The MRRT – who pays and how much?

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The MRRT – who pays and how much

- Background
- Key features
- Frontier issues
- Value impact on projects
- What is likely to happen?
- Example
- Chinese State-Owned-Enterprises (SOEs)

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Background

- RSPT announced (2 May 2010)
- MRRT announced (2 July 2010)
- PTG report (Dec 2010)
- Draft legislation (Mid 2011)
- MRRT commences (1 July 2012)

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MRRT key features

- Australian Coal and iron ore projects
- 30% rate
  - 22.5% (after 25% extraction allowance)
- Tax on resources, not value-adding activities
- MRRT losses are broadly uplifted at LTBR plus 7% (and transferable within a group)
- State royalties are creditable and uplifted at LTBR plus 7% (but not transferrable)
- Existing projects get ‘starting base’ deductions (not transferrable)
- No interest deduction

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Key features (Cont'd)

MRRT & RSPT: highlights of differences		
	RSPT	**MRRT (as proposed by the PTG)**
Resources covered	All non-renewable projects in Australia (other than those covered by PRRT)	Australian coal and iron ore projects
Tax rate	40%	Effectively 22.5%
Taxing point	Never specified	Broadly when resources leave the ROM stockpile
Uplift rate	LTBR	LTBR + 7%
Treatment of existing projects	Book value starting base only (value of resource excluded)	Book value starting base (value of resource excluded) OR market value starting base (value of resource included)
State royalties	Creditability based on 2 May 2010 royalty rates (including scheduled increases)	Full creditability for current and future royalties.

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Frontier issues

- Full State/Territory royalty credits
- Taxing point
- Valuation
- Interim expenditure
- Carbon costs

Full State/Territory royalty credits

- PTG recommended full MRRT creditability for current and future royalties
- Probably requires a Fed-State solution
- Varying impact on different miners

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Taxing point

- TP = when resources leaves the run of mine stockpile
- Varying impact on different miners
  - green-fields / significant capex required
  - established projects
- A flexible taxing point?

Valuation

- Transfer pricing methodologies
  - the comparable uncontrolled price method
  - the cost plus method
  - the netback method
  - the residual price method
- Varying impact on different miners

Interim expenditure

- Expenditure incurred between 2 May 2010 to 30 June 2012
- Interim capital expenditure → starting base
- Interim revenue expenditure → no deduction
- Interim exploration expenditure → no deduction

Carbon costs

- Not discussed in the PTG report
- Carbon costs:
  - carbon tax
  - emission permits
  - mitigation costs
- Issue of apportionment

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Value impact on projects

- Anecdotally, limited impact for many projects
- Effective tax rate of 22.5% is only half the story
  - MRRT is income tax deductible (22.5% → 16%)
  - Net present value (NPV) effect
    - capital costs are immediately deductible
    - royalty credits and losses are broadly uplifted at LTBR + 7%
    - transfer of losses
- Substantial impact subject to further price increases

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MRRT effective rate

	Company	Shareholder (46.5%)
<u>Proposed:</u> MRRT (incl State royalties) & income tax	45.75%	58.75%
<u>Present:</u> State royalty @ 10% & income tax (no MRRT)	37%	51.85%

MRRT effective rate – resident shareholder

		Tax
Mining profit	100	
MRRT @ 30% less extraction allowance*	22.5	22.5
	77.5	
Company income tax @ 30%	23.25	23.25
Dividend	54.25	
Franking credit gross up	23.25	
Personal income tax @ 46.5%	36	
Less franking credit	23.25	
Net personal income tax	12.75	12.75
Total tax		58.75%
10% royalty, no MRRT		51.85%

* includes State royalties

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What is likely to happen?

- Will it become law?
- Will it meet the revenue targets?
  - Treasury's already-revised-down net MRRT revenue estimates (incl. deductibility)
    - 2012: $3.3b
    - 2013: $4.1b
    - 2012-2021: $38.5b (approx. $4.8b p.a.) [RSPT: $99b]
  - State royalties: $4.0b p.a. (QLD coal and WA iron ore royalties 2010)

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What is likely to happen? (Cont'd)

- Possible Gov actions on failing the revenue target?
  - do nothing (accepting this is a "volatile" tax)
  - more "integrity" rules
  - capping royalty creditability
  - reducing/removing the extraction allowance
  - limiting loss transferability
  - increasing the tax rate

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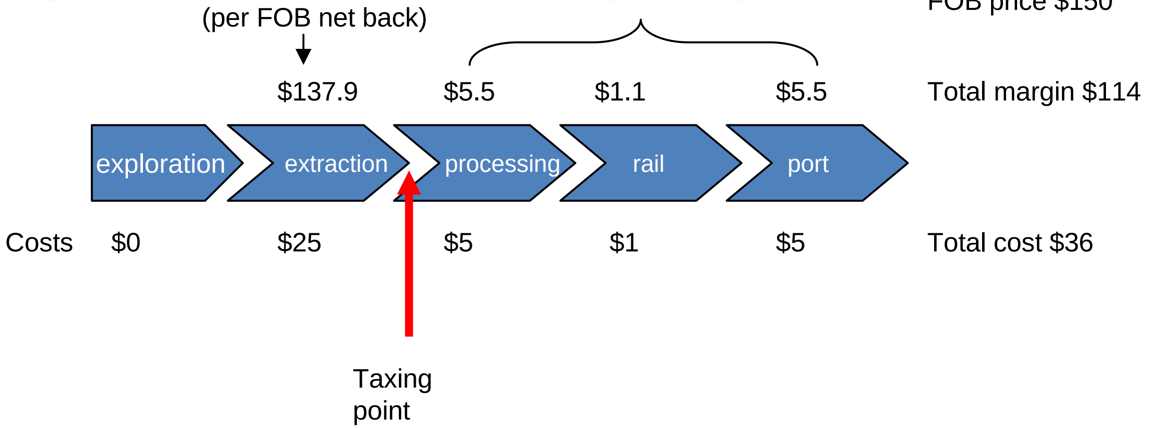
Chinese SOEs

- Will remain a major M&A player
- Sovereign risk
  - Australia
  - Global trend towards a resources tax?
- Passive responses so far
  - Chinese Government (NDRC/SASAC)
  - Chinese companies
- Cheaper to acquire Australian projects?

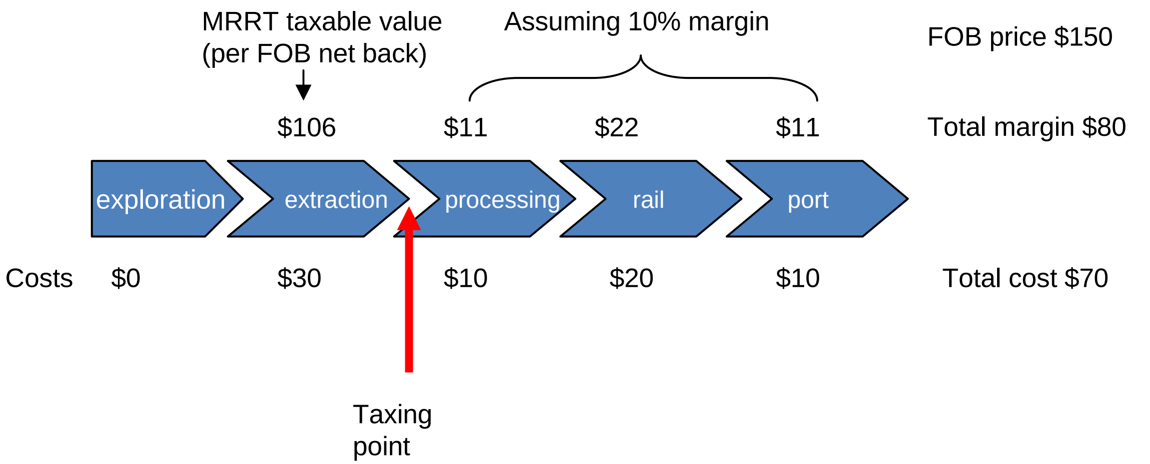
MRRT: coal projects comparison

Project 1



MRRT taxable value	137.9
Less costs before taxing point	(25)
Less starting base deduction (arbitrary figure)	(50)
MRRT taxable income/(loss)	62.9
MRRT tax payable (before royalty credits)	14.15
State royalties (eg QLD rates)	(12)
Net MRRT payable/(excess royalty credits)	**2.15** → Deductible for income tax

Project 2



MRRT taxable value	106
Less costs before taxing point	(30)
Less starting base deduction (arbitrary figure)	(25)
MRRT taxable income/(loss)	51
MRRT tax payable (before royalty credits)	11.48
State royalties (eg QLD rates)	(12)
Net MRRT payable/(excess royalty credits)	**(0.5)** → Credits to carry-forward and be uplifted, but quarantined

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