TaxTalk Alert

2 July 2010

A Step Change by the Australian Government on the Proposed Resource Rent Tax Regime

Today the Australian Government announced that the Resources Super Profits Tax (RSPT) would be scrapped. In its place, we now have a newly titled “Minerals Resources Rent Tax” (MRRT) in conjunction with an extension to the existing Petroleum Resource Rent Tax (PRRT) regime.

Critically, the MRRT will only apply to iron ore and coal projects in Australia, and the PRRT will be extended to apply to all onshore and offshore oil and gas projects, including the North West Shelf.

For the mining industry, the structure of the MRRT generally represents a major positive shift away from the previous RSPT model. For example, the headline rate has dropped to 30 per cent, there is an additional 25 per cent “extraction allowance”, an increase in the MRRT allowance rate to the long term bond rate plus seven per cent and market value can (by choice), be used as the starting base for existing projects.

While this is a major step forward for the Gillard Government politically, there are positive aspects for the resources industry. The concessions made by the Government are expected to reduce Federal tax revenue by $1.5 billion over the first two years under the revised regime.

To limit the revenue impact of these changes, the Government has removed the “refundability” feature of the RSPT for unsuccessful project losses (surprisingly transferability of losses remains). The Government has also removed the 30% Resource Exploration Rebate (“RER”) that was announced in response to the Henry Review and pared back the planned reduction in the Australian corporate tax rate to 29% (rather than 28% as previously announced).

At first glance the revamp appears to be a step forward in the Government’s dispute with the industry. However a significant amount of debate and further consultation is still to come. Importantly, the Government has established a Policy Transition Group, headed by Don Argus and Martin Ferguson, to consult with the industry and advise Government on implementation. However, we should keep in mind before any of this becomes law, the proposals must pass through a Senate that is influenced by the Greens Party, not to mention an impending Federal Election against a Liberal/National Coalition that is standing firm on its opposition to the reforms.

Key features of the MRRT

- Applies to iron ore and coal (bulk commodity) projects in Australia from 1 July 2012 – all other non-renewable mineral projects are excluded
- Miners with “small amounts” of MRRT assessable profits (below A$50m per annum) will be excluded from the MRRT
- The headline rate for MRRT is 30 per cent. Projects will also be entitled to an “extraction allowance” of 25 per cent of the MRRT otherwise payable to recognise the value of know-how that the taxpayer contributes to the extraction process
- Carried forward costs and losses are uplifted at the Government Long Term Bond Rate (LTBR) plus seven per cent, and are transferrable between projects held by the same taxpayer
- The “taxing point” will be set as close as possible to the extraction point for the minerals – reducing the risk that profits attributed to downstream activities could be subject to the tax
- All revenue and capital expenditure post 1 July 2012 will be immediately deductible for MRRT purposes

- Existing projects are to be transitioned into the MRRT, with taxpayers having the choice of the following to determine their starting base (determined at 1 May 2010):
  - Book value – in which case the value of resource rights are not included, however the starting base is subject to an accelerated depreciation deduction over five years, and which is also uplifted at the LTBR plus seven per cent, or
  - Market value – in which case the starting base is depreciated over an appropriate effective life (not exceeding 25 years), with no uplift available.
- All expenditure incurred between 1 May 2010 and 1 July 2012 will be included in the starting base
- Various costs, including financing costs such as interest, will not be deductible in calculating the MRRT liability (similar to the treatment under the current PRRT regime)
- State royalties will continue to be levied but will be a creditable against MRRT payable – royalties will not be cash refundable and royalty credits carried forward are not transferable between projects. However, credits carried forward will be uplifted at the allowance rate.
- MRRT is deductible for income tax purposes
- The corporate tax rate is to be reduced from 30 per cent to 29 per cent from 2013-14. Small companies will benefit from the 29 percent company tax rate from 2012-13.
- The RER is no longer proceeding.

Extension of the Existing PRRT Regime

- The PRRT will be extended to all onshore and offshore oil and gas projects, including coal-seam gas projects and the North West Shelf
- Existing projects to be transitioned into the extended PRRT regime are to have a similar choice between book and market value in determining their starting base

Some Initial Thoughts

When to incur expenditure	• It may be worth considering deferring expenditure if the market value starting base option is to be chosen. Post 1 July 2012 expenditure is immediately deductible whereas pre 1 July 2012 expenditure must be deducted over effective life up to a maximum of 25 years.
“Effective” headline rate	• Given the MRRT includes a 25 per cent extraction allowance, the “effective” headline rate appears to be 22.5 per cent.
Effective tax rate	• As we know from our experience with the RSPT model, overall effective tax rates will always vary on a project by project basis. However after taking into account the headline rate of 30 per cent, the extraction allowance of 25 per cent and the deductibility of the MRRT at a corporate tax rate of 29 per cent, a simple arithmetic process produces a combined tax rate of approximately 45 per cent (subject to whatever is decided upon the credibility of royalties).
Valuations	• The valuation of existing projects will be critical for taxpayers in deciding whether to elect to use book or market value as their starting base. • From our experience with the consolidation regime, we expect the Australian Taxation Office to release valuation guidelines but also challenge valuations. Accordingly, a robust independent valuation of projects will be important. • For integrated projects this will likely require a transfer pricing analysis to allocate value between the project and associated activities and infrastructure beyond the mine gate.
Removal of the RER	• The RER was to provide junior explorers with an incentive to find new mineral resource projects. • Could a decision not to pursue the RER lead to a resurrection of the ‘”flow through shares” model previously promised by the Rudd Government?
Transferability of MRRT deductions	• Miners should be able to transfer their MRRT deductions across projects in their portfolio, which will reduce the MRRT exposure at a group level. • This feature is likely to be considered in detail as part of the consultation process to ensure integrity is embedded that a “fair” amount of MRRT is actually paid to the Government on an annual basis.
What now for small miners?	• Under the RSPT, small miners may have been in a position to receive a refund of State royalties and benefit from the RER.
State royalties	• It remains unclear whether the creditable state royalties will be capped at royalty levels announced prior to 1 May 2010 (as was the case under the RSPT)

Further information

For more information on the changes to the taxing of Australian resources and its impact on the Australian mining industry please contact your local PwC tax partner or:

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