growth in the mining industry helped to increase Australia's prosperity.

Australia experienced the largest terms of trade and resources investment boom in our history, with the mining industry now forming a larger share of Australia's economy. Additional productive capacity in mining has helped to support real GDP growth and will continue to drive higher resources exports well into the future.

In recent years, however, both the mining industry and the Australian economy as a whole have entered a more challenging environment. Commodity prices have fallen markedly from peak levels and mining investment, a major source of growth following the global financial crisis (GFC), has declined from historical highs and is expected to decline further in coming years (Chart 1). For five of the past six years, Australia has experienced below trend growth and the decline in the terms of trade has seen a flattening of national income growth.

Chart 1 **Commodity prices and mining investment**



* In Australian dollar terms

Source: ABS; RBA

The decline in the terms of trade, the ageing of the population (with its impact on workforce participation) and a prolonged period of weaker productivity growth in the 2000s underline uncertainty over the economy's future growth path. Many of these same forces are adding to budgetary challenges for both federal and state governments. In addition, as the tax discussion paper notes, global economic growth remains subdued relative to the years leading up to the GFC.[1]

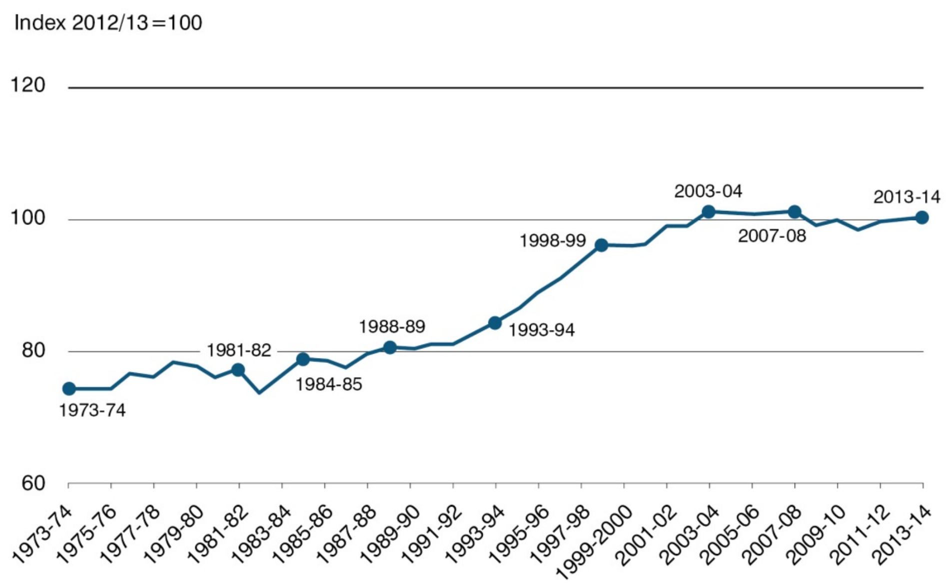
The 2015 Intergenerational Report examined in detail the interlinked challenges around growth, productivity, the ageing of the population and government budgets, as well as the risk to Australian prosperity of failure to address these challenges. The report projects average annual GDP growth of 2.8 per cent over the next 40 years, compared with 3.1 per cent over the past 40 years. It highlights the pressing need to increase productivity and workforce participation in order to drive higher levels of prosperity through economic growth.[2]

Productivity has consistently been the most significant driver of income growth. During the 1990s, Australia's productivity growth was especially high, with labour productivity averaging 2.2 per cent growth per year. This improved performance was the dividend of a sustained period of economic reform begun in the 1980s which opened up Australia's economy and made markets more efficient, competitive and flexible. Since the turn of the century, productivity growth in Australia has slowed with average labour productivity growth in the 2000s of 1.5 per cent per year.

The most comprehensive measure of productivity is multifactor productivity (MFP). MFP measures the amount of output obtained from a combined unit of labour and capital. In principle, it reflects the part of economic growth over and above that resulting from growth in hours worked and growth in capital employed, and is frequently taken to be an indicator of technological progress.

Over the last four decades, Australia's market sector MFP growth has averaged 1.1 per cent per year. Chart 2 shows Australia's poor MFP performance over the past decade. For much of the period, MFP growth has been negative. 2013-14 was the tenth consecutive year of negative or relatively weak MFP growth in the market sector, a pattern atypical in the longer term history of Australia's productivity performance (Chart 2).

Chart 2 **Multifactor productivity growth**



Source: ABS, Productivity Commission estimates

[1] Australian Government, *Re:think: Tax discussion paper*, Australian Government, Canberra, p. 8.
[2] Australian Government, *2015 Intergenerational Report*, Australian Government, Canberra.

Part of the explanation for the slowdown in productivity growth lies in temporary or sector-specific factors, including very high investments in mining and utilities. Nonetheless, as the Intergenerational Report notes:

> … these factors do not explain fully the breadth and magnitude of the slowdown in Australia's productivity growth rates since the 1990s. This has been observed in the majority of industries, suggesting that more fundamental factors are at play. Part of the slowdown may reflect the fading of past reforms. There have been fewer significant policy reforms since the early 2000s. Strong income growth, low unemployment and high rates of profitability through the 2000s may have significantly lowered the pressure on governments to undertake the necessary productivity enhancing reforms and reduced the incentive for businesses to become more competitive during this period.[3]

Allied with the nation's productivity challenge, Australia must continue to make its way in an increasingly competitive global economy. Other nations are not standing still, including when it comes to tax reform. And there is clear evidence that Australia's international competitiveness is not what it should be.

Measures of competitiveness reflect an economy's ability to sell goods and services to the rest of the world and to compete against goods and services produced abroad. In 2014, the MCA released a landmark report on Australia's international competitiveness by Professor Tony Makin of Griffith University.[4] From an analysis of three alternative competiveness measures, Makin finds that Australia's competitiveness has deteriorated markedly since the turn of the century, contributing to the economy's growth rate falling below potential.

The first metric Makin examines is a traditional 'real' exchange rate measure (where the real exchange rate is the nominal exchange rate adjusted for domestic inflation relative to inflation in major trading partners). Overall, the real exchange rate has been up to 25 per cent stronger since the turn of the century compared with the previous decade average.

The second metric is an alternative exchange rate measure based on the relative prices of non-tradeables (products not traded on world markets) to tradables (products which are, or which could be, traded internationally). This relative price can be considered as the 'opportunity cost' of shifting resources between the traded and non-traded goods sectors. On this measure, Australia's competitiveness deteriorated by close to 30 per cent since the late 1990s.

The third metric Makin focuses on is a broader measure devised by the World Economic Forum (WEF). Benchmarking individual economies based on various 'pillars' of economic growth (for example, economic institutions, macroeconomic environment, product and labour market efficiency), it links drivers of both competitiveness and productivity.

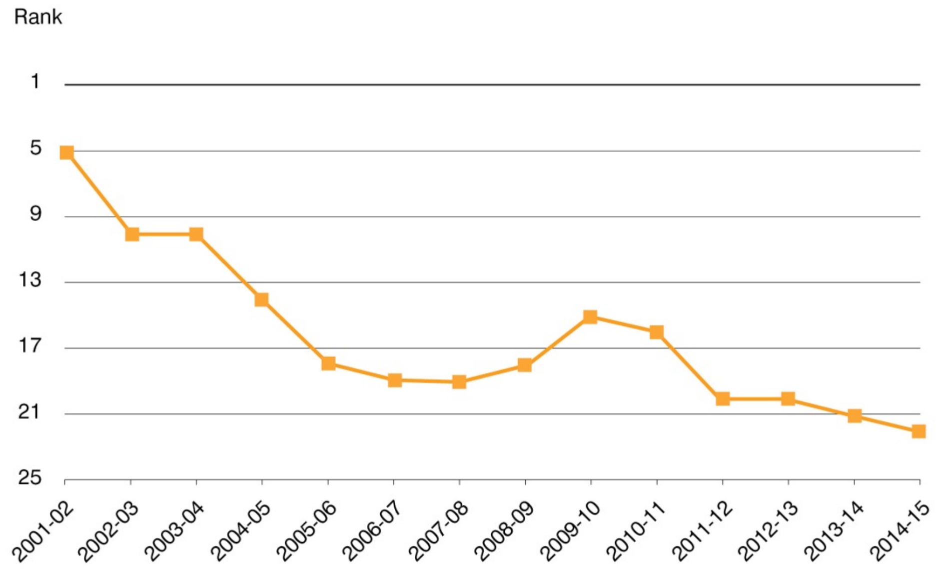
The WEF competitiveness measure also shows a marked deterioration in Australia's relative competitive position. From being ranked in the top 10 most competitive countries in the early 2000s, Australia now ranks 22nd in 2014-15 (Chart 3). 'Tax rates' and 'tax regulations' have registered consistently through the WEF as among the five most problematic areas for doing business in Australia.[5]

Policies to improve Australia's productivity performance, workforce participation and international competitiveness are needed to sustain future economic growth and increases in living standards. Tax reform is essential if Australia is to continue to grow and prosper. Continued economic growth provides the necessary foundation for higher taxation revenues into the future. The focus of growth-oriented tax reform should be on improving the tax mix, rather than introducing new taxes.

---

[3] Ibid, p. 26.
[4] Tony Makin, *Australia's competitiveness: Reversing the slide*, A public policy analysis produced for the Minerals Council of Australia, 06, September 2014.
[5] Ai Group, 'Australian global competitiveness in 2014-15', 3 September 2014.

Chart 3 **World Economic Forum Global Competitiveness Index – Australia's ranking**



Source: Makin 2014, World Economic Forum, Global Competitiveness Report *(various issues)*

Tax reform needs to be comprehensive and apply to all levels of government, especially in light of the relatively constrained tax base of state and territory governments, the inefficient nature of many state/territory taxes and their responsibility for delivering many core government services. A focus of tax reform should be on providing the states and territories with more stable and efficient sources of revenue in return for the removal of particularly inefficient state taxes such as stamp duties.

While tax reform will necessarily take many years to achieve, a clear direction should be set by the White Paper on Reform of Australia's Tax System. Reform should be staged, linked with fiscal circumstances and delivered in conjunction with further steps to improve the targeting, effectiveness and efficiency of government expenditure.

1.2 Tax reform: Objectives and principles

The MCA considers that the core objective of tax reform should be to improve the competitiveness of Australia's tax system and hence the nation's growth potential. This objective can and should be achieved in a way that supports fiscal repair over time and that maintains a high level of equity in the tax-transfer system.

Australia is a medium-sized, open economy heavily reliant on foreign capital. Yet Australia's tax system is no longer competitive in an increasingly globalised world, where capital and skills are more mobile than ever. Australia's statutory corporate tax rate is 30 per cent. The average across the OECD is 25 per cent, while the average of our competitors in the Asia-Pacific region is 23.5 per cent. Many countries have reduced corporate income tax rates over the past decade, while Australia's rate for large businesses has remained unchanged. In addition, Australia's top marginal tax rate on personal income is approaching 50 per cent compared with a top rate in Asia-Pacific economies closer to 30 per cent.[6]

The Government's goal of lower, simpler and fairer taxes accurately reflects the simple reality that taxes distort economic choices and incentives and have negative consequences for economic growth. They reduce incentives to work, save, invest and innovate. As the tax discussion paper notes,

[6] Business Council of Australia, *The Future of Tax: Australia's Current System*, 2014, p. 5 and p. 16.

measures such as the carbon tax and the mining tax acted as a drag on growth.[7] Every additional dollar of tax raised means one less dollar invested by the productive private sector, with the deadweight efficiency costs and administrative burdens of taxes on top of that.[8]

The fundamental purpose of a taxation system is to raise revenue for the public provision of goods and services, including a sustainable social safety net. It should seek to do so in the most growth-friendly way as possible, while ensuring governments have access to a relatively sustainable and stable revenue base.

There are, of course, other matters to be weighed in decisions about tax reform. They include the impact on public finances and trade-offs between efficiency, equity and simplicity. It is important, therefore, that any changes to the tax system be guided by strong policy principles. The MCA recommends that tax reform proposals in the forthcoming White Paper be developed in light of the following high-level principles:

- Reform proposals should enhance Australia's productivity performance, workforce participation and international competitiveness
- Reform proposals should adopt an economy-wide and Federation-wide perspective
- Reform proposals should be consistent with a strong budgetary position into the future and seek to support a sustainable and stable revenue base
- Reform proposals should not adversely affect existing investments or create perceptions of sovereign risk. A stable, competitive tax system encourages investment, especially in highly capital-intensive industries characterised by multi-decade investments
- Fairness should be assessed based on the tax system as a whole, not based on individual elements. Both the progressivity of the tax-transfer system and intergenerational equity are key dimensions of a fair tax system
- Reform proposals should as far as possible reduce tax complexity and minimise administrative and compliance burdens
- Strong consultation and appropriate transitional arrangements are essential to good tax policy design and sustainable reform.

The MCA recognises and supports continued efforts by the Australian Government to address Australia's fiscal challenges. It is critical that governments adopt a growth-oriented, productivity-enhancing approach to achieving fiscal repair and sustainability. The means by which fiscal repair is achieved has a major bearing on investment, growth and job creation.

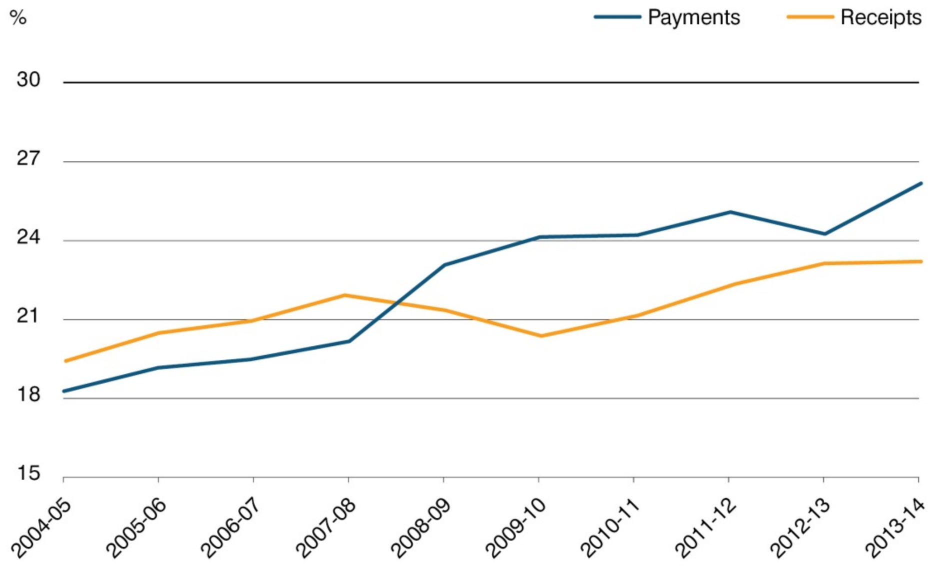
Sound fiscal policy has both macroeconomic and microeconomic dimensions. It should be guided by a medium-term framework that supports sustained economic growth with low inflation. It should also promote higher productivity by fostering a stable investment climate with competitive taxation arrangements while providing appropriate market signals to ensure factors of production flow to where they are most highly valued.

The size and scope of government determines the amount of tax that needs to be collected. The MCA has argued consistently that the primary focus of efforts to close Australia's fiscal sustainability gap should be on spending discipline and more efficient government expenditure, not higher taxes. Continued fiscal reform is needed to improve the quality of public spending, to keep taxes down and to chart a credible path back to budget surplus.

The claim that Australia does not have a government spending problem (only a revenue problem) is mistaken. The Treasury, independent budget specialists in the public and private sector and the National Commission of Audit have outlined the nature of the challenge. Chart 4 shows that general government cash payments have been outstripping receipts since 2008, notwithstanding commitments from sucessive governments to expenditure restraint and fiscal consolidation.

[7] Australian Government, *Re:think: Tax discussion paper*, Australian Government, Canberra, p. iii.
[8] Macroeconomics, *Mid-Year Budget Bulletin*, 'The great crunch of 2015: Fiscal repair and income recession', p. 7.

Chart 4 **Commonwealth cash receipts and payments**
(percentage of nominal GDP)



Source: ABS, Australian National Accounts, Cat. 5206.0; Federal Budget 2015-16, Budget Paper 1

In the period 2009-10 to 2013-14, total payments averaged $366 billion (25 per cent of nominal GDP) compared with $261 billion in the period 2004-05 to 2008-09 (20 per cent of nominal GDP).

The Secretary of the Treasury, Mr John Fraser, has observed that:

> Commonwealth Government spending has grown at an annual average of more than 4 per cent in real terms since 2007-08, compared with 3 per cent during the 1980s and 1990s.
>
> As a result, spending in 2013-14 was around 2½ percentage points higher (as a proportion of GDP) than it was 6 years ago.
>
> This strong growth in expenditure highlights that weakness in revenue is only partly to blame for the current state of government finances.
>
> The reality is that Australia has spent its way to a structural budget problem. Government payments are growing faster than government revenues and without action, this trend will continue.[9]

Spending reform, taxation reform and structural reform need to be pursued simultaneously as part of a concerted and coherent reform agenda to support competitiveness, productivity and growth. Simply relying on higher taxes to fund expanded demands on government will further impair the vitality of Australia's economy and its capacity to grow in a globally competitive environment.

The central message of the 2015 Intergenerational Report is that without serious policy reform to lift our economic growth potential, Australians will experience a much lower rate of growth in living standards than they have become accustomed to in the past. Tax reform designed around a few relatively efficient, broad-based revenue bases with lower, more competitive rates on less efficient taxes remains the best approach to achieving sustainable tax reform in a way that supports growth.

1.3 Reducing reliance on income taxes should be a priority

To increase Australia's growth potential, the MCA recommends that improving the competitiveness of our tax system – for businesses and individuals – should be a central focus of the White Paper on Reform of Australia's Tax System.

[9] John Fraser, Secretary to the Treasury, *Australia's Economic Policy Challenges,* address to the Committee for Economic Development of Australia, 27 February 2015, p. 8f.

The Government's tax discussion paper identifies Australia's relatively heavy reliance on income taxes (in particular, personal income tax and company tax) as a proportion of revenue raised when compared with other OECD countries. Direct taxes account for around two-thirds of total tax receipts. This reliance is projected to increase under current tax arrangements. Australia's reliance on personal income tax in particular is projected to increase over the next decade, largely as a result of wages growth leading to individuals paying higher average tax rates (i.e. bracket creep).

Tax policy research highlights that reduced reliance on income taxes with correspondingly greater weight on broad-based indirect taxation is better for economic growth.[10] Corporate taxes are found to be most harmful for growth, followed by personal income taxes, and then consumption taxes.

Higher personal income taxes and higher effective marginal tax rates reduce workforce participation incentives. A higher personal tax burden reduces reward for effort and can be a barrier to participation. The degree to which the proportion of the population participating in the workforce is expected to decline as a result of population ageing highlights the need for competitive personal tax arrangements. By 2054-55, the participation rate for Australians aged 15 years and over is projected to fall to 62.4 per cent, compared with 64.6 per cent in 2014-15, slowing the rate of economic growth. The number of people of working age (16-65) for every person aged 65 and over is estimated to decrease from 4.5 people today to 2.7 people in 2055.

At the same time, allowing bracket creep in the personal tax system to continue unchecked is neither fair nor sustainable given Australia's fiscal circumstances. Analysis for the Business Council of Australia by Deloitte Access Economics has found that using bracket creep to return to a surplus of 1 per cent of GDP could take two decades. It would mean people earning just 10 per cent more than average weekly ordinary time earnings (about $85,000 per year) would face the top marginal income tax rate, paying some $15,000 more tax than they pay now (in current dollars).[11]

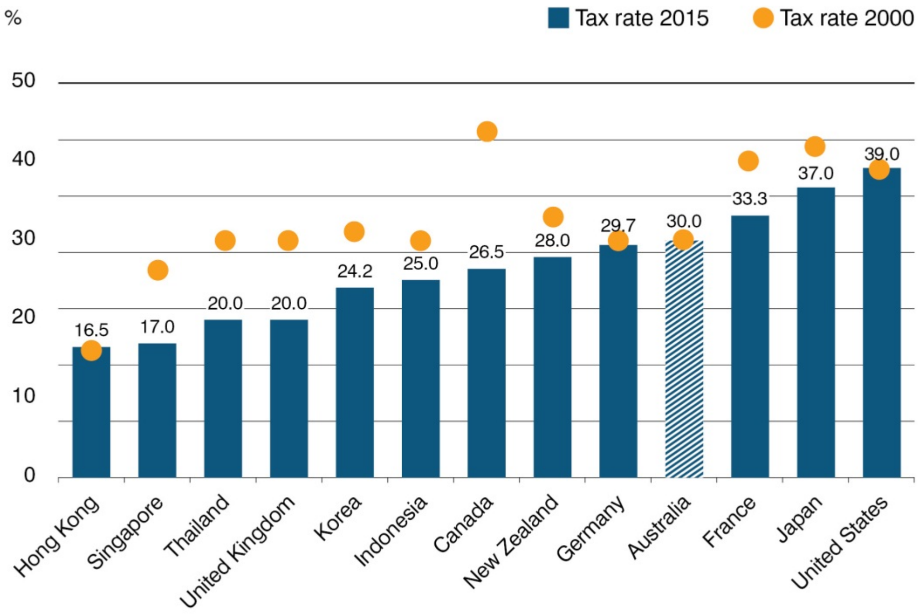
In a similar vein, the former Treasury Secretary Dr Martin Parkinson has pointed to the 'significant costs associated with inaction' on personal income tax, both from an efficiency and equity perspective. The non-indexation of tax thresholds would see someone on average fulltime earnings paying a marginal rate of 39 per cent (including the Medicare levy) from 2015-16. Over the decade ahead, their average tax rate would rise from 23 per cent to 28 per cent, an increase of more than 20 per cent. In general, bracket creep makes the tax system less progressive as the projected increases in the average tax rate tend to be greater for lower income earners than for higher income earners.[12]

Investment is a key driver of productivity, growth and wages in the economy. Investment supports productivity and the wages of Australian workers. Conversely, Treasury research estimates that each additional $1 collected by way of company income tax reduces the living standards of Australian households by around 50 cents in the long run because of reduced investment. This impedes Australia's productivity performance and in turn real wage growth.[13]

With Australia depending heavily on foreign investment, it is becoming more important to develop and maintain a globally competitive company tax system. There is clear evidence that Australia's company tax rate is increasingly uncompetitive and too high for a capital hungry country.

[10] Åsa Johansson, et al., *Taxation and Economic Growth*, OECD Economics Department Working Paper No. 620, July 2008.
[11] Business Council of Australia, *BCA Budget submission 2015-16*, p. 8.
[12] Dr Martin Parkinson, 'Enhancing our living standards through tax reform', BCA/PwC Tax Reform forum, 11 September 2014.
[13] Australian Government, *Re:think: Tax discussion paper*, p. 26. X. Rimmer, J. Smith and S. Wende, 'The incidence of company tax in Australia', *Economic Roundup*, 1, 2014.

Chart 5 **Company tax rates – international benchmarks**



Source: Treasury, KPMG, EY

Chart 5 shows that Australia's company tax rate is high by global standards, particularly given that many other countries have substantially reduced their corporate tax rates. This high rate of company tax also means Australia has a much greater reliance on company tax than comparable jurisdictions. Corporate taxes in Australia comprised almost 19 per cent of total tax revenue in 2012, among the highest in the developed world and significantly higher than some key regional competitors.[14]

The consequences of having a high company tax rate were outlined succinctly by Treasury Deputy Secretary Rob Heferen at the MCA's Biennial Tax Conference in March 2015. He noted that:

> High company tax means that Australia loses economic value because some investment opportunities become unviable. This is a particular issue for an open, capital importing economy such as Australia's, where the investors, especially foreign investors, can easily decide to allocate their capital to opportunities in other jurisdictions.

Mr Heferen also drew attention to the incidence of corporate tax and, by implication, to who benefits from a reduction in company tax. Hence:

> … a higher level of investment should increase the capital available for existing labour (i.e. capital deepening) and thus increase labour productivity. This should, in turn, increase the demand for labour and consequently raise wages and consumption. Therefore, reducing company tax increases the prosperity of Australian workers.

The MCA recommends that the Australian Government's forthcoming White Paper take as a starting point the need to move Australia's statutory corporate tax rate progressively towards the current OECD average of 25 per cent. With a staged process of tax reform and spending discipline, the Government should aim to reach this goal over a five year period.

A pro-growth, productivity-enhancing shift in the tax mix would seek to increase revenue raised by the current system's more efficient taxes while reducing reliance on taxes that have a higher cost to growth and productivity. Australia has shown in the past that this sort of rebalancing of the tax mix can be done in a way that maintains a high level of equity in the tax-transfer system.

[14] Australian Government, *Re:think: Tax discussion paper*, p. 17.

2. MINERALS INDUSTRY TAXATION: TRENDS AND ISSUES

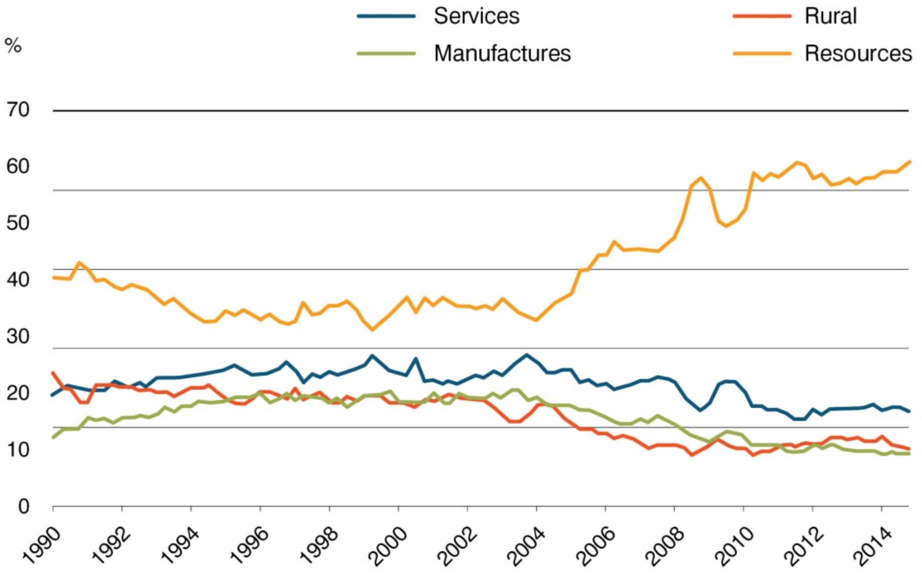
- The minerals industry is Australia's largest export earner and the most globalised sector of the economy. Over the past decade, it has been a major source of growth, investment, jobs and higher living standards, as well as a large contributor to government revenues.
- Mining projects are highly capital intensive with considerable, high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. Securing the benefits of Australia's comparative advantage in mineral resources requires stable and globally competitive tax arrangements.
- Australia is a relatively high tax mining jurisdiction, even after the abolition of the mining tax and the carbon tax. Mining tax ratios in Australia at or near longer term highs, while official company tax data show mining to be among the highest taxed industries in Australia.

2.1 The minerals industry in the Australian economy

The minerals industry is Australia's largest export earner and the most globalised sector of the economy. Over the past decade, it has been a major source of growth, investment, jobs and higher living standards, as well as a large contributor to government revenues. The industry has been at the fulcrum of structural change and, in the wake of the mining boom, now forms a larger part of Australia's economy.

Beginning in the early 2000s, increased demand for bulk commodities used in steel-making and electricity generation (especially from China) resulted in a large rise in commodity prices, and hence in Australia's terms of trade. The rise in commodity prices (interrupted for a short period by the GFC) boosted activity and incomes and encouraged labour and capital to shift towards the mining industry.

Chart 6 **Australia's exports of goods and services**
(shares of total)



Source: Reserve Bank of Australia

This sustained rise in commodity prices was followed by a 'once-in-a-century' mining investment boom. This saw investment in the resources industry roughly quadruple to an historical high of more than 8 per cent of GDP in 2012-13.

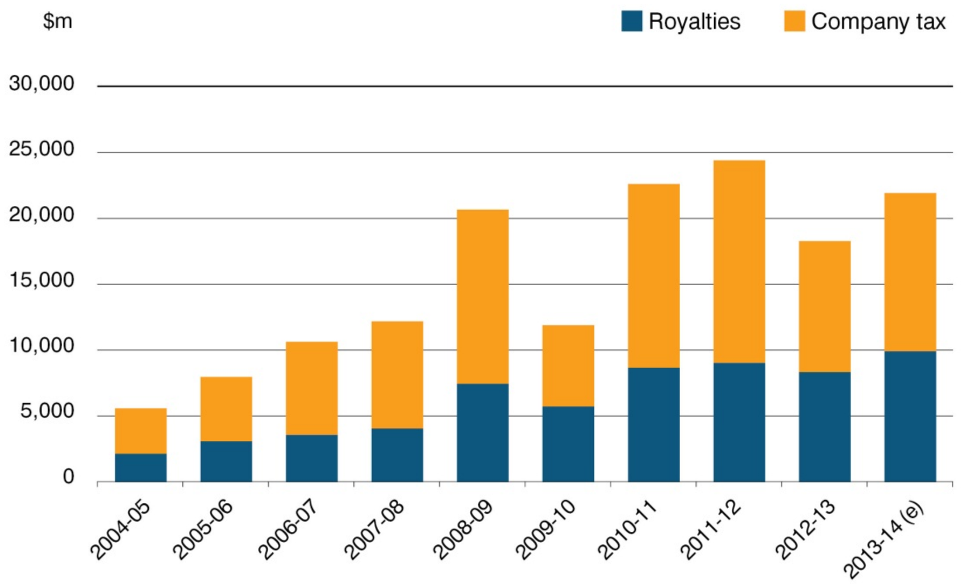
Reserve Bank research has estimated that by 2011-12 the resources economy (including mining-related activities across various sectors of the economy) had grown to around 18 per cent of Australia's GDP, double the share in 2003-04.[15] The resources economy's share of employment also doubled over the period to be almost 10 per cent in 2011-12. The shift in the composition of Australia's export profile was no less dramatic (Chart 6).

Minerals exports (which account for more than 80 per cent of total resources exports) have risen from around one third of Australia's total exports of goods and services in 2003-04 to roughly one half in 2013-14. Minerals exports today contribute about 10 per cent of Australia's GDP. The nation's largest mineral export earners in 2013-14 were iron ore ($75 billion), coal – metallurgical and thermal ($40 billion), gold ($13 billion), aluminium ore and concentrates ($9.7 billion) and copper ($8.7 billion).

The industry's role as a foundation of Australia's high living standards was underlined by research published by the Reserve Bank of Australia in August 2014. This compared economic outcomes in the early 21st century with a 'counterfactual' of no mining boom. The study found that by 2013 the boom had raised real per capita income by 13 per cent, raised real wages by 6 per cent and lowered the unemployment rate by about 1.25 per cent.[16]

The industry's contribution to government revenues has risen around fourfold since the start of the mining boom. Despite steep falls in prices and profitability, Deloitte Access Economics estimate that the minerals industry's direct revenue contribution to governments in Australia from company tax and royalties alone exceeded $40 billion over the two years to June 2014. The total contribution from both instruments between 2004-05 and 2013-14 has been estimated at $156 billion (Chart 7).

Chart 7 **Minerals industry company tax and royalties**
(2004-05 to 2013-14)



Source: Deloitte Access Economics

Mining produces more gross value added per unit of labour than any other industry in Australia – almost double the second highest (the finance sector). Each worker employed in the mining sector generates around $515,000 for the economy. Average wages in mining are much higher than in most other industries. Higher average wages in the industry have resulted in higher average tax rates, higher average tax payments per person and higher tax collections by the Commonwealth. Returns

[15] V. Rayner and J. Bishop, Reserve Bank of Australia, *Industry Dimensions of the Resource Boom: An Input-Output Analysis*, Research Discussion Paper, RDP 2013-02, February 2013.
[16] P. Downes, K. Hanslow and P. Tulip, Reserve Bank of Australia, *The Effect of the Mining Boom on the Australian Economy*, Research Discussion Paper, RDP 2014-08, August 2014.

to the Australian community also come via payroll tax, fringe benefits tax, GST and other indirect taxes, charges and levies.

The gains Australians derive from the nation's comparative advantage in mineral resources are large and enduring. Even so, the MCA has argued consistently since the peak in commodity prices in 2011 that the years of easy revenue gains are over. Prices for most commodities are expected to remain under pressure in the medium term. Lower commodity prices mean that future revenue gains will rely overwhelmingly on expanded export volumes, rigorous cost control and higher productivity.

The global economy continues to offer significant growth opportunities for Australia's minerals industry. Emerging economies led by China and India are still urbanising and industrialising and off a much larger economic base than at the turn of the century. The United Nations expects the world's urban population to increase by 2.4 billion by 2050, with 95 per cent of that growth occurring in less developed regions (and 83 per cent in less developed regions excluding China).

Demand from an expanding Asian middle class, and associated growth in urban infrastructure, will require more and better houses, office buildings and transport systems, as well as a range of consumer goods. Many countries (China included) have relatively low levels of capital stock per capita compared with advanced economies and considerably lower energy usage rates.

The cyclical downturn in market conditions is not expected to alter the broader trend of rising minerals and energy demand or the long-term opportunity for resource rich nations. A more open question concerns Australia's capacity to seize future opportunities.

2.2 Competition for global mining investment

Australia's capacity to capture the next wave of mining investment and to secure future export revenues depends critically on ensuring policy frameworks – not least our taxation system – become more internationally competitive.

Australia's minerals industry is a 'price taker' in highly competitive global markets characterised by strong competing sources of supply. While Australia is a major producer of a number of commodities, the geographic distribution of mineral resources means global competition is intense and there is no shortage of opportunity for the strategic deployment of capital.

The scale of funding required – and the limitations on funding capacity of domestic financial institutions – means Australian mineral resources companies rely heavily on mobile global capital for investment. As well as the overall burden of taxation, predictability of fiscal regimes is a critical factor influencing investment decisions.

It is common for mining companies to rank mining taxation regimes across the world and project-specific reassessments of a country's fiscal regime are always undertaken when evaluating potential investment opportunities. This sensitivity can be attributed to the particular (and often unique) characteristics of minerals resource projects. These characteristics include:

- The exploration phases preceding start-up and production are lengthy and costly, and there is no income during these phases
- The development of a mine is very capital intensive and requires specialist equipment and skills
- A mining project typically has a long life and therefore may be subjected to changes in the political regime or domestic circumstances
- Prices take larger cyclical swings than in most other economic sectors
- The scale of operations can be very large, with high replacement and incremental investment to maintain production
- Mining activities generally get more costly as a project matures because the resource becomes less accessible
- Mine closure and reclamation incur large costs after income has ceased.

Policy settings, particularly the taxation system, are crucial to attracting the investment needed to develop Australia's minerals resources. The former Chairman of the Productivity Commission, Gary Banks, has observed in this context that:

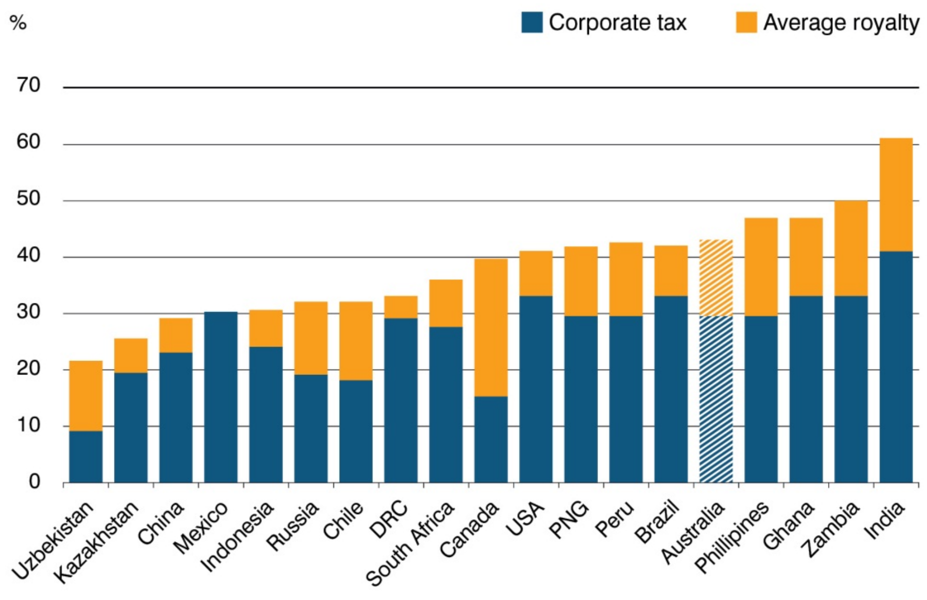
> No country's taxation system is an island. Relative expected returns across resource-prospective countries will be the main determinant of international investment and thus domestic activity in the long term.[17]

These characteristics underscore the industry's vital interest in efficient policy frameworks that meet policy objectives without imposing unnecessary cost burdens – costs that cannot simply be passed on to customers. For the minerals industry (more than most industries) international competitiveness and the capacity of businesses to adjust to changing global market conditions forms a critical lens through which policy frameworks need to be evaluated.

2.3 Australia is a high tax mining jurisdiction

The overall tax burden on mining projects is a key factor influencing investment decisions, especially given the volatility of commodity markets. International comparisons show that Australia is a relatively high tax mining jurisdiction, even after the abolition of the MRRT and the carbon tax. A 2013 study by Goldman Sachs found that the tax take from Australian mining companies is within the top 25 per cent of mining jurisdictions (Chart 8). Major resource-rich competitors like Brazil, Indonesia, Canada, Peru and South Africa – as well as large producers such as China and the United States – all have lower tax rates on mining.

Chart 8 Total tax take for major mining companies by nation



Source: Goldman Sachs

Estimated mining tax ratios (combining company tax and royalties as a share of taxable income) have risen sharply in Australia as commodity prices have fallen and states have increased royalty rates. Using the same measures and methodologies adopted by Australian governments in recent years, Chris Richardson of Deloitte Access Economics has shown that mining tax ratios are now at or above the longer term average (Chart 9).[18]

[17] Gary Banks, Chairman of the Productivity Commission, 'Australia's mining boom: What's the problem?', Address to the Melbourne Institute and the Australian Economic and Social Outlook Conference', 30 June 2011.

[18] Chris Richardson, *Mining tax ratios revisited*, A public policy analysis produced for the Minerals Council of Australia, 08, March 2015.

Chart 9 **Mining tax ratio**

Source: Deloitte Access Economics

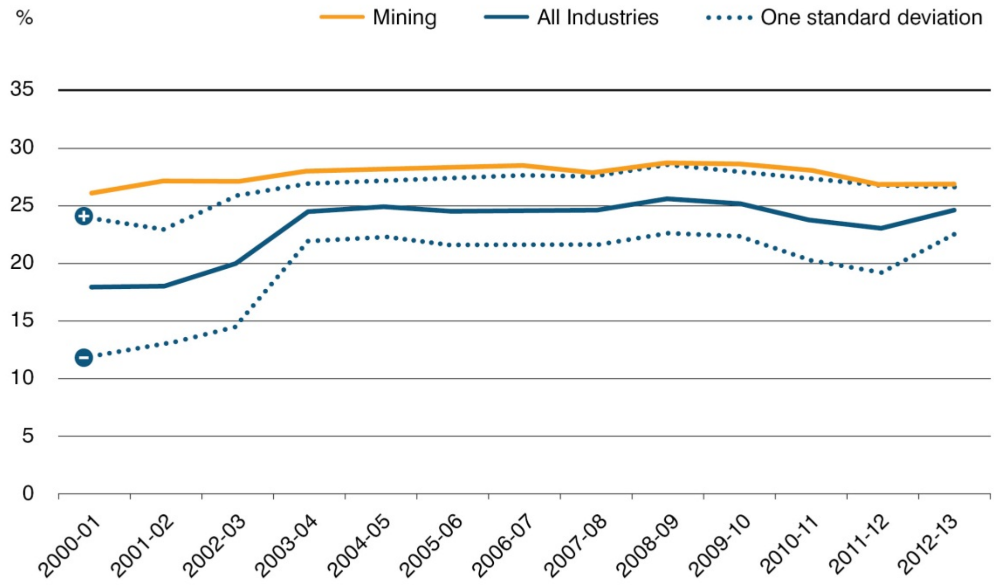
Richardson calculates a mining tax ratio of 53 per cent in 2012-13, above the average of 51 per cent since the turn of the century. Further sharp falls in commodity prices since that time mean this ratio will have risen even higher since 2012-13.

Company tax data from the Australian Taxation Office (ATO) confirm that mining (including oil and gas) is among the highest taxed industries in Australia. After refunds and credits, the net corporate tax rate on mining has been consistently above the average of total industries.

Professor Sinclair Davidson of RMIT has shown that over the decade to 2012-13 (the last year of official data), the average effective company tax rate for mining (net corporate tax as a percentage of taxable income) has remained above the average of all industries, plus one standard deviation (Chart 10). Hence, Professor Davidson concludes that 'the mining industry pays a substantial sum of money in corporate taxation and pays at a rate of close to 30 per cent of its taxable income'.[19]

[19] Sinclair Davidson, 'Official evidence on mining taxes: 2015 update', MCA Background Paper, May 2015.

Chart 10 **Average effective tax rates for all industries and mining**
(Net tax as percentage of taxable income)



Source: ATO Taxation Statistics (various issues). Sinclair Davidson calculations

3. IMPROVING TAX SYSTEM COMPETITIVENESS

- An economy-wide corporate tax cut is the priority business tax reform to improve competiveness and economic growth prospects. Reforms to Australia's capital allowance rules would be a second-best option. Australia's statutory corporate tax rate should be reduced to the (current) OECD average over a five year period.

- Stable tax arrangements for exploration, R&D and business inputs such as fuel are vital to industry competitiveness and investor confidence.

- Taxes that act as barriers to investment, including withholding taxes and stamp duties, should be progressively reduced as part of wider tax reform. Simplification of the capital allowances regime and FBT rules are priorities to reduce business and ATO administrative costs.

- Any future reform of state tax and royalty regimes will require the agreement from all states and territories. More can be done to improve tax system consultation through early engagement with stakeholders on proposed policy and legislative changes.

3.1 Corporate tax

Mining companies rank mining taxation regimes across the world and project-specific reassessments of a country's fiscal regime are undertaken when evaluating potential investment opportunities. The headline corporate tax rate, tax imposts on corporate financing and tax depreciation rules all influence the competitiveness of the fiscal regime.

Corporate tax rate reduction

As noted earlier, Australia's statutory company tax rate is no longer competitive with the average of advanced economies, while the competitiveness gap is wider still with economies in the Asia-Pacific region. A phased reduction in the company tax rate to the OECD average (currently 25 per cent) is needed to recover ground by Australia lost since the last corporate rate reduction in 2001-02. A reduction in the company tax rate will encourage companies considering investment in Australia over the medium to longer term to bring forward investments. The rate cut should apply to all corporates, small and large, to bring the company tax rate back into alignment.

Capital allowances

Reforms arising from the Ralph Review on Business Taxation, in particular the introduction of the Uniform Capital Allowance (UCA) system, more closely aligned Australia's capital allowance regime with economic depreciation and improved neutrality of tax treatment across different types of capital assets. Accelerated depreciation for a number of mining assets was removed as part of the Ralph Review base-broadening reforms. Changes in 2006 to increase the diminishing value rate from 150 per cent to 200 per cent more closely aligned the UCA regime with economic depreciation and improved the competitiveness of Australia's capital allowance arrangements.

In terms of tax competiveness and investment behaviour, there is a legitimate debate about the role and status of Australia's capital allowances regime. The tax discussion paper acknowledges that tax depreciation rules are an important factor influencing the effective marginal tax rate on investments in Australia and raises reform of Australia's depreciation regime as an alternative to a lower corporate tax rate in order to attract foreign investment.[20]

Reforms to tax depreciation rules, including through the introduction of investment allowances or accelerated depreciation, can be effective in increasing business investment. They are, however, unlikely to be as effective as a broad corporate tax cut to improve Australia's long-term growth prospects. There are significant potential downsides to capital allowance changes including distorting investment decisions if investment incentives are not designed well. The discussion paper notes this

[20] Australian Government, *Re:think: Tax discussion paper*, p. 81.

risk stating that changes could 'distort economic outcomes and increase tax system complexity'.[21] Accordingly, any incentives should be applied broadly as allowances targeted at specific industries, business sizes or assets risk increasing tax system complexity and undermining neutrality in the business tax system.

A sound capital allowance regime requires:

- Close alignment to economic depreciation
- Neutrality across asset classes, and
- Simplicity.

There is scope, however, to simplify Australia's UCA regime. Options to reduce compliance costs are outlined in section 3.7.

Business financing arrangements – debt and thin capitalisation

Cost of funding is important to assessing the overall tax cost for mining investment. Mining and other capital-intensive sectors are more highly leveraged than most industries because mining projects have large up-front capital costs that cannot be funded through equity or other sources. With Australia being a large capital importer, the tax treatment of debt expenses (interest deductions) represents an important element in the competitiveness of Australia's business tax system.

The tax discussion paper raises the issue of different tax treatment applying to debt, equity and retained earnings for financing decisions by companies. The paper acknowledges that 'similar to most foreign jurisdictions, under Australia's tax system, interest payments are tax deductible'.[22] Australia's tightly constructed thin capitalisation rules guard against excessive debt loading to increase interest deductions. These rules were strengthened only recently with a reduction in the thin capitalisation safe harbour from a 3:1 debt-to-equity ratio to 1.5:1 (from 1 July 2014). These rules include a broader range of debt compared with other countries (international and domestic, related party and third party debt); regimes in most competitor jurisdictions focus on 'related party' debt.

Any changes to further lower the gearing ratio or change the methodology to give a similar result will increase the cost of debt for investment at a time when Australia needs to encourage investment for increased growth. Companies in the mining industry required to fund large capital investments through debt are at particular risk of having legitimate debt deductions denied merely because of fluctuations in the value of assets (arising from currency movements and commodity price cycles).

Business financing arrangements – withholding taxes

Withholding taxes on interest and dividends increase the cost of debt finance and equity investment in Australia. To encourage inbound investment, the Australian Government should intensify efforts to renew outdated tax treaties to reduce withholding tax rates.

A number of Australia's taxation treaties with key trading partners have not been updated for some time and contain high withholding tax rates. For example, the last tax treaties with China and Indonesia were signed in 1988 and 1992, respectively. A more up-to-date network of tax treaties with key trading partners would reduce barriers to trade and investment. Foreign investment in Australia will be encouraged by reducing the cost of equity and the cost of debt.

Dividend imputation

The discussion paper asks whether the current dividend imputation system continues to serve Australia well. The MCA does not regard reform of dividend imputation as a priority. The role of dividend imputation in removing double taxation of dividends from Australian shareholders remains as relevant today as it was when the regime was introduced with Australian shareholder investment still providing an important source of capital for Australian businesses.

---

[21] Ibid, p. 81.
[22] Ibid, p. 94.

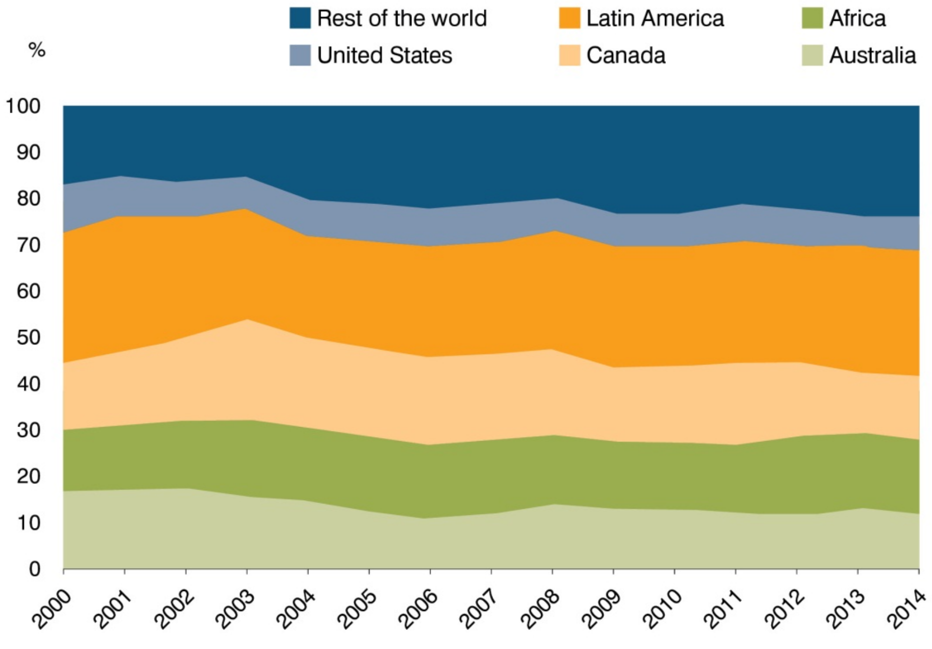
3.2 Exploration tax arrangements

Stable and predictable tax treatment of exploration expenditure is vital to mining industry investment and to promoting a resource pipeline for future investment. Longer term trends in Australia's exploration activity underline the need for certainty in the tax treatment of exploration.

Exploration by its nature is inherently risky with only a small fraction of exploration expenditure resulting in discovery of a viable mining deposit. While Australia possesses a strong mineral endowment, as a mature mining jurisdiction discovery is becoming harder and more costly. In global terms, Australia's share of worldwide exploration expenditure has fallen with Chart 11 showing a decline from 17 per cent to 12 per cent since the turn of the century.

The most recent exploration data shows that exploration expenditure continues its sharp decline. Nominal exploration expenditure fell 31 per cent in 2013-14 to total $2.1 billion, while expenditure of only $1.2 billion in the nine months to March 2015 indicates a continuing decline in exploration investment in the current financial year.

Chart 11 **Global minerals exploration**



Source: US Geological Survey

Taxation treatment is a crucial influence on Australia's competiveness as a destination for minerals exploration. As the Colorado School of Mines has observed:

> Both the rate and form of taxation affect the relative attractiveness of different countries or sub-national regions for investment in mineral exploration and development… Exploration is footloose in that explorers can redirect their activities to regions or countries with more favourable tax regimes.[23]

Australia's immediate deduction regime plays a vital role in generating the exploration activity essential to securing a future pipeline of mining projects and the tax revenues generated by the industry over the longer term, including through royalties payments. It recognises that exploration expenditure is an ongoing, necessary and ordinary business expense of a minerals company and that immediate deductibility is the most practical and efficient way to treat exploration expenditure. Major reviews, including the Ralph Review, have concluded that the immediate deduction is the most practical way to treat exploration expenditure.

[23] Roderick G. Eggert, 'Mineral Exploration and Development: Risk and Reward', Colorado School of Mines, May 2010.

3.3 R&D tax incentive

Australia needs competitive, stable tax arrangements to incentivise investment in R&D. Investment in innovation is crucial to improving industry productivity and cost competitiveness. As Australia's main policy lever to increase investment in innovation, the R&D tax incentive helps to ensure Australia remains a global centre of mining production, research and innovation. Moreover, Australia's potential to diversify the benefits Australia derives from its natural resource endowment through the mining equipment, technology and services (METS) sector is reliant on investment in innovation.

Australia's mining sector currently spends around $4 billion per annum on R&D which accounts for 22 per cent of all business R&D investment. The R&D incentive supports collaborative projects between business and universities, including Rio Tinto's partnership with the University of Queensland's Julius Kruttschnitt Mineral Research Centre to develop technologies for separating and upgrading minerals and Glencore's project with the CSIRO to develop automated laser-guided underground coal longwall technology.

The R&D incentive has been characterised by persistent uncertainty due to changes by successive governments over recent years. Following a major review and far-reaching changes in 2011, further measures saw a $100 million cap on eligible R&D expenditure imposed and proposals made to remove large corporates from eligibility. Legislation to reduce the tax offset rate by 1.5 per cent from 1 July 2014 was also introduced for a second time in June 2015. It is important that Australian businesses now be afforded a stable policy framework in this area to encourage future investment in R&D and to support economic growth.

3.4 Taxes on business inputs

It is a fundamental principle of tax policy that business inputs should not be taxed. It is the principle that underpins the GST and fuel excise. The discussion paper outlines the clear policy rationale of the fuel tax credits (FTC) scheme (known commonly as the 'diesel fuel rebate'), stating that 'FTCs give effect to the policy objective of ensuring that fuel tax on business inputs is minimised'.[24]

This important principle is reflected also in consistent and categorical statements by Treasury rejecting the claim that the scheme is a 'subsidy'. FTCs also recognise that excise is an implicit road user charge originally introduced to fund public roads. Excise on diesel used on privately funded roads or on off grid electricity generation should not be subject to a road user charge.

FTCs are vital to the competitiveness of industries operating in regional and rural Australia. Australia's largest export earning industries including mining, agriculture, tourism, forestry and fishing rely on diesel to operate heavy machinery off-road and generate off grid electricity with diesel generators. Diesel accounts for up to one quarter of operating costs at some mines. Competitor countries recognise the necessity of diesel as a business input to regional industries and do not impose excise on fuel used in agriculture and mining.

The principle of not taxing business inputs extends to the fringe benefits tax (FBT) system. Proposals to remove exemptions for Fly-in, Fly-out (FIFO) workers, for example, should be rejected outright. The FBT system improves the integrity of the tax system by ensuring non-cash benefits provided to employees in the course of their employment are appropriately taxed. Exemptions for transport and employer-provided accommodation provided to FIFO workers are consistent with the clear policy intent of the FBT system. Essential transport and housing provided to workers in remote areas are not 'fringe benefits' that are private in nature. The housing exemption is targeted to housing in defined 'remote areas' where there is limited accommodation available and transport exemptions are provided for travel to and from work in remote locations.

A skilled and mobile workforce is required to deliver resource project investment. Imposing FBT on transport and housing costs of FIFO workers in remote regions would be highly inequitable to workers

[24] Australian Government, *Re:think: Tax discussion paper*, p. 159.

and families reliant on the mining industry, and impose a large tax burden on operations in remote parts of Australia.

3.5 Mining royalty regimes

Royalties and company tax are the main fiscal instruments used by governments to extract revenue from mining. Combined with company tax, royalties influence the effective tax rate that mining investors face in Australia and hence materially impact the economics of investing in projects.

Competitive and stable royalty regimes ensure the community benefits from the development of Australia's natural resources. State and territory governments should seek to balance community returns from the development of resources with the need to attract investment. A series of royalty increases in recent years has contributed to increases in the effective tax rate faced by mining in Australia.

Table 1: State and Territory royalty increases

State	Royalty increase	Date of increase
Queensland	Increased royalty rate on coal values exceeding $100 a tonne from 7 per cent to 10 per cent. Coal royalties increased from 10 per cent to 12.5 per cent per tonne between $100 and $150 and to 15 per cent thereafter.	1 July 2008 1 October 2012
Western Australia	Iron ore fines royalty rate increased from 5.625 per cent to 7.5 per cent	1 July 2012 - 1 July 2013
New South Wales	Coal royalty rates Increased by 1 percentage point	1 January 2009

Source: Deloitte Access Economics

As a state revenue source, royalty reform is ultimately a matter for each state government to consider. Any long-term national reform of Australia's resource taxation arrangements would require agreement from all states, the Northern Territory and the Commonwealth. An open, transparent and thorough consultation with the community and industry would be an absolute prerequisite to any royalty reform.

3.6 Stamp duties

Stamp duties on transfers of business assets act as a tax barrier to investment and efficient business decisions. Stamp duties inhibit transfers and impede rationalisation decisions and M&As. A more challenging economic climate makes the imperative to reduce artificial impediments to transactions more urgent as consolidations, mergers and acquisitions and joint venture transactions increase. Removal of stamp duties will improve economic growth by reducing costs of investment and encouraging efficient business decisions.

Stamp duties on residential conveyances can act as a barrier to labour mobility. Reform of stamp duties on housing should also be considered by state governments to reduce financial imposts on Australians moving for work purposes. Clearly, the full consent and involvement of state and territory governments is needed to progress reform of stamp duties.

3.7 Tax system complexity

The discussion paper points to the increasing complexity of Australia's tax system, while acknowledging that it is difficult to measure. To better understand the level of complexity in Australia's tax system, and inform measures to reduce compliance costs, the paper suggests developing a metric to measure complexity.

There are options to reduce business compliance costs in the short term in specific areas of the tax law. In the business tax system, relevant areas relate to FBT, capital allowances and the use of safe harbours in complex areas of the law. In the state taxes sphere, harmonising payroll taxes would provide the greatest compliance cost savings for businesses operating across state boundaries.

In addition to specific areas that require simplification, key drivers of tax complexity such as the sheer volume of tax law changes and the ad-hoc nature of changes must be addressed through tax system governance changes. Reforms on tax system governance are addressed in section 3.8.

Safe harbours, capital allowances and the FBT regime

Safe harbours can significantly reduce compliance costs and promote tax law compliance. There are options to simplify capital allowance rules and integrity rules through appropriate safe harbour arrangements.

The current UCA regime requires the Tax Commissioner to set effective lives for a large range of assets, each with differing effective lives. Streamlining depreciation rates and asset classes through the creation of a limited number of depreciation ‘pools' with a single depreciation rate would reduce compliance costs for business. The option of self-assessment of effective lives should remain where the taxpayer can show that the effective life of an asset is shorter than the safe harbour pool.

In addition to reducing compliance costs, safe harbours should also be extended to other areas of the tax law to improve certainty for taxpayers. This includes complex areas of the law such as transfer pricing in relation to loans. In light of the proposed introduction of harsher penalties for breaches of complex and compliance-heavy ‘reasonably arguable positon' (RAP) requirements in the transfer pricing regime, safe harbours can give taxpayers clear pathways to comply with the transfer pricing rules. This would promote compliance with transfer pricing rules and keep compliance costs to a minimum, both for taxpayers and the ATO.

Aligning tax and accounting depreciation, as suggested by the discussion paper, is a more fundamental reform option. The MCA does not support this option. It would involve a substantial change in Australia's UCA regime that would risk harming the competiveness of Australia's capital allowance regime. Compliance costs can be effectively reduced using safe harbours (as outlined above) without harming Australia's tax competiveness.

The FBT system is a further source of compliance costs on business. Simplification of the system should be given consideration in the medium term, though any proposal should be mindful of the need to preserve the core purpose of the FBT system; namely, to increase fairness and to protect the integrity of the personal income tax system by ensuring benefits provided in lieu of wages and salary are taxed. In the near term, there are a number of options available to simplify the system and to reduce compliance costs for employers, including:

- Introducing grouping provisions in the FBT law to allow employers to be grouped for FBT reporting purposes (as already occurs for corporate income tax returns)
- Increasing the reportable fringe benefits amount threshold, and
- Increasing the minor benefit limit.

3.8 Tax system governance and transparency

The tax policy design process needs to be improved if Australia is to secure a more predictable and simpler tax system. Investor certainty is undermined by regular changes to tax policy. Improvements can be made to the tax policy making process through:

- *Early stage consultation* – early engagement will help to reduce the need for constant ad-hoc tax law changes. Contestability in policy advice, by business and the public, at the design phase is essential to improve tax policy development and engagement with business on corporate tax changes is a prerequisite to better quality tax law

- *Improved tax system information and transparency* – meaningful tax transparency initiatives will help to improve public understanding of tax concepts and help to ground debate in more accurate information
- *Alignment with global processes* – acting in a co-ordinated way with overseas tax authorities as part of the OECD Base Erosion and Profit Shifting (BEPS) project will more effectively address international tax avoidance risks and align Australia's tax transparency initiatives with international initiatives
- *Implementing the Extractives Industry Transparency Initiative (EITI)* - the Australian mining industry is committed to tax transparency through the EITI. The MCA looks forward to government approval to move from the pilot phase to implementation of the EITI.

The importance of consultation has been recognised in a number of reviews over recent years including by the Board of Taxation, the Inspector General of Taxation and the 2009 Tax Design Review Panel. Successive governments have made well-intentioned commitments to improve the process, design and delivery of taxation legislation, including through better consultation. While Treasury and the ATO have made substantial improvements to consultation practices in recent times, a legacy of ad-hoc tax law changes remains a source of concern to investors.

The Australian mining industry is committed to meaningful and globally consistent tax transparency. A number of mining companies operating in Australia release detailed tax payment information on a voluntary basis. In addition to the EITI, the development of a voluntary code, announced by the Australian Government on 12 May 2015, has the potential to improve transparency and understanding of company tax contributions. The minerals industry will be an active participant in the Board of Taxation-led consultation process.