Minerals Resource Rent Tax replaces RSPT

RSPT no more

On 2 July the Australian Government announced that, due to industry concerns, it had scrapped the Resource Super Profits Tax (RSPT) and proposes to replace it with the Minerals Resource Rent Tax (MRRT) to take effect from 1 July 2012.

To fund the changes proposed under the MRRT, the Government has announced that it will reduce the corporate tax rate to 29% from 1 July 2013, with no further reduction (it had originally proposed a further reduction to 28% from 1 July 2014).

The tax rate for "small companies" will also be reduced to 29% with effect from 1 July 2012. No changes are proposed to the superannuation reforms announced on 2 May.

Further work and consultation

Additional work and consultation with the mining industry and other stakeholders is required before all details of the MRRT can be finalised.

In this regard, the Government has announced that it is establishing a Policy Transition Group (PTG) to be headed by the Resources Minister, Martin Ferguson AM, and Don Argus AC. The PTG will consult with industry and provide advice to the Government as to the implementation of the new MRRT and Petroleum Resource Rent Tax (PRRT) arrangements.

Who does the MRRT affect?

Although it differs in substance to the proposed RSPT, the MRRT nonetheless represents a new tax on companies that operate in the Australian mining sector.

However unlike the RSPT, the MRRT will only apply to the mining of iron ore and coal. Onshore and offshore oil and gas projects (including those located in the North West Shelf) along with the coal seam gas industry will be caught by the existing PRRT regime.

Although the effective rate of tax under the MRRT as estimated by the Government will drop to 42.3% over the life of a project (from an estimated effective tax rate under the RSPT of approximately 54-57%), this rate is still higher than the average international tax rates of approximately 36% for iron ore and 39% for coal. [Annexure B contains a working example demonstrating how the MRRT will operate and how the effective rate of 42.3% has been calculated by the Government.]

It should also be noted that no franking credits will arise under the MRRT as it is not a "corporate income tax".

The current Federal Opposition has indicated that if they win the next election, they will rescind the MRRT.

Sovereign risk

Much like the RSPT, the introduction of the MRRT can still be seen as a sovereign risk for prospective investors in the Australian mining industry.

However, the Government has largely addressed the issue of retrospectivity by allowing existing projects to elect to transition into the MRRT tax regime by using market values for existing projects, including the value of the resource.

As we understand it, if the MRRT is introduced there is nothing to prevent the proposed resource tax rate of 30% from being increased or the net being widened to increase the number of companies or industries affected by the tax. However, presumably this will require an Act of Parliament to implement.

How is the MRRT different to the RSPT?

The MRRT differs from the RSPT in a number of respects:

(a) the tax will only apply to iron ore and coal mining activities;

(b) the resource tax rate is 30% rather than 40% as originally proposed (although, we note that due to the 25% "extraction allowance", the effective MRRT rate is likely to be 22.5%).
The extraction allowance is described as "compensation for miners for the extra

returns from such things as managerial expertise, entrepreneurship and technical innovation captured by the tax";

(c) all onshore and offshore (including the North West Shelf) oil and gas projects will come under the current PRRT. Also, the coal seam gas industry will be caught by the PRRT;

(d) the uplift factor before the MRRT will apply has been increased from the Long Term Bond Rate (LTBR) to the LTBR plus 7%. The uplift will only apply to transitioned projects electing book value and to carry forward undeducted capital/ operating costs together with unused royalty credits;

(e) the estimated combined effective tax rate for companies affected by the tax will drop from approximately 54%-57% to between 42% and 45%; and

(f) the income tax exploration rebate for exploration companies who cannot offset exploration deductions against other income has been removed.

Refer to Annexure A for a more detailed analysis of the key differences.

Key outstanding issues

- Details

There are a number of issues that still need to be addressed fully and, until Exposure Draft legislation is made publicly available (anticipated to occur in June 2011), it is difficult to assess fully the impact of the MRRT.

- Constitutional Challenge

As with the RSPT, there is a still a question of whether the MRRT is constitutionally valid.

Potential impact of MRRT on future investment in Australia's mining industry

The proposed MRRT is a positive step for investors and mining investment in Australia. After months of uncertainty in relation to the RSPT and how it would be applied, the news that the MRRT will carve out certain commodities provides both reassurance and greater certainty for emerging projects, particularly projects which do not produce iron ore, coal, oil and gas. Furthermore, the Government's compromise with the major mining companies ensures that the expansion of existing projects, which were claimed to have been put on hold as a result of the RSPT, are now more likely to go ahead (all other things being equal).

As the MRRT will only be imposed when profits exceed the LTBR plus 7% (compared with the RSPT which kicked in at the LTBR), the MRRT is more reflective of a tax on profits above a risk adjusted rate of return than the so called "super profits tax" (which was a profit above a risk free rate of return). The increased uplift threshold should not prevent miners from recovering their cost of capital plus a reasonable margin (and therefore meet their required internal rate of return) before being subject to the tax. As a result, arguably, companies in the mining industry should find it easier to raise capital for new projects (compared to the RSPT), which may positively impact M&A activity in the sector. When combined with the reduction in the rate of the tax from 40% to an effective rate of 22.5%, and the ensuing effects on mining companies' expected effective tax rates, the key changes arising under the MRRT regime should also increase Australia's international competitiveness as compared to the RSPT, which was widely perceived to be a deterrent to international investment in Australian mining.

However, the MRRT has not removed all investor uncertainty generated by the RSPT. A number of issues remain outstanding. Whilst the key headline terms of the MRRT have been negotiated with the major mining companies, the details have yet to be finalised and, by the Government's own admission, this is expected to be a lengthy process, with the Exposure Draft not being released for public comment until June 2011. Furthermore, the legislation also has to be passed successfully, post election. We note that the Opposition remains firmly opposed to the resource tax even in its modified form, while the Greens (who may hold the balance of power in the Senate post-election) have stated that they will closely scrutinise the changes to the tax if/when the Bill is introduced.

Accordingly, a level of uncertainty about the precise form and content of the legislation still exists, which may mean that international investor sentiment remains cautious in the short term. Further, the impact which the months of uncertainty surrounding the RSPT (and its role in the removal of a sitting Prime Minister) may have already had on international investors' perception of Australia's political stability and sovereign risk is unknown.

Annexure A - Key differences between the RSPT and the MRRT

NAME	Resource Super Profits Tax (RSPT)	Minerals Resource Rent Tax (MRRT)
DATE PROPOSED TAX ANNOUNCED	2 May 2010	2 July 2010
APPLICATION	To the extraction of all natural non-renewable resources in Australia	To the mining of iron ore and coal within Australia Onshore and offshore oil and gas projects (including the North West Shelf) will be subject to PRRT
COMMENCEMENT DATE	1 July 2012	1 July 2012
THRESHOLD	None	Taxpayer with MRRT assessable profits of less than $50 million will not have a MRRT liability
RESOURCE TAX RATE	40%	30% Less "extraction allowance" provides for an adjusted rate of 22.5%
EFFECTIVE TAX RATE (Combined income tax and resource tax rate)	Approximately 54% - 57%	Depending on the calculation, anywhere between 42% and 45% Taxpayer with MRRT assessable profits of less than $50 million will not have a MRRT liability
EXTRACTION ALLOWANCE	None	25% of profit subject to MRRT
TAXING POINT	Uncertain Described as the point at which revenue from the extracted resource and deductible costs can be determined, being as close to the mining gate or well head as possible	Clarified At the mining gate, using appropriate pricing arrangements to ensure only the value of the resource is taxed The taxing point will be on the value of the natural resource, not on the value added by the miner
UPLIFT	On: • Undepreciated capital • Carried forward losses	On: • Transitional costs when valued at book value • Carried forward losses • Unused credits for royalties paid
UPLIFT RATE	LTBR	LTBR plus 7%
RESOURCE LOSSES	RSPT losses refundable and transferable	MRRT losses transferable to other iron ore and coal projects in Australia MRRT losses not refundable
ROYALTIES	Remain payable with a rebate. Unused rebate can be refunded or transferred	Remain payable with a credit. Unused credit can be carried forward and uplifted but cannot be refunded or transferred
EXPLORATION AND OPERATING COSTS	Immediately deductible	Immediately deductible
CAPITAL EXPENDITURE INCURRED AFTER 1 JULY 2012	Amortised at a rate to be agreed	Immediate write-off for new investment on an incurred basis, for MRRT purposes

TRANSITION	Existing capital starting base recognised at book value as at last audited accounts (excluding value of resources), uplifted until 1 July 2012, and deductible over 5 years at accelerated rate of depreciation If no audited accounts, recognised at market value Capital or exploration expenditure between 2 May 2010 and 1 July 2012 amortisable / deductible	Starting base for capital assets can be either (at the taxpayers election): Recognised at market value • market value as at 1 May 2010; • written down over effective life (a period of up to 25 years); • including mining rights; and • will not be uplifted. OR Recognised at book value • current written down book value (excluding the value of the resource); • depreciated at an accelerated rate over 5 years; • excluding mining rights; and • will be uplifted at LTBR plus 7%. All capital expenditure incurred between 2 May 2010 and 1 July 2012 is added to starting base and depreciated from 1 July 2012
EXPLORATION REBATE	Refundable tax offset at the company tax rate, for exploration expenditure carried out in Australia on or after 1 July 2011	No longer applies. Resource exploration costs continue to be deductible as they were prior to the introduction of the RSPT
DEDUCTIONS	Deductibility of expenditure under RSPT broadly based on categories used under PRRT	Deductibility of expenditure under MRRT broadly based on categories used under PRRT
INCOME TAX	RSPT an allowable deduction for income tax purposes	MRRT an allowable deduction for income tax purposes
COMPANY TAX RATE	Reduced: • 2013-2014: 29% • 2014-2015: 28%	Reduced: • 2013-2014: 29% NB: "small companies" will have tax rate reduced to 29% from 2012-2013
ESTIMATED NUMBER OF AFFECTED COMPANIES	Approximately 2500	Approximately 320

Annexure B - Example Calculation[2]

The following example is intended to illustrate how the MRRT will apply to iron ore and coal projects, commencing after 1 July 2012.

The example presents outcomes for a single project company with an equity financed mine that operates for 5 years. The company is assumed to invest $1 billion in the first year of the project. Over the life of the project the pre-tax rate of return (revenue less operating and investment costs) is 50 per cent.

The MRRT is levied at a rate of 30 per cent of the operating margin (revenue less operating and investment costs) less the MRRT allowance and the extraction allowance. The MRRT allowance is calculated as the value of unused losses uplifted by an allowance rate equal to the long-term Government bond rate plus 7 percentage points. The extraction allowance provides a 25 per cent discount to the MRRT liability to focus the tax on the value of the resource rather than the value added through mining expertise.

State royalties are assumed to be equal to 7.5 per cent of sales revenue and are credited against the MRRT liability to produce the net MRRT liability. Where royalty payments exceed the MRRT liability in any one year, the balance is uplifted at the allowance rate to be offset against future MRRT liabilities. The total resource charge is the sum of royalties paid in the year and the net MRRT liability.

In this example the average tax rate over the life of the project (total tax as a percentage of total profit before tax) is 42.3 per cent.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Resource Charge	$m	$m	$m	$m	$m	$m
Revenue	0	520	830	910	1090	1100
Operating expenses	0	130	210	230	270	280
Depreciation	1000	0	0	0	0	0
MRRT allowance @ 13% (LTBR of 6% plus 7%)	0	130	96	28	0	0
MRRT profit/loss	-1000	-740	-216	436	820	820
MRRT @ 30%	0	0	0	131	246	246
Extraction allowance @ 25%	0	0	0	33	62	62
MRRT after extraction allowance	0	0	0	98	185	185
Royalty @ 7.5%	0	39	62	68	82	83
Uplifted Royalty offset	0	0	44	120	102	0
Net MRRT	0	0	0	0	1	102
Total resource charge	**0**	**39**	**62**	**68**	**82**	**185**
Company Tax						
Revenue	0	520	830	910	1090	1100
Operating expenses	0	130	210	230	270	280
Depreciation	0	200	200	200	200	200
Total resource charge	0	39	62	68	82	185
Company taxable income	0	151	358	412	538	436
Company tax @ 29%	**0**	**44**	**104**	**119**	**156**	**126**
Profit before tax	0	190	420	480	620	620
Total tax	0	83	166	188	238	311

* Figures presented in the table above may not add due to rounding

2 Example calculation as provided by the Australian Government in its fact sheet dated 2 July 2010 titled "A New Resource Taxation Regime" at pages 3 to 4. Available online: http://www.futuretax.gov.au/documents/attachments/factsheet_resource_taxation.pdf

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