

CFMEU

Construction, Forestry, Mining and Energy Union

Minerals Resource Rent Tax Repeal And Other Measures Bill 2013

Submission in response to proposed legislation

31 October 2013

Sent by email: MRRTrepeal@treasury.gov.au

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The Mining Boom

Let's spread it around

Introduction

The Construction, Forestry, Mining and Energy Union (CFMEU) is responding to the announcement by the Australian Government on 24 October of legislative measures to repeal the Minerals Resource Rent Tax and associated measures. The time given for public response is extremely brief – one week – and this response shall also be brief.

The CFMEU consists of three Divisions, namely the Mining and Energy Division, the Forestry and Furnishing Products Division and the Construction and General Division. We are the major union in these industries and represent approximately 110,000 members across Australia.

Why the CFMEU supports resource rent taxation

As the largest union operating in the Australian mining industry the CFMEU is acutely aware of the major role played by mining in the national economy and international trade, and also in regional communities. We have seen many booms and busts in the mining industry. And while we can see the rapid growth of large newly industrialising nations like China and India, we were never a believer in the minerals supercycle being particularly long-lasting (though of course we prefer to live in a boom!).

In the context of continuing environmental challenges (and especially climate change in respect of fossil fuel industries) and increasing scale and capital intensity, it is imperative that the industry maintain and enhance its “social licence to operate”. The industry must make large and ongoing contributions to both regional communities and the Australian community as a whole.

For this reason we support the industry having to bear the largest possible tax burden that still enables it to attract investment and pay reasonable returns to investors. We are not in favour of subsidising resource industries, and we do not support “race to the bottom” competition among national (or State) governments to attract investors through tax concessions or subsidies.

The Australian mining industry generally pays a substantial level of tax. But in many recent years it could have paid more without diminishing its attractiveness as an investment. And given that what the industry produces is effectively produced under licence from the Australian people – because the minerals

belong to all Australians – it is incumbent on both the industry and Governments to maximise the public contribution of the industry.

The CFMEU therefore strongly opposes the abolition of the MRRT. The MRRT has its faults (discussed below) but they should be fixed, and not via abolition of the tax.

The rationale for the MRRT

The rationale for a resources rent tax for the Australian mining, oil and gas industries remains strong. It makes economic sense to tax an industry heavily when it is highly profitable, and to tax it less when it is less profitable. This is especially so where the industry relies on access to inputs that are the property of the Australian people – our mineral resources.

A well-designed resource rent tax does not lessen investment as it enables and indeed facilitates the achievement of reasonable rates of return before the tax cuts in. The resource rent taxes applied by the Norwegian Government to North Sea oil and gas can range up to 90% - but this has not stopped investment occurring.

The long standing royalty regimes administered by the State Governments are inherently less flexible and more arbitrary. The royalties become fixed costs of production that apply whether or not the firm is profitable, and may have the effect of causing earlier closure of mines – mines that might have had a better future once the mineral price cycle rebounded.

The Australian people and those who represent them should be seeking to maximise the return from the exploitation of our limited mineral resources. Further we should be seeking to gain permanent or enduring benefits from the exploitation of resources that are finite and will ultimately be depleted.

The mining industry itself has supported resource rent taxation at various times – and especially when it was in its less profitable phases. It was only at the height of the resources boom that the industry was so strongly against the Resources Super Profits Tax (RSPT) and the MRRT.

Mining industry opposition to the MRRT should be seen for the narrow self-serving “rent-seeking” that it was (and is).

Perverse outcomes

The perverse outcome of the repeal of this legislation will be that the oil and gas industries are subject to a resource rent tax – which has enabled those industries to thrive – while the mining industry will not be.

The Australian mining industry will once again be subject principally to a hotch potch of State-based royalties – set opportunistically by State Governments – rather than a consistent national regime that would be clearly understandable to investors.

Another perverse outcome is that the abolition of resource rent taxation will encourage more speculative investments in the industry – fuelling wasteful activity that ultimately becomes a deadweight on the industry through write-downs of over-capitalised assets.

We need to encourage investment but not speculation. Investment that is long term is wanted, but speculative activity – that often relies on the buying and selling of mineral assets with actual production being a secondary aspect – is damaging to the industry in exaggerating the boom and bust cycle and inflicting pain on both mining communities and genuine investors.

Through removing some of the prospect of “super profits”, resource rent taxation helps dampen down unproductive speculative activity.

Deficiencies of the RSPT and MRRT

The RSPT had its faults – while being theoretically attractive it had practical problems and the CFMEU does not support Governments effectively becoming co-investors in resource industry projects.

However, the compromise produced in the MRRT had greater deficiencies. These included:

- Being only applied to coal and iron ore, when very high profit rates have also been observed in other mining industries eg copper and gold. The MRRT should have applied to all or most mineral commodities (with quarrying or construction materials probably being the only exception).
- Being set at too low a rate – the effective rate of 22.5% as a share of profits above the threshold was too low.

- The uplift rate for undeducted expenses / losses being too high – the Long Term Bond Rate plus 7% - effectively created a threshold profit rate that was too high. Double digit profit rates are great if you can get them, but should not be the standard rate above which a profits-based tax can apply.
- The “taxing point” being too artificially-derived. Placing the taxing point close to the point of extraction (allegedly to capture the value of the mineral at that point rather than when the company has added value to it) resulted in the taxing point being distant from observed market prices – which are usually at the port or elsewhere further along the market chain. This created unnecessary complexity and opacity, and more opportunities for tax minimisation or evasion.
- The choice of a market-value basis for companies to deduct the value of an operation before the MRRT applied.

This last deficiency was perhaps the most outrageous rort negotiated by the mining industry in the MRRT compromise. While the theory of resource rent taxation is clear that a firm should be able to deduct the cost of their investment in the calculation of tax payable, that deduction should be limited to the amount of money actually spent.

When BHP Billiton, Rio Tinto and Xstrata negotiated for companies to be able to deduct the market value of their mines from the MRRT calculation, it enabled (especially at the height of the resources boom) for the companies to deduct amounts that were far higher than the amounts they had ever actually spent on the mines. Being able to receive a tax deduction in respect of monies never actually spent is absurd.

Some of the assets of those big three companies have been in operation for decades and have already been thoroughly depreciated. They continue to generate large revenues and profits and therefore have large current market values (especially at the height of the resources boom). Those market values represent a boon to the owners but there is no good reason why they should form the basis for claiming deductions from a profits-based tax. The general principle with respect to deductions from tax is that the expenditure must have actually occurred. So it is a fundamentally a rort that the MRRT allowed companies to receive large deductions for monies they had never actually spent.

It is suspected that the deductions for market value of assets may be one key reason why the MRRT did not produce the revenues that were expected in its first year(s) of operation.

The shortcomings of the MRRT should be fixed.

Loss of associated measures

The CFMEU is disappointed with the repeal of measures that were associated with the MRRT.

Of great concern are the loss of measures to reduce inequality and the burden of raising children ie. the loss of the Low Income Superannuation Contribution, the Income Support Bonus and the Schoolkids Bonus.

It is also a loss to small and medium size businesses (which mostly don't exist in mining) to lose:

- the enhanced capital allowances for small business
- the loss carry-back provisions (that would help a firm survive a tough year or two by enabling losses to be claimed against tax paid in previous years, rather than only carried forward).

It is also disappointing that increases in the mandatory superannuation contributions have been postponed by two years. Given that this measure was not actually related to Government expenditures (except insofar as it is an employer) it is particularly disappointing that the measure has been proposed as part of the MRRT repeal.

The correct use of mining industry tax revenues

It is well-known that resource rent taxes are a volatile form of revenue for government. The amounts raised will vary a great deal from year to year, and will vary more than industry revenue. The tax is designed that way – when profits are high the tax revenue is high, while in the downturn phases of the industry cycle the tax raised will be low when profits are low.

The volatility of the revenue stream poses special challenges for government budgets. It is unwise for governments to plan budget expenditures that might consume all or most of the revenue from a resource rent tax. The expenditures may be constant but the revenues won't be.

This is one reason for setting aside a large proportion of any resource rent tax into a Sovereign Wealth Fund or similar mechanism. The goal is to enable revenue flows to be evened out across the mineral commodities price cycle so that government expenditures are not adversely affected.

The other reason for establishing an SWF or similar is for reasons of intergenerational equity. Australia's mineral resources are extensive, but they are finite. And they will become progressively more difficult to extract as they deplete.

It is only legitimate to "use up" a public asset if it is replaced by other assets. With respect to mineral resources that are a natural asset belonging to the Australian people, this means that natural assets below the ground should be turned into perpetual financial assets above the ground.

An SWF will hold and grow financial assets for future generations, so that they too may benefit from Australia's mineral resources.

This is exactly what the Sovereign Wealth Funds operated by the Norwegian Government achieve. The two funds operated under The Government Pension Fund of Norway have around US\$780 billion under management – originally derived from resource rent taxation of North Sea oil and gas but now generating large returns in their own right. This is a substantial asset for a nation of just 5 million people.

Whether it is via resource rent taxation or simply the use of company tax revenues, Australia has not effectively managed its returns from the resources boom. One reason for Australia's structural budget problems was the series of income tax cuts carried out in the last decade (by both LNP and Labor governments) that relied in part on higher company tax payments during the resources boom. The company tax payments from resources (and other) companies have now fallen but the income tax cuts remain in place.

This has been a major public policy failure. Repealing the MRRT – actually abolishing the mechanism by which Australia's natural resources can be managed for future generations – perpetuates and magnifies that failure.

The Minerals Resource Rent Tax is flawed. But it is unquestionably a step in the right direction for the efficient, effective and equitable taxation of minerals extraction. The MRRT should be fixed, not abolished.