(16)

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S22 exemption

From: McDonald, Hamish
Sent: Wednesday, 17 March 2010 10:24 AM
To: McDonald, Hamish; Davis, Graeme; Hazlehurst, David; McCullough, Paul; Fitzpatrick, Mandy; Parker, David; Ray, Nigel
Cc: Jacobs, Martin
Subject: RE: Updated paper [~~SEC=PROTECTED~~]

Sorry,

Attached is a slightly updated version – Martin and I thought that it would be useful to add to the worked examples, to show how royalties work by comparison to RSPT (and also royalty crediting and transition options).

It would be good if you could in particular check this on p29-30.

Cheers,
Hamish

From: McDonald, Hamish
Sent: Wednesday, 17 March 2010 10:13 AM
To: Graeme Davis (Davis, Graeme); David Hazlehurst; Paul McCullough (McCullough, Paul); Fitzpatrick, Mandy; David Parker; Nigel Ray (Nigel.Ray@treasury.gov.au)
Cc: Jacobs, Martin
Subject: Updated paper ~~[SEC=PROTECTED]~~

Hi,

Attached is an updated paper..

Cheers,
Hamish

S 22 exemption

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Forward tax agenda

Tsr's Office, 16 March 2010

Overview

This paper looks at key decision points and handling strategies for a forward tax agenda.

A. Schematic of design questions

S 22 exemption

D. RSPT Design question 1: coverage of the RSPT

E. RSPT Design question 2: interaction of the RSPT with state royalties

F. RSPT Design question 3: a deal for the states

S22 exemption

K. RSPT handling strategy 3: dealing with the states

S 22 exemption

S 22 exemption

All in with credit for existing projects	5 year phase in with capped liability
• All projects included, existing projects get a credit for past investments • Default credit could be broadly equal to the undepreciated tax value of the investments • Provide a softer transition through a more generous credit (eg closer to market value rather than tax value)	• All projects included, existing projects get a credit for past investments • Default credit could be broadly equal to the undepreciated tax value of the investments • Provide a softer transition by capping RSPT liabilities in the first 5 years

RSPT design question 2: Design question 2: Interaction of the RSPT with state royalties

Replaces state royalties from day one	Initially bolted on top of royalties, with an offer to the states to replace their royalties	Permanently bolted on top of royalties
• States must remove their royalties from day one	• Design RSPT to co-exist with state royalties • make an offer to the states to remove their royalties	• Design RSPT to co-exist with state royalties • No offer to the states to remove their royalties

S 47B exemption

S22 exemption

P 5 - 8 S 22 exemption

D. RSPT design question 1: coverage of the RSPT

There are different options for which projects the RSPT might cover - these are listed below with the highest return options at the top, and the lower return ones towards the bottom.

- We recommend further consideration of options 1 and 2.
- The choice between these options (ie how big a transition credit to provide to existing projects) boils down to how much we want to use the reform to fund. Spending on additional transition credits will reduce spending available on other items (Section G draws the different spending priorities together).

Option	Description	Comments
1. All in with a credit for existing investments	Include all projects from the start. Existing projects get a credit broadly equal to the tax value of their assets. Providing a larger credit (for example closer to market value) would create a softer transition.	With a credit broadly equal to the tax value of assets, this generates: • Around $10b revenue from 13-14. • Overall share price effect could be 10-15% on major miners (see below) A larger credit would: • Reduce the revenue • Reduce the share price impact in proportion with the smaller revenue impact
2. All in with a credit for existing investments and a 5 year capped liability	Include all projects from the start. Existing projects get a credit broadly equal to the tax value of their assets. The additional tax liability for existing projects would be capped over the first 5 years	The cap on tax liability would: • Reduce revenues over the first 5 years • Mitigate some of the share price impact and company concerns over the change.
3. Opt in arrangements	Include new projects from the start. Existing projects have a period where they can choose whether to be in the new regime or remain under royalties	• Likely to generate no net revenue (and quite possibly negative net revenue) for the length of the transition. Effectively pays out revenue to the firms that would win under an RSPT, without getting extra revenue from any firm that would lose. • Administrative complexity for firms having to calculate their outcome under both regimes, in order to make their choice • Likely to result in parallel systems for a significant period of time
4. Include only greenfields and brownfields extensions	Include new projects and extensions to existing projects from the start.	• Not clear if this is administratively viable • Comment from one resource company is this would be workable • However, it would be difficult to distinguish between revenues and operating costs from new investment and old investment, and probably impossible to validate.
5. Include only greenfields projects	Only include new projects. All existing projects grandfathered.	An RSPT with this restriction would not be worth doing. • Excluding existing projects would create large distortions to choices about whether to expand existing mines rather than exploit new deposits, which could significantly detract from productivity. Some mines may last for 100 years or more (eg Olympic Dam). • This would also create significant extra complexity for firms, at the boundary of new projects and extensions to existing projects.

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P 12 - S 47 B exemption

F. RSPT design question 3: a deal for the states

Attributes of an offer

S47B exemption

> The offer:
> - Means no states are worse off compared to their projected royalty revenue at existing royalty rates (and GST interactions) into the future;
> -
> - protects states during resource downturns while also providing them some of the benefits during upswings

- This means that the offer might be thought of conceptually as having two components:
  - A "cash out" component, which is designed to mimic the projections of existing royalties and put states in the same position as they would have been with no change (including CGC interactions).

S47B exemption

P 14-16 - S47B exemption

P17-26 - S22 / S47B exemption

K. RSPT handling strategy 3: dealing with the states

Front foot strategy

- S47 B exemption
- This offer will mean no states are worse off compared to their projected royalty receipts into the future.

S47B exemption

- We will protect states during resource downturns and provide them with extra benefits during booms
- State Premiers should not stand in the way of their states benefitting from these changes.

Defensive strategies

S22 exemption

S47 B exemption

S22 exemption

S47B exemption.

P 28 - 30 - S22 exemption

Illustrative worked example of a resource profits tax on different hypothetical resource projects

No tax

	High profit project	Marginal project	Loss project
	$m	$m	$m
Annual Sales	150	80	25
Less Annual Operating Costs	30	30	30
Profit	**120**	**50**	**(5)**
Total tax liability	0	0	0

Royalties

	High profit project	Marginal project	Loss project
	$m	$m	$m
Annual Sales	150	80	25
Royalties[(a)]	16	9	3
Less Annual Operating Costs	30	30	30
Profit	**104**	**41**	**(8)**
Total tax liability	16	9	3

(a) Royalties set at 11% of sale price. This matches the total $28 m of revenue raised by the resource rent tax, below

Resource rent tax

	High profit project	Marginal project	Loss project
	$m	$m	$m
Annual Sales	150	80	25
Less Annual Operating Costs	30	30	30
Profit	**120**	**50**	**(5)**
Less Interest allowance for undeducted capital[(a)]	50	50	50
Profit/loss subject to resource tax	**70**	**0**	**(55)**
Resource tax liability (assuming 40 per cent rate)	28	0[(b)]	(22)[(c)]

(a) The allowance is based on an assumed $1 billion of undeducted capital costs multiplied by the government's long term bond rate of 5 per cent.
(b) The resource tax does not impact on the marginal company's viability. By contrast, a royalty regime does reduce the viability of a marginal project..
(c)The company would carry forward a $55m loss (with interest allowance), which is worth $22m in tax terms, to reduce future resource liabilities. If the company never makes a profit and exits the resource sector, it would be refunded unclaimed costs and receive a payment from the government equivalent to $22m ($55m * 0.4), uplifted by the annual interest allowance.

Resource rent tax and royalty crediting

	High profit project $m	Marginal project $m	Loss project $m
Annual Sales	150	80	25
Less Annual Operating Costs	30	30	30
Profit	**120**	**50**	**(5)**
Less Interest allowance for undeducted capital[a]	50	50	50
Profit/loss subject to resource tax	**70**	**0**	**(55)**
Gross resource tax liability	28	0	(22)
Royalty payment to States [a]	**16**	**9**	**3**
Credit for royalties paid against resource tax	-16	(9)	(3)
Net resource tax liability	**12**	**(9)** [c]	**(25)** [c]
Net tax paid	28	0	(22)

(a) Royalties set at 11% of sale price – ie 11% of annual sales (as in example above). Royalties paid don't feed into profit and loss calculation for resource rent tax purposes

(b) The allowance is based on an assumed $1 billion of undeducted capital costs multiplied by the government's long term bond rate of 5 per cent.

(c) The company pays $9m in royalties, but also carries forward a $9m tax credit for royalties paid, which is refundable if the company winds up before making a profit.

(c)The company would carry forward a $55m loss (with interest allowance), which is worth $22m in tax terms, to reduce future resource liabilities. If the company never makes a profit and exits the resource sector, it would be refunded unclaimed costs and receive a payment from the government equivalent to $22m ($55m * 0.4), uplifted by the annual interest allowance. Company also carries forward a $3m tax credit for royalties paid, which is also refundable if the company winds up before making a profit.

Resource rent tax – more generous transition

	High profit project $m	Marginal project $m	Loss project $m
Annual Sales	150	80	25
Less Annual Operating Costs	30	30	30
Profit	**120**	**50**	**(5)**
Less Interest allowance for undeducted capital[a]	100	100	100
Profit/loss subject to resource tax	**20**	**(50)**	**(105)**
Resource tax liability (assuming 40 per cent rate)	8	(20)[b]	(75)[c]

(a) The allowance is based on an assumed $1 billion of undeducted capital costs multiplied by the government's long term bond rate of 5 per cent.

(b) The company would carry forward a $20m loss (with interest allowance) to reduce future resource liabilities. If the company never makes a profit and exits the resource sector, it would be refunded unclaimed costs and receive a payment from the government equivalent to $20m ($50m * 0.4), uplifted by the annual interest allowance.

(c)The company would carry forward a $75m loss (with interest allowance) to reduce future resource liabilities. If the company never makes a profit and exits the resource sector, it would be refunded unclaimed costs and receive a payment from the government equivalent to $42m ($105m * 0.4), uplifted by the annual interest allowance.

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S 22 exemption

Key design elements

Key design elements of the proposed RSPT are:

- A 40% rate
- Using the **government bond rate for the interest uplift** factor
- proposed **coverage be for all resources** (noting AFTS recommended excluding low rent resources) but leave room for consultation on style of carve out from the regime eg exclude some minerals or simplify the treatment for small players
- **losses** from resource projects would be both **transferable against profits from another project** by the owners **and ultimately losses are refundable**
- **apply the regime in parallel to existing state royalties** but provide entities with a refundable credit against RPT liability for any government royalties paid by them
- **all existing projects to be brought into the system** with consultation on the recognition of costs incurred prior to announcement by the private producers - these costs would not be transferable or refundable once the new regime is running. Important the costs recognised at their value at the time of announcement to address integrity issues.
- Revenue and project impacts have been conducted on the basis of **tax values being used to recognise prior costs**
- Costs incurred from announcement but prior to commencement of the new regime to have the same treatment as costs incurred post commencement to avoid distorting investment decisions (ie transferable and refundable)
- regime will only **apply at the actual private producer level** and not at the investor level eg at the company/trust level and not at the shareholder/beneficiary level
- the **reduction in company tax rate** linked to introduction of resource tax regime with initial reduction
- **likely to commence from 1 July 2012** at the earliest.

S 22 exemption

S 22 exemption