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From: Francis, Geoff
Sent: Thursday, 6 May 2010 2:02 PM
To: McDonald, Hamish; Rueckert, Michelle; Dickinson, Howard
Cc: Winters, Tracey; Jacobs, Martin; Barrett, Chris (Treasurer's Office); Taylor, Steven; Johnson, Shane
Subject: RE: Query - RSPT treatment of interest expenses [SEC=UNCLASSIFIED]

Hamish

some advice on why interest and other financing costs are not deductible for RSPT purposes.

Regards

Geoff

From: McDonald, Hamish
Sent: Thursday, 6 May 2010 12:25 PM
To: Francis, Geoff; Rueckert, Michelle; Dickinson, Howard
Cc: Winters, Tracey; Jacobs, Martin; Barrett, Chris (Treasurer's Office)
Subject: Query - RSPT treatment of interest expenses [SEC=UNCLASSIFIED]

Hi,
I think there is some real progress being made in building people's understanding of the RSPT. The broad design is really getting better understanding - of a Brown tax, with some deferral of the Government 40% contribution, and using the long term bond rate uplift on that contribution to compensate for the deferral. Minister Ferguson's office are doing a bunch of communications with miners, and putting across the point that the uplift factor is not meant to be some sort of estimate of their WACC, it is compensation for the deferral of the government contribution.

But we have been receiving a lot of queries from miners about the treatment of interest expenses in the RSPT.

The question we are getting is about the treatment of interest expenses. Miners are saying that interest expenses are not deductible. They are also saying that this is the wrong treatment - these are legitimate financing costs and should be taken out of profits. They point to the fact that their interest financing costs are typically at rates of 9% or even higher, and say that it is wrong if these costs are not excluded from the profit calculation. At one level you could think of this as us saying "you must lend to us at the bond rate, but we know your borrowings are at a higher rate".

So two questions:

1. Are interest expenses deductible for the calculation of RSPT profits?
2. If interest expenses are not deductible, can we please have the explanation as to why this is correct? or is it a problem?

If we could get an answer on these fairly swiftly, it would be most appreciated.

Cheers,
Hamish

Why are interest and other financing costs not deductible for RSPT purposes?

Interest expenses are not deductible under RSPT to provide neutrality between equity and debt financing. This is the same as for the PRRT and other cash flow taxes such as GST.

- It means the project interest derives the same RSPT profit (rent) irrespective of the financing used by the owner of the project interest.

The RSPT is designed to tax the rent on the project. Financing arrangements lead to a third party providing a portion of the capital required to develop a project in return for an interest payment. This interest payment is in effect a portion of the rents from the projects that relate to the supply of capital. If interest expenses were deductible it would lead to a portion of the rents generated by the project not being subject to RSPT.

Under company tax interest expenses are deductible to those paying and then form part of assessable income to those that receive them, resulting in no change to the tax base. However if a deduction was provided under RSPT, the party receiving the interest payment would not be assessed for RSPT and therefore the tax base for RSPT purposes is reduced.

Possible talking points

- The RSPT taxes the economic rents associated with the exploitation of Australia's non-renewable resources irrespective of the form of financing. It therefore does not allow for a deduction of interest or any other financing costs incurred at the investor level.
- Under the RSPT all forms of finance are treated the same (unlike company tax). This is the same as the PRRT and other cash flow taxes such as GST.
- If interest were deductible under the RSPT it would bias financing decisions toward debt. To prevent this interest income would need to be taxable at the RSPT rate in the hands of the lender.
- It is also worth noting that under existing royalty arrangements, financing costs including interest, are not deductible.