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9 June 2010

Treasurer

BRIEFING ON FORTESCUE METALS GROUP LIMITED

Timing: Urgent.

Recommendation/Issue:

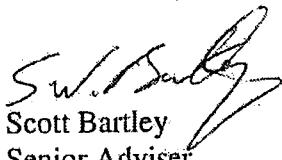
- That you note the attached briefing.

Noted

Signature:/...../2010

KEY POINTS

- Your office requested a background briefing on Fortescue Metals Group Limited.
- The Resource Tax Consultation Panel Secretariat spoke with participants from Fortescue Metals Group Limited on 11 May 2010.
 - Background information on Fortescue Metals Group Limited and key issues from this discussion are provided at Attachment A.
- The Resource Tax Consultation Panel met with Fortescue Metals Group Limited on 12 May 2010.
 - The minutes from this meeting are provided at Attachment B.


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Panel Brief:
Fortescue Metals Group

KEY ISSUES RAISED DURING THE MEETING WITH THE SECRETARIAT

- During the discussion with the Fortescue participants (Julian Tapp and Deidre Willmott) some familiar company perspectives emerged:
 - The long term bond rate is insufficient to compensate companies for the delayed tax relief for capital expenditure and operating losses;
 - Refundability is likely to be of little value to financiers since the probability of making a negative return is very low; and
 - Shareholders of mining companies are not in the business of investing in low risk/low return assets.
- However, they agreed that a cash flow tax would be efficient, as the pre-tax and post-tax rate of return would be equivalent, and that the same outcome could be achieved if it were possible for a company to divest itself of the deferred tax asset at the bond rate.
 - The Secretariat considers that it is possible to create a marketable security from the deferred tax asset that could be intermediated by the finance market at a relatively low margin. Given the right uplift rate, companies might be able to assign such assets to financiers at face value as a repayment of credit.
- A second key concern is the uncertainty about the taxing point. Much of the capital invested in Fortescue's mining operations is in processing ore and transporting it to port. The participants indicated a preference for a taxing point prior to any processing activity, including on-site processing (similar to the in-principle position in the Announcement Paper).
 - However, they seemed open to the idea of including downstream infrastructure if the tax were to operate as a cash flow tax, noting that infrastructure assets are lower risk / lower return.
 - Fortescue would have little starting capital unless their processing and downstream assets are included. As their investment is relatively recent, they would be able to bring most of that value into the RSPT as starting capital if a downstream taxing point were chosen.
- A third concern is the potential implication of the RSPT for the financing of mine expansions. They were more concerned about these implications when iron ore prices return to 'normal levels', as post RSPT cash flows will still be significant at current iron ore prices.
 - The low level of capital invested in resource extraction (pre-processing) means that Fortescue would have the benefit only a small capital shield if the taxing point were set prior to any processing.
 - They noted that the RSPT is a better tax when prices are low.

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P3 - exempt under s 45, s 47(1)(b) + s 22

P4 - P12 - s 22 exemption