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TREASURY EXECUTIVE MIN

Minute No.

2 July 2010

Deputy Prime Minister and Treasurer

cc: Secretary to the Treasury
Executive Director, Revenue Group

MINERAL RESOURCE RENT TAX (MRRT) - MARKET VALUATION OF MINING PROJECTS

Timing: For information

Recommendation/Issue:

- That you note the issues that will be involved in working out the market value of a mining project for the purposes of the MRRT and that those issues will be examined by the Policy Transition Group (PTG).

Noted Signature:.. ...../...../2010

KEY POINTS

- The MRRT announced today provides an option for taxpayers with existing iron ore and coal projects to use a market valuation of project assets for their starting base.
  - If that option is chosen, the market value of the assets is deducted over their effective life (or 25 years if shorter).
  - The starting base under this option will include the value of the resources *in situ*, which could find its way into the valuation of a range of project assets (such as earthworks and mining rights).
- A key issue is when and how market value will be determined. That will be an issue to be examined by the PTG established by the Government and to be led by the Minister for Resources and Energy and Mr Don Argus AC.
- Market valuation of existing iron ore and coal projects will be a complex exercise.
  - The compliance costs to industry of this approach would be significantly higher than using accounting book value (although it is likely that they will be more than compensated for this cost by the increased starting base).
- There are a range of market valuation methodologies available; what is appropriate depends on the nature of the asset being valued.
  - Guidelines would be required, although these could draw on the existing "*Market valuation for tax purposes*" guidelines prepared by the ATO for the consolidation regime (implemented in 2002 and 2003). Those guidelines set out various methodologies for valuing, and allocating value to, assets and businesses.

- Those existing guidelines will need to be tailored to the mining industry. The tailored guidelines will need to be available by mid 2011 in order to allow a reasonable period for the valuation to be complete by 1 July 2012.

- Examples of methodologies that may be appropriate for valuing intangible assets in a project are:
  - An income based approach (using a capitalisation of net income or discounted cash flow method).
  - Market capitalisation of a mining firm, stripping out downstream and overseas asset values and values of tangible project assets.

- For a project's tangible assets, examples of methodologies are:
  - Depreciated replacement cost, which requires a calculation of replacement value less an allowance for any age or obsolescence. It may be appropriate to use insurance values as the replacement value.
  - A disposal of surplus assets approach, which assumes an auction of the asset for its realisable value less the costs of sale. This method would only be appropriate for assets with a deep market (like some motor vehicles).

- There will be significant risks for the integrity of the MRRT under the market valuation approach.
  - The approach will create strong incentives for mining companies to inflate the recorded value of their assets to be included in the starting base.
  - Strong incentives will also exist to push the value implicit in the resources towards assets with shorter effective lives (like earthworks) rather than to those with longer effective lives (like mining rights).

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