Australian Government

The Treasury

Resource tax issues

A presentation to the Treasurer
14 March 2010

(14)

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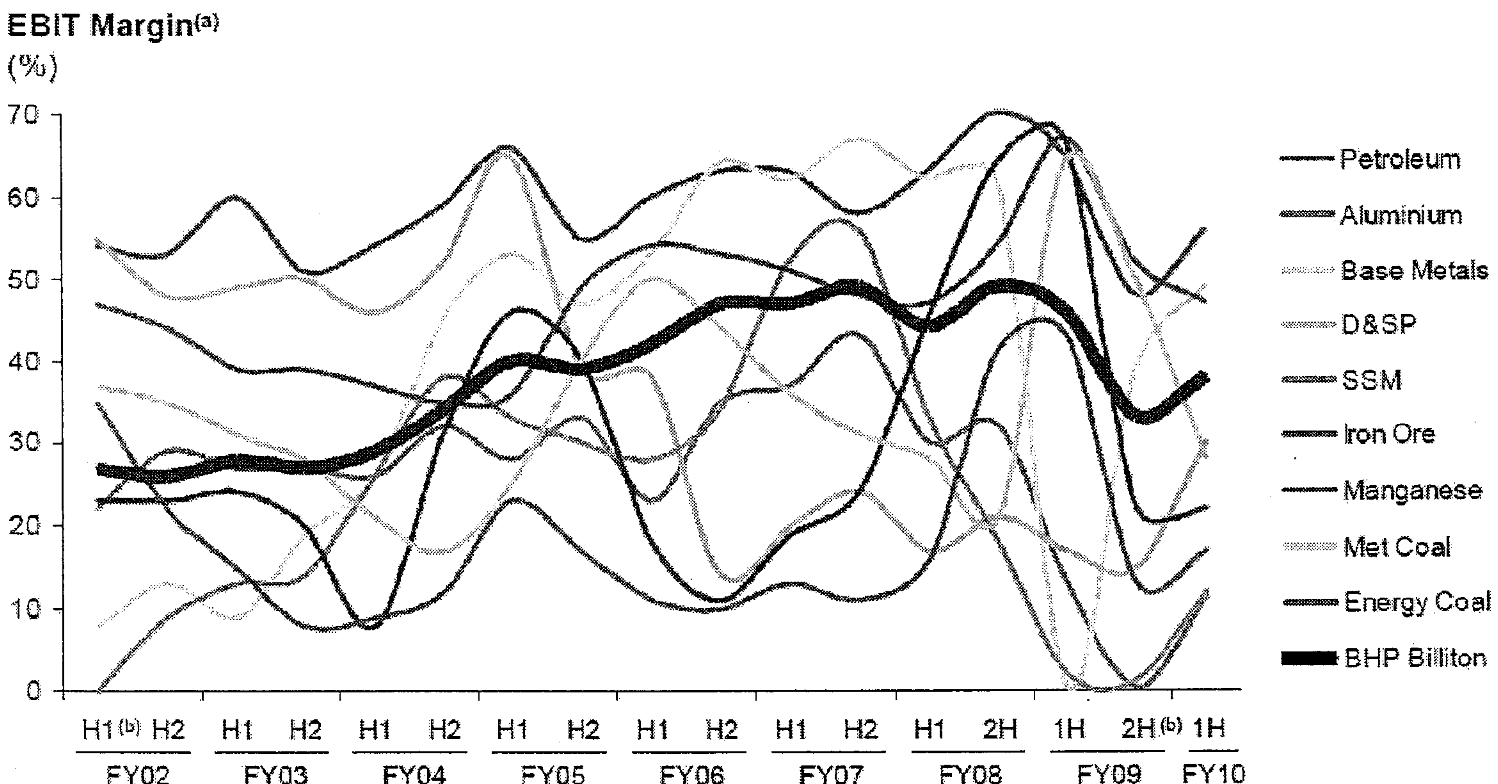
2 major resource players

- BHP Billiton & Rio significant across several industries
- Other players tend to be more specialised

Company	Iron Ore	Black Coal	Bauxite	Nickel Ore	Copper Ore	Uranium	Gold	Oil and Gas
BHP Billiton Ltd	**42.0**	**16.0**	**18.0**	**51.0**	**20.0**	**40.0**		**19.0**
Rio Tinto Ltd	**53.0**	**7.8**	**34.0**		**3.0**			
Woodside Petroleum								14.5
Santos Ltd								8.5
Shell Energy								7.0
ExxonMobil								7.8
Alcoa			45.0					
Energy Resources						**51.0***		
Xstrata		9.5			28.0			
Newcrest Mining					13.0		22.0	
Minara				20.0				
Barrick							26.0	
Newmont							18.0	
Other	5.0	66.7	3.0	29.0	36.0	9.0	34.0	43.2

* Substantially owned by Rio Tinto

Industry gross margins are volatile



(a) Calculated on the basis of UKGAAP for periods prior to FY05, except for the exclusion of PRT from Petroleum's and BHP Billiton Group's results for all periods. All periods exclude third party trading activities. The Exploration and Technology business has been included in BHP Billiton Group's results from FY02 to FY05 and excluded from Diamonds and Speciality Products.

(b) Negative margins are not shown as the y-axis is set at zero. SSM had a negative EBIT margin in H1 FY02, both Base Metals and SSM had negative EBIT margins in H1 FY09 and both Aluminium and SSM had negative EBIT margins in H2 09.

Source: BHP Interim Results for fiscal year 2010, 31 December 2009.

Industry gross margins are volatile

- RPT liabilities correlated with gross margins
  - An important feature for small players
- Volatility lower for large diversified producers
  - Will pay more tax in the current price environment
- Revenue could be more variable than under existing taxes
  - If circumstances were similar to the late 90s then there would be little, if any, additional revenue raised above what would have been raised from existing state royalties

Large producers will pay more

- BHP Billiton and Rio Tinto have business models based on investing in large long-term low-cost mines

	BHP Billiton		Rio Tinto	
Commodity	Australian % of BHP Billiton global prod'n	Gross margin (a)	Australian % of Rio Tinto global prod'n (vol)	Gross margin (a)
Oil & gas	57	57	-	-
Iron ore	93	62	93	33
Metallurgical coal	100	58	100	21
Thermal coal	17	22	15	
Uranium	100	18	57	
Base metals	16-99 (b)		0-5	30
Alumina	67	5 (c)	90	-5 (c)
Nickel	71	-36 (d)	-	-
Cobalt	100		-	-
Manganese	*0*	*53*	-	-
Diamonds	*0*	*16*	72	31 (e)

(a) Underlying EBIT/Revenue. Underlying EBIT is EBIT less abnormals.
(b) Includes copper (16%), zinc (34%), gold (38%), silver (83%), lead (99%).
(c) Gross margin includes aluminium production. (d) Gross margin for stainless steel production.
(e) Includes titanium and borate minerals.

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Commodity prices up in 2010*

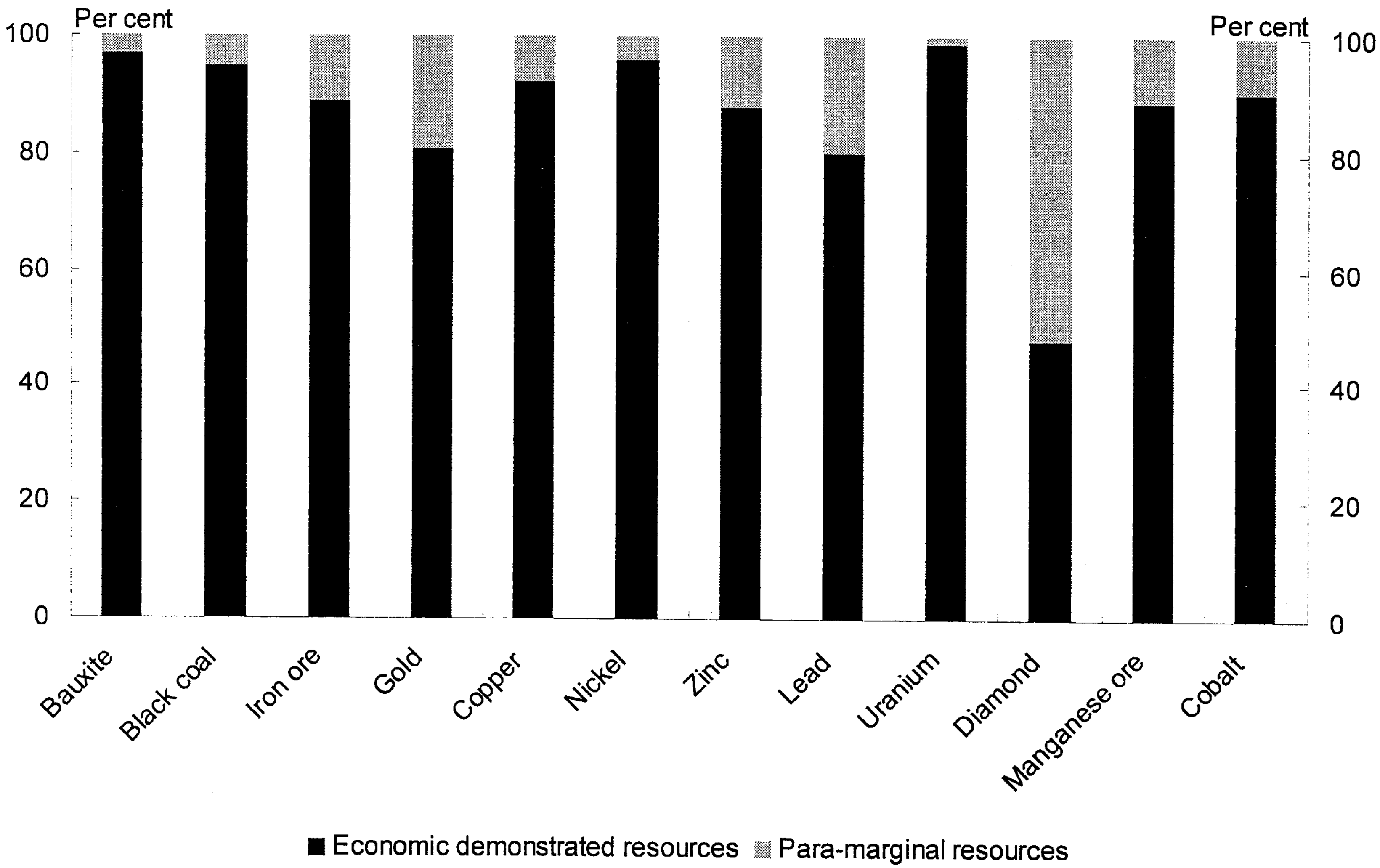
Commodity	Change in price (%)
Oil	34.9
Gold	8.6
Aluminium	18.0
Alumina	27.6
Nickel	26.7
Copper	32.6
Zinc	29.2

*Source: ABARE

Lots of planned investment

- Some projects may not proceed as planned
  - Removing royalties will make marginal reserves economic

Increased economic resources



Royalties have increased with prices

- Queensland

  2000 – removed coal royalty concessions

  2002 – transport deductions denied for coal royalty calculations

  2008 – 2nd tier added to coal royalty @ 10% above $100/t

  – increases in a range of other royalties

- NSW

  2008 – coal royalties up 1.2%pts + transport deductions denied

- Western Australia

  2000 – changes to the structure of royalty rates for base metals

  2005 – increased flat rate royalties on construction materials and metallurgical content

  2010 – removal of Pilbara iron ore concession ($300m+)

  – possible increase in gold royalties (?)

Key considerations

- How much revenue is required for other initiatives?
  - when is this revenue required?
- How much revenue is available for States?
- How much should be spent on bringing existing projects into RPT?

Key pressure points

- **Transitioning existing projects into RPT**
- Managing the States
- Pressure to increase uplift rate

Key judgement

- The urgency of collecting revenue and the desired amount of revenue needs to be decided
- The faster and harder existing projects are transitioned into the RPT, the faster and greater revenue collections will be
- However, a quick transition reduces acceptability

Transitioning existing projects

- The key to smoothing the transition will be to minimise the impact on earnings over the first 3-5 years
- Can be achieved by an initial contribution
  - some uncertainty but moves to RPT from day 1
- Alternative is a 'opt in' process
  - certainty but maintains royalties with associated economic costs

Transitioning existing projects into RPT

- An initial government contribution could reduce the impact of RPT on firms over the first 3 to 5 years
  - there is no ‘right’ amount of contribution and firms will always ask for more
  - the size of the initial contribution can be adjusted
- An option is to replicate the outcome had the RPT existed for some time
  - this contribution could be made available in the first year or possibly the first 3 years
- There are a range of alternatives

Opting in

- For first 5 years, firms could choose irrevocably
  - to be included in the RPT regime; or
  - remain under existing royalty arrangements
- Royalties would increase substantially every year for firms under the existing system, including over the two years between announcement and commencement
- After 5 years, all firms would be in RPT

Key pressure points

- Transitioning existing projects into RPT
- **Managing the States**
- Pressure to increase uplift rate

Managing the States

- A mix of mechanisms can be used but will need to aligned

- The preferred outcome needs to be defined
  - the mechanism to achieve this outcome can then be determined

Possible option

- A principle that no State would be worse off compared to current royalty projections
- Additionally, provide an incentive (maybe an ongoing) payment to large resource States
- Mechanism to protect States during downturns while providing benefits during upswings.

Key considerations

1. State agreement not required to start RPT, however the objective is to remove royalties
2. The offer could consist of:

   S47B exemption

   – possibly link funding to remove bad state taxes
3. Transition path could leave States in at least the same position with some extra for the resource States

Key considerations

4. Risk sharing arrangements

   - S 47 B exemption

5. Horizontal Fiscal Equalisation implications
   - some States will want at least some of the revenue quarantined from HFE
   - need to take account of Health changes

Key pressure points

- Managing the States
- Transitioning existing projects into RPT
- **Pressure to increase uplift rate**

Pressure to increase uplift rate

- Uplift rate preserves the value of the government's delayed guaranteed contribution

- The uplift rate reflects the risk that government will not provide its contribution
  - bond rate is a reasonable approximation for this risk
  - however, the technical characteristics are different from a bond

Pressure to increase uplift rate

- A firms hurdle rate or cost of capital are not appropriate
  - the risk of default is with the government not the project
  - these rates reflect project risk rather than risk that government does not pay its contribution
- The proposed 40% tax rate accounts for the bond rate as the appropriate uplift rate
  - increasing the uplift rate would mean revisiting tax rate