Minerals Council of Australia

27 February 2012

The General Manager
Tax System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Tax Laws Amendment (2012 Measures No. 2) Bill 2012: miscellaneous amendments to the taxation laws:

Submission by the Minerals Council of Australia

Dear Sir/Madam

In submissions on the Minerals Resource Rent Tax (MRRT), the Minerals Council of Australia (MCA) has emphasised consistently the importance of close and effective consultation between government and industry representatives through the legislative drafting and implementation processes.

Following the introduction of the MRRT Bill 2011 and related bills into the Australian Parliament in November 2011, the MCA noted that "with certain caveats" the bills represented a workable basis for implementation of the MRRT in line with the agreement made by the Australian Government with major mining companies in July 2010, as modified by the recommendations of the Government's Policy Transition Group. An important caveat related to the fact that the legislation would have benefited from more extensive consultation through the Resource Tax Implementation Group (RTIG) so as to identify potential errors or unintended consequences.

Subsequently, industry representatives – following a detailed review of both the MRRT Bill and the related Explanatory Memorandum (EM) – have identified areas where the Bill and explanatory material contained errors and/or were in need of technical corrections to ensure they operate in accordance with the policy intent. While some of these issues were highlighted in consultations with Treasury in November 2011, a more complete outline of issues was forwarded to Treasury by RTIG members Anthony Portas and Brian Purdy on 7 February 2012 (see Attachment A).

In this context, the MCA welcomes the Treasurer's stated intention on behalf of the Government (in a letter to the MCA Chief Executive Officer dated 16 December 2011) to address necessary corrections in the first available Tax Laws Amendment Bill in 2012 and that Treasury "will continue to consult with the Resource Tax Implementation Group on any technical clarifications that may be needed".

The MCA notes that the Treasurer's letter did not address required changes to the original EM. While a small number of issues raised by industry representatives have been addressed subsequently in the amended EM introduced into the Senate on 7 February 2012, it is expected that further changes to the original EM will be needed as part of the process of "technical clarification".

Given that we understand the Australian Taxation Office (ATO) will also be bringing forward proposed technical amendments it is important that the Government ensure industry (preferably via the RTIG) is involved in evaluating all such proposals. We would urge the Government to clarify at an early stage the process whereby further technical issues relating to both the legislation and the original EM can be dealt with.

WALTER TURNBULL BUILDING
LEVEL THREE
44 SYDNEY AVENUE FORREST CANBERRA ACT 2603
PO BOX 4497 KINGSTON ACT 2604
TELEPHONE: + 61 2 6233 0600
FACSIMILE: + 61 2 6233 0699
WEB: www.minerals.org.au
EMAIL: info@minerals.org.au
ABN 21 191 309 229

Tax Laws Amendment (2012 Measures No. 2) Bill 2012: miscellaneous amendments to the taxation laws

The exposure draft legislation of "Tax Laws Amendment (2012 Measures No. 2) Bill 2012: miscellaneous amendments to the taxation laws" released on 13 February 2012 includes amendments, mostly to the MRRT legislation. It is stated by Treasury that "amendments seek to ensure the law operates as intended by correcting technical or drafting defects, removing anomalies and addressing unintended outcomes. The amendments are part of the Government's commitment to the care and maintenance of the taxation laws."

- ***Starting base losses – incomplete definition***

Industry representatives in November 2011 identified the unintended consequence whereby the original MRRT Bill did not achieve indexation of starting base losses based on the Consumer Price Index (CPI) – under the market value method for valuing and depreciating starting base. Accordingly, the MCA supports proposed amendments to give effect to the policy intent on indexation of starting base losses.

- ***Other amendments***

With the exception of the one item mentioned below, we do not have any objection to the other proposed amendments.

Subsection 30-25(5)

Section 30-25(5) is the provision which contains the 'safe harbour' methodology for the calculation of MRRT revenue, using the 'net-back' methodology. It has been amended based on a concern of Treasury regarding the perceived potential for double counting of downstream costs in the netback methodology (refer explanation in Amended EM paragraph 1.23). However, the amendment has been made in such a way that it could now be interpreted as disallowing a single counting of downstream costs in some circumstances. We discuss this below, together with a proposed solution.

The final paragraph of the amended version of subsection 30-25(5) states:

> *"However, the costs mentioned in paragraph (a) of this subsection only include costs to the extent that they reasonably relate to the *mining revenue event."*

The original paragraph of the House of Representatives version of subsection 30-25(5) stated (with the underlined words those that have been removed):

> *"However, the costs mentioned in paragraph (a) of this subsection only include costs to the extent that they reasonably relate to the *taxable resource in relation to which the *mining revenue event happens."*

The wording of the amended paragraph may create ambiguity in situations where a miner incurs expenditure on a periodic basis, regardless of whether production – and therefore mining revenue events – are occurring (e.g. take or pay contracts for rail and port capacity). This is because the paragraph may be read to require a direct nexus between a particular cost and a particular mining revenue event for the amount to be take into account in calculating the mining revenue using the safe harbour net back calculation method. This could create an anomalous outcome that is inconsistent with MRRT principles, as it may disallow appropriate downstream costs from the safe harbour netback calculations.

The use of the word 'reasonably' may alleviate this risk, as a reasonable person may form the opinion that such costs are incurred in order to secure certain services for the entire year, regardless of usage. If that argument is correct then the costs would relate to all mining revenue events that occur in a given MRRT year.

Industry recommends that in order to remove the ambiguity from subsection 30-25(5), a further example be included in the EM to the amendments (after Example 1.2) to the effect that situations may exist where costs incurred over the course of a MRRT year may relate to all mining revenue events that occur during that MRRT year and are able to be apportioned against all mining revenue events in calculating the mining revenue for that year. This can be explained in the following example:

> *Continuing from the two previous examples, assume that Schofield has contracted with a third party, Railway, on a take or pay basis to provide rail services in order to transport the coal from its coal mine to its power station. Schofield is applying the safe harbour method in calculating its mining revenue.*
>
> *Due to a flood, the coal mine owned by Schofield is unable to produce coal for a period of months during the MRRT year. During this period, Schofield continues to pay Railway in accordance with its take or pay obligations, in order to secure its rail services for when the mine recommences production.*
>
> *In calculating its mining revenue for the MRRT year, Schofield would determine the total payments to Railways under the take or pay contract for the year, and apportion them across all mining revenue events for that year. The fact that there were no coal sales during the period of the flood stoppage does not mean that the payments to Railway during that period do not 'reasonably' relate to the other mining revenue events during the year.*

The Minerals Council of Australia is happy to discuss any of the issues raised above. Should you wish to do so, please contact John Kunkel, Director – Economics and Taxation (02/6233 0649) in the first instance.

Yours sincerely

John Kunkel
Director – Economics and Taxation

Attachment A

ERRORS IDENTIFIED BY MINING INDUSTRY REPRESENTATIVES IN MRRT LEGISLATION AND EXPLANATORY MEMORANDUM: SUBMISSION TO TREASURY FEBRUARY 2012

1. MRRT Legislation

a) Starting Base Losses

It appears that the current drafting does not actually permit the CPI indexation of starting base losses. This could possibly even lead to all carried forward starting base losses being eliminated (on the basis that they are indexed by multiplying by zero, and hence become zero). This arises because the relevant MRRT section links to the wrong ITAA definition, or alternatively an ITAA amendment needed to link the relevant provisions has not been included in CATP. The logic is as follows:

- The starting point is s80-45(1)(b) of the MRRT Bill which is applied to determine the CPI uplift factor for carried forward starting base losses, where the market value approach has been chosen. The formula makes reference to '**index numbers**'.

- Division 300 of the MRRT Bill provides that the term 'index number' has the meaning given in s995-1(1) of the ITAA 1997. The s995-1(1) definition then points to s960-265, which is essentially a table listing 13 items. Pursuant to the s995-1(1) definition, if the amount relates to items 8 – 12 in the s960-265 table, then the index number has the meaning given in s960-285, and if the amount relates to another provision in the s260-265 table, then the index number has the meaning given in s960-280. Accordingly, if there is no item in that list in respect of MRRT, then you don't appear to get an index number. MRRT is not in the list, and there does not appear to be a CATP amendment to add it to the list.

- Paragraph 7.50 of the EM states that the uplift factor that applies where the market valuation approach that has been chosen is *"the CPI for the previous year ending 31 March. The CPI is expressed in the same way as in subsection 960-275(1) of the ITAA 1997".*

- S960-275(1) of the ITAA 1997 states that *"for indexation of amounts on an annual basis, the indexation factor is...."* and then provides the exact same formula that is shown at s80-45(1)(b) of the MRRT bill. Accordingly, it is correct to say that s80-45(1)(b) operates in the same way as s960-275(1), but only if the MRRT formula works. Both formulas require an 'index number' to operate, and as noted above there does not appear to be an index number for the MRRT provision.

- We can't find any section in the MRRT (Consequential Amendments & Transitional Provisions) Bill which amends the s960-265 table to include amounts indexed under the MRRT Bill and the section pointed to by paragraph 7.50 of the EM doesn't provide a definition of index number either. This means there is effectively no definition of 'index number' to apply to the formula provided in Division 80 of the MRRT Bill, which creates

uncertainty with regard to the source of the index numbers. It probably means they are nil, which would then eliminate any carry-forward starting base losses.

If you agree with the analysis, the easiest way to fix it would be to either:

- Amend the MRRT s300 definition of 'index number' to point directly to s960-280 ITAA 1997, rather than to s995. That way you go directly to the section which has the index numbers and do not need to reference the table in s960-265; or
- Keep the MRRT s300 definition, but amend the table in s960-265 to include MRRT as an item in that table.

b) S35-50(a) Financing Costs

This paragraph includes expenditure in 'excluded expenditure' to the extent that it relates to an arrangement that gives rise to a financial arrangement. Finance and operating leases and hire purchase arrangements will generally be financial arrangements. Section 35-55 deals with leasing and hire purchase arrangements. Section 35-50 should be amended to include a subsection (2), to provide that (new) subsection (1) does not apply to financial arrangements that are lease or hire purchase arrangements.

c) Starting base allowance for interim expenditure incurred during 2 May 2010 and 30 June 2012

The starting base value of a starting base asset is determined as the sum of the market value of the asset on 1 May 2010 and the sum of the amounts of interim expenditure incurred in relation to the asset. [section 90-40]

Interim expenditure includes the cost or cost base of an asset where the entity **incurs** the amount during the relevant period being:

(i) if the entity held the asset at all times between 2 May 2010 and 30 June 2012, the period is 2 May 2010 to 30 June 2012.
(ii) otherwise, the period starts on the first day the entity held the asset and ends on 30 June 2012. [section 90-55]

For capital assets, an entity may incur the expenditure before it "holds" the asset. For example, an entity may enter into a contract and make payment to purchase an asset with ownership passing on delivery. If delivery occurs after the contract is entered into, such expenditure would not meet the requirements in section 90-55 and would not qualify as interim expenditure (i.e. the expenditure is incurred before the first day that the entity held the asset). A technical correction is therefore required to the legislation to ensure that this expenditure is not excluded due to the time periods listed in section 90-55.

d) Application of grouping provisions for the purposes of the Low Profits Offset and Simplified MRRT to State Owned Enterprises

The low profits offset rule and the eligibility for the simplified MRRT method operate on a "grouping" basis. An entity includes a body politic. Accordingly, certain state owned enterprises may have their projects grouped together in determining their eligibility for these concessions.

This may be the case even where the relevant subsidiaries operate independently of each other, with multiple businesses and/or a number of other shareholders throughout the ownership structure. This may result in enterprises that would otherwise qualify for the low profits offset or simplified MRRT method being subject to MRRT liabilities and reporting requirements due to application of the grouping rules. Technical corrections should be made to exclude such groups where the legislative intent is not to group such entities.

e) ***Production Rights & Exploration Rights***

Section 15-15 defines a production right and section 70-25(3) defines an exploration right. Because of sub-section 15-15(2) if a particular right is an exploration right, then it cannot also be a production right. If a right confers both an authority to extract resources and an authority to explore (other than an incidental purpose to explore) it will be treated as an exploration right, even if it also confers and is used for extraction. This is inappropriate, as many production rights permit exploration as well as extraction.

This definitions need to be rectified so that the definition of an exploration right excludes a right which also confers an authority to extract.

f) ***Meaning of a pre-mining project interest***

The concept of a pre-mining project interest is defined by sections 70-25 by reference to an interest in an exploration right. Only entities who 'hold' a pre-mining project interest can obtain a pre-mining loss (section 70-30(1)(a)). Generally the concept of who 'holds' is defined by section 250-5 by reference to the tests in section 40.

This concept of a pre-mining project interest and of someone who 'holds' such an interest are drafted more narrowly than is the concept of a 'mining project interest' which looks not simply at having an interest in a production right, but more broadly at entitlements to share in the output of a mining venture (being an undertaking with a particular purpose) (section 15-5).

There will be circumstances in which someone does not have a legal or beneficial interest in an exploration right, yet they have contractual entitlements which mean that they will be entitled to participate in any mining venture which might arise contemporaneously with the obtaining of a production right over an area which is the subject of the existing exploration right.

It would seem more appropriate to define a pre-mining project interest:

(a) in circumstances in which the entitlements to participate in the output of any exploration venture, which exist or would exist if the exploration right authorised the production of taxable resources from the area which it covers, can be identified - by reference to those entitlements; or

(b) in circumstances in which the entitlements to participate in the output of any exploration venture cannot be determined - by reference to the exploration right.

This approach would be more consistent with that taken in relation to mining project interests in section 15-5(3) and (4). A similar approach to the holding of a pre-mining project interest could be taken, to that taken in relation to mining project interests in section 250-5(3).

g) ***Are receipts of private royalties assessable?***

Section 30-55 provides for certain amounts to be included in mining revenue. Those amounts must be received or become receivable 'for a' supply or proposed supply of taxable resources.

The concept of a mining royalty is defined in section 35-45(2) in fairly broad terms. Payments of mining royalties are generally not deductible expenditure (section 35-40(2)) and it would therefore be expected that receipts of private mining royalties would not be assessable.

The concept of a private mining royalty is not however confined to an amount that is a 'royalty', but is defined in broader terms. There are existing arrangements between participants in an undertaking which forms the basis of a mining project interest under which payments are made by one participant to another participant.

There is a risk that these may be seen to be a private mining royalty. Those payments will not be deductible and should not be assessable. Given that participation in the mining venture is not dependent upon registration on the title for the production right, it may often by the case that there are changes in ownership of property within a mining venture which are not treated as an 'initial supply' (see section 30-20), but are intended to occur within the mining venture. Those payments may be both a private royalty and an amount which could be seen to be received or become receivable for a supply or proposed supply within the umbrella of the mining venture, even although these supplies are disregarded for MRRT purposes. Supplies which are not 'initial supplies' are not ignored for the purposes of section 30-55.

Section 30-55 needs to be amended either to make clear that the supplies to which it refers in paragraph (b) are supplies which are 'initial supplies' or at the very least, to make clear that amounts that are paid as a private mining royalty are not assessable to the recipient under section 30-55.

2. Explanatory Memorandum to MRRT Legislation

a) *Market Values & Private Mining Royalties*

Paragraph 7.95 has some new wording added (compared to the final draft seen by RTIG) in relation to pre-May 2010 private mining royalties. The final sentence states (in effect) that private royalties under pre-2 May 2010 arrangements do impact the market valuations, as they are not excluded expenditure. **This is not correct.** Only certain pre-2 May 2010 private royalty arrangements involving State & Territory Bodies are not excluded expenditure.

We recommend that the final sentence be redrafted as follows: "*However, this does not include private royalties paid on or after 1 July 2012 under certain pre-2 May 2010 arrangements with State & Territory Bodies, as these are not excluded expenditure (explained in Chapter 5)*".

b) *Changes to Mining Ventures & the Termination Rule*

New EM commentary relating to s135-15 states that *"a change in, or renewal of, a mining venture relating to a mining project interest does not cause the termination day for the mining project interest to happen";*. Paragraph 11.71 of the EM suggests that minor changes to a mining venture will **not** result in the termination of an MPI. The converse of that is that any change to a mining venture which is **not 'minor'** will result in a termination of a mining venture, with all of the adverse tax implications that flow from termination. 11.72 then goes on to say that a termination will occur when the mining venture has substantially changed to the extent that the mining venture can be characterised as a different mining venture. 11.73 states that if a mining venture changes and that change results in the mining venture covering an additional area, then the new area will be a new mining venture and hence new MPI to that extent.

Both paragraphs 11.71 and 11.72 do not reflect the actual wording of s135-15, and which will likely lead to many disputes with the ATO. The wording of the section is very clear – changes and renewals to mining ventures do **not** result in terminations. The wording in these EM paragraphs contradicts the wording in the section, and start focussing on 'non-minor' of 'substantial' changes resulting in terminations. In contrast, we are comfortable with paragraph 11.73, which correctly states the principle in relation to extensions of areas under both mining ventures and production rights. It is appropriate that additional project area and/or additional tonnages should create a new additional MPI, but the sections are clear that they do not terminate the old MPI (s15-5(5) & s135-10(2)).

Already agreed with Treasury: the current drafting of the EM does not reflect the law or intended policy. Agreed that the word "minor"; will be removed from paragraph 11.71. Paragraph 11.72 will be deleted.

c) *Changing Choices – Example 18.16*

This example contains a typo, with a reference to the 2012 MRRT year, instead of the 2013 MRRT year.

Already agreed with Treasury: Minor error - to be fixed in the EM.

d) *S115-15: Combinations - Choosing to Override Non-Compliance*

This section permits the combination of MPIs in circumstances where the relevant conditions are not met, if the miner foregoes the starting base and royalty credits etc. Where a miner chooses to override non-compliance, clarification should be provided that allowances for one (or both) of the combining interests needs to be cancelled. This should be made clear in the EM, as the legislation is ambiguous.

END