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TREASURY EXECUTIVE MINUTE

Minute No. 20121024

19 April 2012

Assistant Treasurer, Minister Assisting for Deregulation

cc: Deputy Prime Minister and Treasurer

MEETING WITH BHP BILLITON'S CHIEF FINANCIAL OFFICER ON 23 APRIL 2012

Timing: Your office has requested this briefing by 19 April 2012, in preparation for your attendance at a meeting with BHP Billiton's Chief Financial Officer on 23 April 2012.

Recommendation/Issue: That you note this briefing on tax policy issues that may be relevant to BHP Billiton.

Noted Signature: ..../...../2012

KEY POINTS

- You are scheduled to meet with Mr Graham Kerr, recently appointed Chief Financial Officer of BHP Billiton, on 23 April 2012.
  - Background information about BHP Billiton and biographical details for Mr Kerr are provided at Additional Information
- Mr Kerr has requested this meeting to introduce himself and to discuss a range of tax policy issues. Briefings on the following issues are attached:
  - Retrospective application of transfer pricing rules – see Attachment A;
  - Business Tax Working Group – see Attachment B;
  - Tax deductibility of overburden removal – see Attachment C; and
  - Ensuring the effective operation of Part IVA – see Attachment D.
- The following areas have been consulted in the preparation of this minute: International Tax and Treaties Division, Business Tax Division and Industry, Environment and Defence Division.

Contact Officer: Ext:

Manager
Business Tax Working Group Secretariat

ADDITIONAL INFORMATION

Mr Graham Kerr

- Graham Kerr was appointed Chief Financial Officer of the BHP Billiton Group in November 2011. Since joining the Group in 1994, he has worked in a wide range of finance, treasury and operational roles and has held positions as the President of Diamonds and Specialty Products, Chief Financial Officer of Stainless Steel Materials, Vice President Finance – BHP Billiton Diamonds and Finance Director for EKATI.
  - In 2004, Graham left BHP Billiton for a two year period when he was General Manager Commercial for Iluka Resources Ltd.

BHP Billiton

- BHP Billiton is the world's largest diversified natural resources company; and is among the world's largest producers of major commodities including aluminium, copper, energy coal, iron ore, manganese, metallurgical coal, nickel, silver and titanium minerals, uranium; and also has substantial interests in oil and gas.

Recent projects and financial performance

- In 2010-11, BHP approved development of US$12.9 billion (BHP's share) worth of projects of which around US$10.6 billion are in Australia.
- BHP's financial performance remains strong, with profit around US$10 billion in the six months to December 2011.
  - Sales revenue for the half-year ended 31 December 2011 increased on the equivalent prior year period by 9.7 per cent to US$37.5 billion
    - This was mainly due to record Western Australian Iron Ore production and stronger bulk commodity and petroleum products prices.
  - BHP's after-tax profit over the same period decreased by 5.5 per cent to US$9.9 billion. The decrease was caused by a combination of:
    - temporary reduction in production at several of BHP's leading businesses (flooding effects at Queensland Coal; and industrial action and lower grade copper in Chile);
    - underlying cost pressures (especially increased labour and contractor costs); and
    - higher income taxation expenses in Australia.

Mineral Resource Rent Tax (MRRT) and Petroleum Resource Rent Tax (PRRT)

- From 1 July 2012, the MRRT will apply to the mining of iron ore and coal in Australia. The existing PRRT will be extended to include all onshore and offshore projects involving both oil and gas production.
  - The MRRT will apply to coal and iron ore. The MRRT will have a headline rate of 30 per cent.
    - : The MRRT will provide a full credit for state royalties paid.
    - : Taxpayers with profits of less than $75 million per annum will be excluded from the MRRT.
  - The PRRT will be extended to include all onshore and offshore oil and gas projects. The PRRT tax rate is 40 per cent.
- The Australian Government will shortly be consulting on a series of minor technical amendments to the MRRT and PRRT through the Resource Tax Implementation Group with a view to introducing the amendments in the upcoming winter sittings.
  - The amendments are minor in nature and remedy technical errors with the operation of the Bills.
- The MRRT and PRRT Bills have been developed in partnership with the resource sector through one of the most comprehensive stakeholder consultation processes undertaken. BHP was an active participant in all aspects of the consultation process.
  - BHP met with the Policy Transition Group during the policy design phase.
  - BHP has a direct representative on the Resource Tax Implementation Group and provided detailed technical comments on the MRRT exposure draft.
- BHP has made minimal public comments on the MRRT or PRRT. These taxation measures were not in recent analyst briefings and have not been mentioned in recent presentations.

Carbon pricing

- BHP Billiton is expected to be a liable entity under the Carbon Pricing Mechanism. BHP is likely to be eligible for assistance under the Jobs and Competitiveness Program, Coal Sector Jobs Package and Coal Mining Abatement Technology Support Package.
- In 2010, BHP's Chief Executive Officer, Marius Kloppers, called on Australia to take a global lead on pricing carbon. He has since criticised the Government's climate change policy for the lack of compensation for trade-exposed industries, particularly coal and LNG.

ATTACHMENT A

RETROSPECTIVE APPLICATION OF TRANSFER PRICING RULES

ISSUE

- Mr Kerr may wish to discuss the retrospective nature of recent Government announcements and legislation, such as proposed backdated changes to the transfer pricing rules.

KEY POINTS

- On 1 November 2011, the Government announced a review of Australia's transfer pricing laws to align with international best practice as set out by the Organisation for Economic Co-operation and Development (OECD). This would include retrospective amendments to confirm that international transfer pricing rules in Australia's tax treaties, and incorporated into our domestic law, provide assessment authority for treaty-related transfer pricing dealings.

- Since retrospective amendments to the tax laws can affect the pre-existing rights of taxpayers, the Government typically introduces such amendments only where they are required to clarify the intent of the law and either:

  - the amendments favour the taxpayer; or

  - an existing issue poses a significant threat to the revenue base.

- Several factors led to the Government's announcement to review Australia's transfer pricing laws, including the 1 June 2011 decision of the Full Federal Court in *Commissioner of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74. The proposed amendments will have two components:

  - a prospective modernisation of domestic transfer pricing rules to align with the OECD; and

  - backdated amendments to confirm that international transfer pricing rules in our tax treaties provide assessment authority for treaty-related transfer pricing dealings. These amendments will apply in treaty cases for income years commencing on or after 1 July 2004.

- The backdated changes to the transfer pricing regime will affect only those taxpayers who have not applied the treaty rules in place for all relevant years, and similarly have not applied the law consistently with the Australian Taxation Office's (ATO's) longstanding guidance.

  - The ATO's view of the law has been further supported by detailed analysis from Queen's Counsel and former Federal Court Judge, Mr Ron Merkel.

  - However, some multinationals and their advisers have adopted a contrary view of the law.

- There can be no doubt that, based on the supporting materials to the relevant provisions, the law was intended to apply in this way since as far back as 1982.

- Numerous later parliamentary documents, also on the public record, document that the legislature has held and reinforced this view under successive governments.

- These foreshadowed reforms have potential application to about $270 billion in related party dealings each year, or approximately 50 per cent of total trade flows. Revenue risks were a prominent consideration in developing these rules.

  - Having said that, the intention (as explained in the 2011-12 Mid-Year Economic and Fiscal Outlook) is only to protect current revenue, and not to generate additional flows.

SUGGESTED SPEAKING POINTS

- The Government normally introduces backdated legislation only if it benefits taxpayers or if there is a significant threat to the revenue base where it is necessary to clarify the Government's policy intent and the amendment favours the taxpayer or there is a significant threat to the revenue base.

  - Numerous documents, all of which are on the public record, clearly demonstrate that the legislature understood the law to be effective in enabling the treaty to be relied upon to provide separate liability provisions.

- I note that these proposed retrospective changes affect only those taxpayers who have not applied the tax treaty rules in place for all relevant income years, and similarly have not applied the law consistent with longstanding ATO guidance.

- Importantly, the threat to the revenue base is very real. Transfer pricing rules potentially apply to about $270 billion in related party dealings each income year, or about half of total trade flows.

- An important thing to remember is that these amendments protect current revenue – they do not create a new revenue base.

- I note that some have put forward suggestions on introducing time limits and de minimus rules as part of the transfer pricing reform. Treasury is considering these suggestions as part of the prospective transfer pricing legislative amendments.

Contacts: (Transfer pricing)
(Retrospectivity)

ATTACHMENT B

BUSINESS TAX WORKING GROUP

ISSUE

- The Business Tax Working Group's (Working Group) final report on the tax treatment of losses was released on 13 April 2012.
  - The Working Group considers that further analysis and consultation is required before any conclusions can be drawn about savings options that might offset the cost of reforms to the tax treatment of losses (recommendation 1).
  - However, the Working Group considers that loss carry back would be a worthwhile reform in the near term and recommends a model involving a two year carry back period for companies only (recommendation 2).
  - The Working Group has also recommended that the Government, as a matter of priority, should undertake further work to develop a model for reforming the same business test (recommendation 3).
- In releasing the report, the Treasurer welcomed the opportunity for further discussion and public debate about business tax reform but did not comment on how or when the Government will respond to the Working Group's recommendations.
- The Working Group will now turn its focus to possible longer term reforms to the business tax system with a final report due to the Treasurer in December 2012.

KEY POINTS

- The Treasurer established the Working Group in October 2011 to look at how the business tax system can be improved to support businesses responding to the challenges and opportunities presented by a changing economy.
  - The Working Group is required to identify savings from within the business tax system or business expenditure programs to offset the cost of any recommendations it makes to the Treasurer.
  - The Working Group is chaired by Mr Chris Jordan (also the Chair of the Board of Taxation) with other members drawn from business groups, the tax advisory profession, academia and the union movement.
- The Treasurer asked the Working Group to focus initially on possible changes to the tax treatment of losses before moving on to possible longer term reform directions for the business tax system.

Interim report on the tax treatment of losses

- An interim report on the tax treatment of losses was submitted to the Treasurer and publicly released in December 2011.
  - That report discussed possible reforms including loss carry back, changes to the loss integrity measures and applying an uplift factor to losses as they are carried forward. It did not discuss how such reforms might be paid for.

Consultation

- Having considered the 24 submissions received on the interim report, the Working Group undertook a further round of targeted, confidential consultation on specific reform proposals and possible offsetting savings.
  - BHP Billiton did not make a submission on the interim report. However, a submission was received from the Corporate Tax Association (CTA) of which BHP Billiton is a member.
  - Consultation meetings were held in Melbourne, Sydney, Brisbane and Perth over the course of March 2012. Meetings with interested CTA members (but not BHP Billiton) were held in each of those locations.
- Prior to the release of the final report, the Working Group's savings options received significant media coverage, particularly in relation to the mining industry. Of specific concern was the elimination of deductions for exploration and prospecting and changes to accelerated depreciation allowances for industries including petroleum, oil and gas.
- The Minerals Council of Australia (MCA), of which BHP Billiton is also a member, wrote a letter to the Chair on 9 March 2012, calling for public consultation on savings options.
  - Mr Jordan responded on 12 April 2012, explaining the rationale for the Working Group's approach to consultation and noting the various opportunities to engage with the Working Group that had been made available to the MCA and its members.
- The MCA have publicly criticised the Working Group for considering savings options that are significant to the mining industry particularly in light of the imminent commencement of the Minerals Resource Rent Tax and carbon pricing mechanism.
  - The MCA have also commented on the lack of certainty surrounding the Working Group's recommendations of savings options, finding resulting speculation in the media and within industries as damaging and unnecessary.
- On 19 April 2012, representatives of BHP Billiton (Christian Bennet – Vice President, Government Relations and Chen Leong – Vice President, Tax Asia Pacific) met with Revenue Group's Executive Director, Rob Heferen, who is also a member of the Working Group.
  - BHP Billiton were seeking an update on the activities of the Working Group and also expressed interest in the preparation of the forthcoming 2012-13 Budget.

Final report on the tax treatment of losses

- The Working Group's final report on the tax treatment of losses contains three recommendations.
  - The Working Group has recommended that the Government undertake further analysis and consultation before deciding whether or not to proceed with the savings options identified in the report (recommendation 1). (This approach has generally been welcomed by stakeholders concerned about the process so far.)
    - Specifically, the Working Group identified removing statutory effective life caps for certain assets, removing the immediate deduction for certain expenditure on exploration and prospecting, amending the R&D non-refundable tax incentive and tightening Australia's thin capitalisation rules as potential savings options.
  - The Working Group also gave its support for loss carry back and set out a preferred model for its implementation (recommendation 2).
    - Under the Working Group's preferred model, loss carry back would be limited to companies with a two year carry back period on an ongoing basis but phased in from 2013-14 with an initial one year carry back period.
    - The amount of the losses that could be carried back would be capped at not less than $1 million (limiting refunds to no more than $290,000 assuming a 29 per cent tax rate). The amount of any refund under loss carry back would also be limited to a company's franking account balance.
  - The Working Group also recommended that the Government undertake further analysis with a view to reforming the same business test which currently limits access to company tax losses following a change in majority ownership (recommendation 3).
    - The final report discusses a number of potential approaches to reforming the same business test including a modified 'predominantly the same' test or replacing the test with a statutory drip-feed mechanism.

Next steps for the Working Group

- The Working Group will now focus on longer term reform directions for the business tax system with a final report due to the Treasurer in December 2012. This will conclude the Working Group's activities.
  - The Treasurer has asked the Working Group to consider two possible directions: a further reduction in the corporate tax rate (that is, the continuation of 'broad base low rate' model) or moving towards a business expenditure tax, particularly an allowance for corporate equity.
  - The Working Group will conduct further consultation as part of its consideration of these alternatives models and how any specific recommendations (such as a company tax rate cut) might be paid for.

SUGGESTED SPEAKING POINT

- The Government welcomes the Business Tax Working Group's final report on the tax treatment of losses and looks forward to continuing the public debate about how we might reform the business tax system so that it better supports Australian businesses seeking to innovate and invest for the future.

- However, business tax reform needs to be considered alongside the Government's commitment to fiscal responsibility. That is why we have asked the Working Group to identify savings to offset the cost of any reforms it recommends. We hope that the result will be reforms that are worthwhile in principle and affordable in the current tight fiscal environment.

- I hope that BHP will engage constructively with the Working Group, either directly or through its membership with the MCA and CTA, as it moves on to consider longer term reform directions for the business tax system.

Contact:

ATTACHMENT C

TAX DEDUCTIBILITY OF OVERBURDEN REMOVAL

ISSUE

- There has been public speculation that the Government may be considering changes to the tax deductibility of overburden removal.
- Recent press reports identify BHP Billiton as one of the taxpayers likely to be affected by any such change, particularly in respect of its Olympic Dam mine (Australian Financial Review, *Cut tax breaks at our peril: miners*, 19 April 2012).

KEY POINTS

- Overburden is the largely worthless rock that, in the context of open pit mining, is removed to expose and mine the ore body.
  - Higher prices for minerals have made it more lucrative for mining companies to look for ore bodies at greater depths than was previously considered viable.
- In 1995, the Australian Taxation Office (ATO) issued a public ruling (TR 95/36) that, in open pit mines, the cost of overburden removal is a revenue expense and hence immediately deductible (except where associated with the construction of haulage roads).
- Section 38

SUGGESTED SPEAKING POINTS

- I would encourage any taxpayer concerned about the application of the law to their particular circumstances to seek the advice of the ATO.

Contact:

ATTACHMENT D

ENSURING THE EFFECTIVE OPERATION OF PART IVA

ISSUE

- Representatives from BHP may wish to discuss the scope of the Government's proposed amendments to Part IVA of the *Income Tax Assessment Act 1936* (Part IVA), and the potential for uncertainty until these amendments are finalised.

KEY POINTS

- Part IVA is fundamental to the integrity of the tax system. It is designed to counter schemes that comply with the technical requirements of the tax law, including the ordinary provisions and specific anti-avoidance provisions, but that, when viewed objectively, are conducted or carried out in a particular way primarily to avoid tax.
  - For Part IVA to operate there must be a 'scheme' and a 'tax benefit' obtained in connection with the scheme, and it must be reasonable to conclude that a person entered into the scheme for the 'sole or dominant purpose' of enabling a taxpayer to obtain the 'tax benefit'. If these conditions are satisfied, the Commissioner of Taxation (Commissioner) may cancel any 'tax benefit' obtained through the scheme.
- Recent court decisions that have been adverse to the Commissioner suggest that there is a technical deficiency in the way in which Part IVA seeks to determine whether or not a taxpayer has obtained a 'tax benefit' in connection with a scheme. This deficiency has the potential to undermine the effective operation of Part IVA.
- On 24 February 2012, Treasury and Australian Taxation Office (ATO) officers met with industry representatives to further discuss the policy intent behind Part IVA, and the possible need for amendments to ensure its ongoing effectiveness.
  - The representatives agreed with the policy intent of Part IVA, as set out by Treasury in a paper circulated before the meeting. However, the representatives considered that the current law gives effect to that policy intent, so no amendments are required.
  - They also considered that the amendments proposed to clarify the operation of Part IVA, which were broadly outlined in the Treasury paper, would not harm its effectiveness.
- On 1 March 2012, the Government announced that it would act to protect the integrity of the law by clarifying that:
  - it is not sufficient for a taxpayer to establish that they have not obtained a 'tax benefit' for the purposes of Part IVA by simply arguing that without the tax advantage of the scheme, they would not have entered into an arrangement that attracted tax; and
  - Part IVA can apply to steps within broader commercial arrangements, where the steps have been implemented in a particular way so as to avoid tax.
- The proposed amendments will apply to schemes entered into or carried out after 1 March 2012.

  - This application date minimises any potential for taxpayers to obtain unintended tax advantages in the period before the amendments become law.

- Treasury is currently consulting with independent experts about how best to implement the proposed clarifications, without unintentionally affecting genuine commercial and business activities.

- Following this, Treasury will hold a roundtable discussion with interested stakeholders to canvass the different options for implementing the Government's announced clarifications to Part IVA.

SUGGESTED SPEAKING POINTS

- The Government understands that the operation of Part IVA is a particularly sensitive area of the income tax law. This is why the Government is obtaining advice from independent experts about how best to implement its announced changes, in addition to its normal consultation processes.

- The Government is aware that some tax advisers consider the application of Part IVA will remain uncertain until the Government introduces legislation to implement its announced changes.

- While there may be some uncertainty surrounding the term 'tax benefit' in the interim, this should only be an issue for those taxpayers that have entered into a scheme with the dominant purpose of avoiding tax.

- The Government does not propose to change the operation of the purpose test in Part IVA, which was designed to be the key determinant of whether the Part applies to a scheme.

- The announced start date for these changes is necessary as it minimises the potential for taxpayers to obtain unintended tax advantages in the period before the amendments become law.

Contact: