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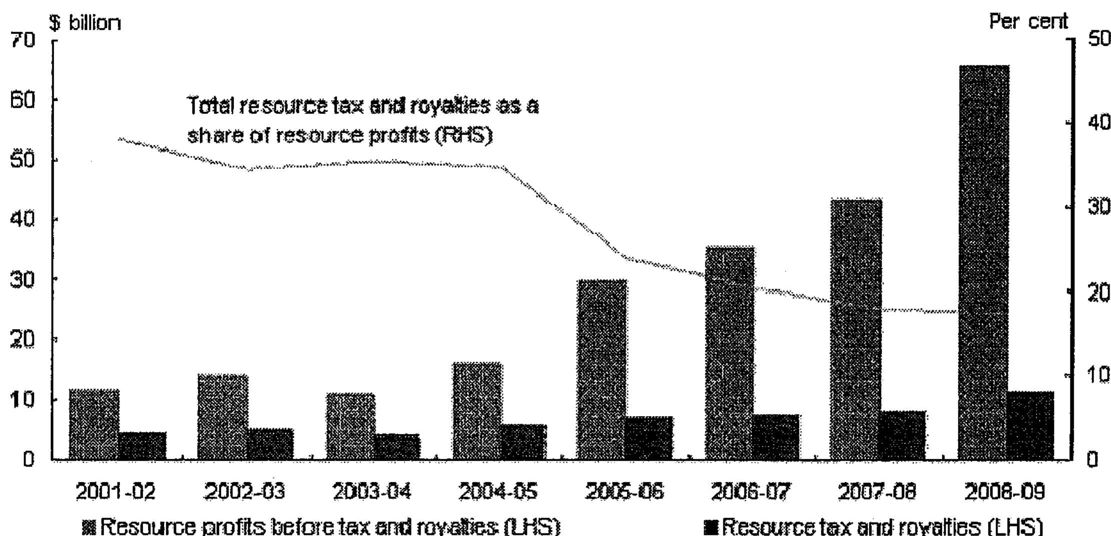
Resource Super Profits Tax

PMO and TO, 10 February 2010

Current Royalty Regime

- Mining companies pay both the company tax rate of 30 per cent and extra taxes on resources.
- The tax regime for resources depends on whether the mining project is onshore or offshore.
  - If onshore, the company is subject to State royalty regimes. If offshore, the company is generally subject to the Australian Government's petroleum resource rent tax.
- The State royalty regimes are largely charged on a volume basis, such as a certain dollar amount per ton of resource extracted or recovered.
- This means that current resource taxes are largely unresponsive to changes in profit, especially during commodity booms. They pick up profits from quantity increases, but do not pick up profits from price increases.
  - States sometimes increase royalties during booms, but this is often too late to pick up much of the boom. Frequent changes to royalties are bad for sovereign risk, so the more the States do this, the more they are likely to discourage potential new investment.
- Existing resource taxes and royalties have collected a declining share of the return to resources over the recent period of increasing profitability in the resource sector.

Existing taxes are inefficient and unresponsive



*Resource profits before tax and royalties are measured using income less an allowance for corporate capital. Chart includes resource specific taxes only (i.e. excludes company tax).

- Royalties also distort investment decisions. By charging a fixed rate to every mine, they increase the hurdle rate of return that a prospective mine needs to generate to be viable. This means some mines do not get developed that would be viable in the absence of royalties.
  - This can also mean mines close earlier, when price expectations fall or when deposits have reached a mature, more-costly stage.

Proposed Resource Super Profits Tax

- A single resource super profits tax at a rate that gives an effective tax rate of 55 per cent on super profits earned by companies.
  - The AFTS report recommended an RSPT rate of 40 per cent of super profits. This was based on the company tax rate being lowered to 25 per cent. With RSPT payments being tax deductible for the purposes of income tax assessment, RSPT would be 30 per cent of super profits after tax. Combined

with the 25 per cent income tax, the total amount of tax on super profits would be 55 per cent of super profits earned by companies.

- The AFTS report recommends preserving this overall RSPT plus income tax proportion of super profits. It included a formula for deriving the RSPT rate at different income tax rates.

- The starting point would be to include all mining operations in the RSPT, with the tax imposed at the project rather than company level.
  - AFTS recommends excluding low profit resources (e.g. cement mines). Treasury suggest considering a position where all resources are included by default, but there is scope to exclude mines on the basis of low profit compared to the compliance costs of the RSPT.
- The RSPT would be consistent with current international trends in resource charging in developed countries. The most relevant comparison is Norway, as it is also a developed economy with significant resources.
  - Norway's petroleum tax system approximates a rent based tax. Though based on its company income tax system, it utilises an uplift on expenditure to exempt the normal return and reimburses the tax value of exploration expenditure for companies in a loss position. Norway imposes a total tax rate on resource rents of 78 per cent, consisting of a 50 per cent rent based tax rate and company income tax of 28 per cent, with no deduction at the company tax level for the rent based tax paid.
  - A sensitivity is the fact that Norway places revenues from petroleum into a sovereign wealth fund.

States and Territories

- State royalties are overwhelmingly raised by Queensland (40.6%) and Western Australia (38.5%).
- However, redistribution of revenue under Horizontal Fiscal Equalisation means that in the medium term, the revenues are shared much more evenly between the States.
  - Currently all State resource royalties are taken into account in the Commonwealth Grants Commission (CGC) process consistent with the principle of horizontal fiscal equalisation.
  - The CGC takes into account mining royalties when working out the formula for redistributing GST revenue between the States. The CGC assesses the royalty revenue each State could raise from mining if it made the Australian average effort. (Note that data lags and averaging in the process mean that if a State increases the rate of its royalty taxes, it takes about 7 years for the process to fully account for the change through the CGC formulas for GST revenue).
  - Of the approximately 70 project payments from the Commonwealth to the States in 2008-09, only 4 were quarantined from the CGC process.

Current royalties and resource taxes, GST shares, and impacts of revenue proposals

	Royalty revenue		GST share
	$m est, 2008-09	% of states 2008-09	% of states 2009-10
NSW	1,279	15.4%	30.2%
Vic	50	0.6%	22.8%
Qld	3,365	40.6%	18.5%
WA[1]	3,191	38.5%	8.1%
SA	142	1.7%	9.2%
Tas	30	0.4%	3.7%
ACT	0	0.0%	2.0%
NT[1]	229	2.8%	5.4%
Total states	**8,287**	**100%**	**100%**
Commonwealth[2]	**3,895**		

- The preferred position would be for the RSPT system to replace the various systems of State and Territory royalties. However, in order to stage the difficult parts of the RSPT process, it might be best to initially introduce the RSPT to operate alongside the State royalties.
  - This will allow us to put the tax in place before negotiating a new intergovernmental agreement, but would not preclude us from offering additional payments. By negotiating at a later date, it means that we do not have to add this dimension when we will already be defending the tax from claims by the mining sector.
  - Resource companies will not face double tax as they will receive a credit for the royalties against the RSPT. Providing the credit for State royalties, effectively removes them from the calculations for new resource projects. Thus, simply providing a credit can achieve the efficiency benefits of the RSPT (without the removal of royalties).
- Allowing the RSPT to initially operate alongside State royalties will mean States will not be made worse off.
  - In fact, the more efficient RSPT will encourage investment and production which will mean higher royalties revenues and more GST revenues (from the boost to economic growth).

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Companies

- Many exploration companies should be winners.
  - The RSPT taxes marginal projects less than current royalties, which means more marginal projects become viable to keep operating.
  - The RSPT taxes high-profit projects more than current royalties, but these are nevertheless viable to develop.
  - Exploration companies also benefit from the proposed resource exploration rebate. Currently, small exploration companies have to wait until they make a profit, before realising the value of the deductions associated with their exploration. The rebate will provide immediate recognition of the deductions. The rebate is in lieu of the election commitment to introduce a flow through share

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