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TREASURY EXECUTIVE MINUTE

Minute No.

7 May 2010

Treasurer

QUESTIONS REGARDING THE RESOURCE SUPER PROFITS TAX (RSPT)

Timing: Can be used immediately.

Recommendation/Issue:

- That you note this briefing when responding to questions regarding the RSPT.

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

KEY POINTS

- On 6 May 2010 your office requested explanatory material to assist in responding to questions regarding the proposed RSPT. Some questions and answers are contained in Attachment A.

Geoff Francis

Geoff Francis
Principal Adviser
Business Tax Division

Contact Officer: Geoff Francis Ext: 2456

ATTACHMENT A

RSPT QUESTIONS AND ANSWERS

Q: Miners are already heavily taxed. Why should they have to pay more than other sectors.

Mining inherently involves the extraction of community owned non-renewable resources, so it is appropriate that the community receives an additional return from mining above those taxes that generally apply to businesses, such as company tax.

- Good governments do not give away publicly owned resources for free, whether that be land, spectrum, forestry or other publicly owned resources, simply because a company pays company tax.

Q: The RSPT is now a triple tax on mining, after royalties and company tax.

Under the RSPT, firms will receive a refundable tax credit for royalties paid. That is, firms will be able to reduce RSPT liability dollar for dollar for royalties paid. If royalty payments are higher than the RSPT liability in any year, firms will get a cash refund for the difference.

- This removes the tax effect of royalties, while allowing the States to keep their existing royalties.

The RSPT will be deductible for company income tax purposes. This means the combined effective rate of taxation is at most 56.8 per cent (once the company income tax cut is fully in place). Only projects earning extremely high returns would be paying close to this rate.

Where firms have lower profit levels the effective tax rate will be lower, as shown below for some illustrative projects returns.

Project Return	**Approximate effective rate of tax** (combined effect of company tax plus RSPT based on a bond rate of 6 per cent)
Government bond rate (6 per cent)	28 per cent (ie company tax rate)
15 per cent	45 per cent
30 per cent	51 per cent
50 per cent	53.3 per cent

The above rates do not place any value on the refundability provisions of the tax, and hence they overstate the effective tax rate.

Comparisons of headline rates to other countries can be misleading, as most resource tax regimes do not include refundability of losses. Refundability of losses will be of significant value to new resource projects, as it lowers their risk, particularly for smaller miners.

Q: The RSPT is not a tax on super profits.

Unlike the company income tax system, which only allows capital to be depreciated against its historical cost, the RSPT applies an interest allowance (uplift) to undepreciated capital maintaining its value over time – this provides effectively the same treatment as if the capital expenditure was immediately expensed.

Because the company income tax system depreciates capital according to its historic cost, the time delay means that it taxes the normal return to capital. That is, it taxes normal profits.

Because the RSPT applies an interest allowance (uplift) to undepreciated capital and other unutilised expenses it avoids taxing the normal return. That is, it is only taxing revenue less expenses, where those expenses have their real value maintained over time.

Key features are provided within the RSPT to enable expenses to be deducted even when there is no tax payable.

- Transferability of losses to other profitable projects within a company group is one means by which losses can be utilised immediately.
- Refundability of expenses at the RSPT rate ensures that, in the event that expenses can not be deducted or transferred, the firm will still receive the tax benefit.

Q: The government bond rate is too low for an interest allowance under the RSPT. The PRRT has a higher uplift rate (bond rate plus 5).

It is true that the PRRT offers a higher uplift rate but, because unutilised expenses are neither transferable nor refundable, there is no guarantee that a firm will ever be able to use those losses.

Under the RSPT, all expenses are guaranteed to be able to be used for tax purposes. Transferability and refundability ensures that. As expenses are guaranteed by the Government to be able to be utilised, it is appropriate to grow those expenses by the long term government bond rate.

- The firm's cost of capital is not an appropriate interest allowance as this captures firm and project risk, e.g. that the firm or project will fail. This is independent of the ability to be able to utilise expense deductions.

Q: It is unfair to apply the RSPT retrospectively to mining investments undertaken in good faith.

Existing projects will be transitioned into the scheme by being given a starting base, which recognises the book value of their existing investments. The starting base can be deducted against RSPT liability. The starting base will not be transferable or refundable.

Accelerated depreciation will be provided for the starting base allowing it to be fully used within the first five years of the tax. This will provide a significant cash flow benefit for resource firms during the early years of the scheme.

Q: This RSPT differs from the one proposed by AFTS.

The RSPT differs from AFTS in two respects.

First, it includes all minerals, whereas AFTS has proposed excluding some, such as sand and gravel.

- It is important to include low value added and low profit minerals which are subject to royalties as these are the most likely to benefit from the RSPT. They will have their royalties refunded, and if they are genuinely low profit would not pay RSPT.

- The consultation process could result in the exclusion of some minerals/activities where there is no net benefit to society from their inclusion.

Second, projects within the scope of the PRRT can continue to remain within the PRRT unless they elect to move into the RSPT.

Q: The RSPT is taxing risk. People who take risks and are rewarded should not have to pay an extra tax.

The RSPT does not tax risk. It lowers risk by providing transferability and refundability of losses. In effect, a new project has only 60 per cent of its capital at risk and therefore receives 60 per cent of the profit.

- As the Government is underwriting 40 per cent of the risk, it takes 40 per cent of the profits.

This is not a new feature of the tax system. Other parts of the tax system already offer refundability.

The R&D rebate and the new resource exploration rebate also refunds losses, giving the same treatment to smaller companies that is available to big companies, who already can access those losses by deducting against profits from other parts of their business.

Through consolidation a company can transfer losses from one project to another for income tax purposes, thus effectively getting tax back on failed projects.

Q: Will the RSPT cause electricity prices to rise.

The RSPT is a tax on profits. As such it should not affect the prices at which gas and coal are sold into the domestic market.

Coal fired electricity stations use low value coal, not the high quality coal that is currently being exported at prices in excess of $100 tonne. As a result, producers have lower profit margins and it is therefore unlikely that there will be significant rent in these inputs.

Coal and gas are currently subject to royalties, so the RSPT would have to increase coal and gas prices by more than this before there would be any impact on the cost of electricity generation or retail gas.

- If royalties were higher than the RSPT liability, the RSPT could see electricity prices fall.

But suppose there is a net increase in the price of coal or gas used in electricity generation. Energy costs account for up to 30 per cent of the cost of producing electricity but less than 10 per cent of retail electricity prices. So, a 10 per cent increase in the cost of coal inputs would result in an increase of less than 1 per cent in the retail price of electricity.

Wholesale gas prices account for around 20 per cent of residential prices so a 10 per cent increase in that price would result in an increase in residential gas prices of around 2 per cent.