



## Australian Government

### The Treasury

## COSTING MINUTE

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**Date:** 16/12/2009  
**Ref:** CQAU 2009-250  
**File:**

**To:** Thomas Abhayaratna, Australia's Future Tax System

**Cc:** James Kelly, Australia's Future Tax System

**TITLE** AFTS proposal - Resource rent tax

### SUMMARY OF PROPOSAL

#### Intent of the proposal

To replace the existing resource taxes and royalties imposed on non-renewable resources at state and Commonwealth levels with a resource rent tax levied by the Commonwealth.

#### Current taxation treatment/problem

The existing resources taxes and royalties imposed on non-renewable resources by the states and the Commonwealth are unresponsive to changes in profit and distort investment and production decisions and thereby erode the value of resource rents available for the community. Ad hoc changes to output based royalties to vary the charge with changes in profits (due to changes in economic conditions) impose sovereign risk on investment.

#### Proposed taxation treatment

The existing resource rent, royalties and production excises imposed on non-renewable resources at state and Commonwealth levels would be replaced by a resource rent tax levied by the Commonwealth. The resource rent tax would be applied to all non-renewable resources (oil, gas and minerals), except for some minerals that generate very low rent. A list of those that should be assumed to generate low rent is included in the Assumptions Section of this costing.

The proposed resource rent tax would be calculated for each project, but losses could be transferred to offset the liability of another resource rent project within a common interest. The tax value of undeducted expenditure and unutilised losses would be refunded when a project is closed (upon surrender of the exploration, development or production licence). The taxable resource profit would be measured as income less an allowance for corporate capital (ACC). The ACC rate be set equal to the long-term government bond rate. A base rate of 40 per cent be applied to all ACC profits.

Payments of the resource rent tax would be allowed as a deductible expense in the calculation of income tax. The refunding of losses would be taxable for income tax.

The resource rent tax rate be automatically adjusted to offset any future change in the company tax rate to ensure that total rents collected on resources through taxation are unchanged.

A cash bidding system be used to collect any expected excess rents (above those expected to be collected by the rent tax or other taxes), and allocate exploration rights to private firms. The cash bids would be a deductible expense for resource rent purposes (and company tax purposes).

In respect of the transition of existing projects to the new system:

- o existing projects would be transferred into the new system, including projects covered by state and Commonwealth regimes (including the North West Shelf project, Barrow Island project and Petroleum Resource Rent Tax projects).
- o transitional adjustments for existing projects would be facilitated by adjusting the starting ACC base, rather than providing a concessional tax rate or allowance rate. ACC base reflecting the value of undepreciated assets and carry forward expenditure (unutilised losses) where it is possible to identify this for the project. The starting ACC base would be included in the calculation of the allowance. This would assist shielding investors from tax on the normal return to previous expenditure where the investor has not already recouped a return for that expenditure (undeducted expenditure). The starting ACC base would be depreciated over time so that investors could recover a tax credit for undepreciated or unutilised cost of their previous investments. The starting ACC base, including its unutilised depreciation and its allowance, would be quarantined from the new ACC and would not be refunded when a project is closed.

## ELEMENTS AND OPTIONS

### Elements

Element ID	Description
A	A flat tax of 40 per cent on all profits measured under the proposed allowance for corporate capital regime (with an ACC rate equal to the long term government bond rate each year).
B	Revenues could be allocated in proportion to each State's share of gross rent-based tax receipts calculated prior to the transfer of losses from non tax paying projects.
C	The Commonwealth will guarantee, for 4 years, a revenue stream equivalent to that expected under the existing arrangement (with the existing extraction path). This guarantee would be a temporary loan to the states which would be paid back as states revenue greater than their expected stream of output based royalties.
D	States would keep their existing royalty regimes in place. A firm that is subject to both the rent-based tax and a State royalty would be entitled to a credit for the latter against the total liability for the former. If in a period the credit exceeded the rent-based tax liability, the excess would be refunded.

### Options examined

Option ID	Option	Assumed start date	Was a Departmental Impact Assessment sought?	Was a Tax Regulation Impact (preliminary assessment) sought?
1	A & B	01/07/2010	No	No
2	A & D	01/07/2010	No	No
3	A & C	01/07/2010	No	No

**FINANCIAL IMPLICATIONS****IMPACT ON FISCAL BALANCE - ACCRUAL-BUDGET (\$m)**

<b>Option ID</b>	<b>Year of Maturity</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>
1	2014-15	-	260	2070	2520	2270
	<i>Revenue</i>	-	13060	14770	16920	19670
	<i>Expense</i>	-	-12800	-12700	-14400	-17400
2	2014-15	-	3960	5170	6920	9170
	<i>Revenue</i>	-	13060	14770	16920	19670
	<i>Expense</i>	-	-9100	-9600	-10000	-10500
3	2014-15	-	3960	5170	6920	9170
	<i>Revenue</i>	-	13060	14770	16920	19670
	<i>Expense</i>	-	-9100	-9600	-10000	-10500

- Nil

**IMPACT ON UNDERLYING CASH BALANCE (\$m)**

<b>Option ID</b>	<b>Year of Maturity</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>
1	2014-15	-	260	2070	2520	2270
	<i>Revenue</i>	-	13060	14770	16920	19670
	<i>Expense</i>	-	-12800	-12700	-14400	-17400
2	2014-15	-	3960	5170	6920	9170
	<i>Revenue</i>	-	13060	14770	16920	19670
	<i>Expense</i>	-	-9100	-9600	-10000	-10500
3	2014-15	-	3960	5170	6920	9170
	<i>Revenue</i>	-	13060	14770	16920	19670
	<i>Expense</i>	-	-9100	-9600	-10000	-10500

- Nil

*The costing of each option has been undertaken independently from those of other options, meaning that the costs are not necessarily additive.*

## **RELIABILITY**

Caution should be used when citing this costing. These results are highly reliant on assumptions and are generated from incomplete data. Please refer to the Assumptions section of this Costing Minute. Reliability is very low. The costing provides an indication of order of magnitude only.

## **COSTING DETAILS**

### **Methodology**

- 1) The estimate of the total undepreciated capital stock was derived used the effective lives of mining assets at a subdivision level were estimated with the assistance of the KPMG mining assets publication. These average effective lives were used to derive the total capital stock in the particular subdivision of the mining industry. The stock was then adjusted by depreciation and capital expenditure to produce a total capital stock for the year. For the purposes of this costing the ACC base has been uplifted by 10% across all industries which reflects the compensation that may be provided to certain projects upon entry into the RRT. This uplift is also depreciated over the average effective life of the assets in the industry.
- 2) Income, expenses and change in inventory information from ABS Cat. 8415.0 was used at a subdivision level (eg coal mining, oil & gas extraction) to calculate operating profits. The operating profits included deductions for royalties/taxes and interest which had to be removed to ensure consistency with the Allowance for Corporate Capital (ACC) approach. Total income is grown into future years based on price/production forecasts sourced from ABARE. Expenses are grown generally in line with production levels (assume most expense are variable costs). Data was used at a subdivision level to allow for better analysis of the impacts on different parts of the mining industry and to more easily apply ABARE's price/production forecasts to the appropriate subdivision. Exploration expenditure was also sourced from ABARE and was an expense.
- 3) ABARE's forecasts of prices and production of a number of commodities were taken from the Australian Commodities publication. The price or the total annual value of the commodity is provided as a forecast and this was used with production forecasts to estimate the income and expenses of the relevant industry going forward. The ABARE price and production forecasts are business as usual forecasts and do not directly factor in any changes that may occur as a result of the CPRS.
- 4) The ACC is calculated by applying the LTBR to the total capital stock in that year. The LTBR is the historical numbers sourced from the ATO's PRRT site. This ACC amount was then deducted from the adjusted operating profit of the subdivision and the appropriate tax rate was applied. No RRT is payable where the adjusted operating profit is less than zero. This loss can be carried forward and applied against future profits. No explicit assumption has been made about refunds of losses where the project has closed down but the compensation to the projects on entry reflects some of the costs of these losses.
- 5) Information on existing resource taxation arrangements were sourced from Final Budget

Outcomes or from the Department of Resources, Energy and Tourism. These were used to adjust for the impact on company tax and the various options under this proposal.

## **Data**

Data sources used in this costing:

- ABS Cat. 8415.0 (2001-02 to 2006-07)
- ABS Cat. 8155.0 (2007-08)
- ABARE Australian Commodities - March quarter, Volume 16, number 1
- ABARE Australian Commodities - March quarter, Volume 15, number 1
- ABARE Australian Commodities - March quarter, Volume 14, number 1
- ABARE Australian Mineral Statistics 2009
- ABARE Australian Mineral Statistics 2008
- KPMG Energy & Natural Resources Tax Facts - Document on the effective lives of assets in different sectors of the mining industry.
- State Royalties sourced from the Department of Resources, Energy and Tourism
- IBISWorld reports - output and revenue from states/territories by commodity

## **Assumptions**

### Resource Rent Tax (RRT) Assumptions

#### ACC and LTBR

- the long term bond rate (LTBR) is the historical rate sourced from the Tax Office PRRT site. The rate going forward is set at 4.5%
- the Allowance for Corporate Capital (ACC) is calculated by applying the LTBR to the company's total capital stock
- the ACC is a deduction at the project level

#### Capital Stock

- the average effective life of assets in the mining industry differs depending on the type of mining operation. The KPMG publication on effective lives of mining assets has assisted in assessing the average effective lives of assets. These average lives have assisted in deriving the total capital stock for each sector of the mining industry.
- The total capital stock is adjusted each year by capital allowances and capital expenditure which have been both sourced from ABS data.
- As compensation for existing mining projects moving into the RRT the asset base can be adjusted to which in turn impacts on the ACC deduction. The base adjustment for this costing was assumed to be 15%.

### Resource Rent Tax - General

- the RRT applies to petroleum (crude oil, condensate, natural gas including coal seam gas), bulk commodities (coal, iron ore), base metals (gold, silver, copper, lead, nickel, tin, zinc), diamonds, other precious stones and mineral sands.
- the tax value of residual losses to be refunded when project is closed (no explicit assumptions have been made about this)
- RRT calculated at a project level but losses can be transferred to other RRT projects within group.
- the base tax rate of RRT is 40% will be applied to profits less the ACC.
- existing projects to be transferred into the system and compensation will be way of an adjustment to the starting base. This uplift of the starting base of existing mines is assumed to be 15%.
- exploration expenditure is sourced from ABARE publications and is an allowable deduction at the project level.
- Australian Commodities (ABARE) supplies the price and volumes of commodities into the future. These have been used to derive income and expense estimates from 2007-08 to 2014-15.
- Interest expenses have been added back as interest deductions are not allowed as a deduction under the RRT.
- Royalty expenses have been added back in certain circumstances as these may be removed under the RRT.

#### Company Tax Assumptions

- corporate tax rate is assumed to be 25%
- payments of RRT are allowed as a deductible expense in the calculation of company income tax

#### Existing Taxes

- Existing taxes on resources include the Petroleum Resource Rent Tax (PRRT), the Crude Oil Excise, and a variety of State Royalty Taxes. This data was source from the Department of Resources, Energy and Tourism.

### **ADDITIONAL INFORMATION**

#### **Departmental impacts**

An assessment of the Departmental Impact has not been requested.

#### **Tax Regulation Impact (preliminary assessment)**

A preliminary assessment of the Tax Regulation Impact has not been requested.

*All material provided in this minute must be cleared by the Tax Analysis Division incorporated into Executive Minutes, Cabinet Submissions, any other briefing material, or when used for external purposes.*

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