

Australia

Reform Issues in Mineral Tax Policy for Economic Development: The Mineral Resource Rent Tax in Australia

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Issue: 2011 (Volume 65), No. 1

Published online: 28 October 2010

In this article, the authors examine the theoretical background to, and practical implications of, the introduction of a resource-based mineral tax in democracies with specific regard to the example of Australia and the political crisis engendered in Australia by the proposed implementation of such a tax.

1. Introduction

Taxation reform is an important component of fiscal policy and many governments are considering such reform in the current economic climate. In particular, economies, such as Australia, that have increased their budget deficits through fiscal stimulus packages designed to ameliorate the effects of the global financial crisis are looking for options to reduce their budget deficits and strengthen the economy. In this regard, economic instability in the European Union, where Greece faced the risk of default on its national debt, reveals the risk posed by excessive budget deficits. [1]

In recognition of the pressing need faced by many countries to reduce their national debt, the International Monetary Fund (IMF) recently proposed a number of possible fiscal reforms. [2] These include stabilizing age-related spending, redesigning unemployment benefits and reversing recent increases in military expenditure. The IMF also noted that countries rich in natural resources, such as Australia, have greater prospects for economic recovery, as "the element of location-specific rent in resource returns provides a potentially robust source of relatively non-distorting revenue". The IMF suggested that this could be done through a profit-based tax, as most developed economies should be "sufficiently able to diversify the risks of natural resource exploitation to make profit/cash flow based instruments more efficient than fixed fees and royalties". Further, "movement towards explicit rent taxation could produce a marked revenue enhancement". [3]

Australia is one country that is seeking to reduce its budget deficit post-global financial crisis. [4] To this end, the Henry Tax Review, which was released on 2 May 2010, [5] suggested implementing the proposals of the IMF by replacing current royalties charges on mining companies with a 40% tax rate on profits above a 6% rate of return. This was modelled to eliminate Australia's budget deficit within a few years. [6] Further, a profits tax is generally accepted as being more economically efficient than the existing system of royalty charges. [7]

The resources super profits tax (RSPT) proposed by the Henry Tax Review was supported by the Commonwealth government, [8] but strongly opposed by mining companies. The resulting political controversy saw the removal of the then incumbent Prime Minister. A significant compromise was negotiated between the new Prime Minister and the largest companies in the mining industry in the form of the mineral resource rent tax (MRRT), which meant that mining companies would pay significantly less tax under this new proposal. The difficulties experienced by the Australian government in implementing significant taxation policy reform highlight the role that stakeholders play in policy formulation in democracies. [9] This can be difficult due to the powerful lobby groups involved and the role that the media plays in democracies, thereby resulting in the arguments for economic efficiency favouring tax reform being obscured. [10] As with all democracies, the Australian government had a duty to negotiate with various interest groups and reconcile their competing interests. Australia has some of the world's richest natural resource deposits, which means that mining is an important part of the Australian economy. Export earnings for commodity exports are predicted to reach AUD 169.8 billion in 2010-11, an increase of 28.4%. Mining exports account for 37.6% of Australia's total exports. [11] Further, the demand for Australia's natural resources is likely to remain strong. Traditionally, Japan has been Australia's major export partner, [12] although China and India are catching up due to their rapid economic growth. This increasing demand for natural resource exports has led to a surge in commodity prices. [13] As such, the mining industry is a very important player in the negotiations of any mineral taxation reform, which means that mining companies are a powerful stakeholder group in the Australian economy and, therefore, their interests must be taken into account when reforming mineral taxation policy. As such the Australian government must balance the short-term interests of the mining companies and the growth in Australia's GDP against the policy objectives of increasing the tax

revenue collected from the mining industry and eliminating Australia's budget deficit.

This article provides an analysis of the implications of the proposed introduction of an MRRT in the Australian social, economic and political context, where mining is an important part of the economy. In this respect, the article is a valuable illustration of the application of stakeholder theory in deliberative democracies by considering the difficulties experienced in taxation reform. The discussion in the article should be particularly valuable to policymakers in democracies seeking to formulate and implement effective taxation reforms.

The article is in two main parts. Section 2. considers the theory behind taxation reform in democracies and the factors that led to a resources rent tax being proposed. Section 3. then examines the mining tax debate in the Australian political context, with a particular focus on the upheavals the proposal for a resources rent tax caused to the incumbent political party, including a change in Prime Minister. The authors conclude that taxation reform is always a challenging task and a democracy is no exception. In order to meet these challenges policymakers and the tax department must both balance the long-term benefits to the economy, whilst resolving the short-term competing interests of a wide variety of stakeholders.

2. Tax Reform in Democracies

2.1. Introductory remarks

The taxation system of any country is an influential factor that is considered by foreign companies when making their investment decisions. As such, many countries have tax concessions for industries that are important to their economy to encourage foreign investment. Mining is one such industry. This culture of tax concessions becomes socially, economically and politically embedded in a country. [14] Investors also view political risk as a major risk factor in their investment decisions, [15] which means that foreign investment is generally based on the assumption that the legislative framework will remain stable.

Accordingly, changes to the taxation system may result in political upheaval. These upheavals are largest and unavoidable when a sudden or abrupt transformation of a country's tax culture is attempted. In contrast, smoother, gradualist approaches to transformation of the taxation system may avoid serious shocks to the tax culture of a country. [16]

The problems experienced by democracies in formulating and implementing effective taxation reform can be attributed to the requirement of such governments to develop policies that meet the requirements of a variety of stakeholders with competing interests. However, some stakeholders are more powerful than others or are affected by the policy more than others. This means that democracies pay greater attention to their interests in formulating policies. In Australia, this problem is particularly acute when dealing with the mining sector. The mining industry is vital to Australia's economy and, therefore, acts as influential stakeholders in any policy negotiations, particularly for policies that directly affect them. This was demonstrated by the role played by the mining industry in the political negotiations surrounding the introduction of a minerals resource rent tax in Australia.

2.2. Mining tax reform

2.2.1. Initial comments

One of the main arguments in favour of introducing an MRRT in Australia is that a profits tax is economically more efficient and less distortionary than the existing system of royalties charges that is currently in place. [17] There are generally four main components of effective taxation reform: (1) efficiency (neutrality); (2) fairness; (3) transparency; and (4) simplicity. [18]

Royalty charges are not considered to be neutral, as they are taxes on the amount of production. [19] For example, in Victoria, a specific royalty applies to brown coal production charged at 5.88c per gigajoule of energy, adjusted annually for inflation. [20] The overall effect of the current royalty system is that it causes a deadweight loss. That is, firms are likely to invest and produce less than they otherwise would [21] and, therefore, it distorts firms' production and investment decisions. [22]

The Henry Tax Review considered royalties to be problematic, as they do not reflect the profitability of the mining project. Imposing a flat-rate royalty charge means that small, risky mining ventures pay more tax in proportion to the profits that they make. In contrast, the MRRT is imposed on profit only, which means that large mining projects pay more tax and small risky projects less. Further, when projects become less profitable as a result of a decrease in commodity prices, the amount of tax paid under the MRRT is reduced.

There is another justification for the imposition of a higher rate of taxation on the natural resources sector. Federally, the effective company tax rate paid by the mining sector is less than other sectors. Further, economic theory states that countries that are overly reliant on natural resources for their economic prosperity may not be able to sustain their economic growth after the natural resources run out. This is termed the "natural resource curse", which indicates a situation where resource-rich economies fail to translate the short-term economic benefits that come from mining into long-term economic growth. This is because mining is a cyclical industry and, therefore, the benefits to the economy brought by mining are not permanent. The distribution of government revenue from mining tends to be uneven between generations, which means that government expenditure is greater when natural resource deposits last and then reduces when natural resource deposits are exhausted. [23] Reliance on wealth from mining will often see a country switch from needing to generate a trade surplus in manufacturing or service exports to being able to rely on commodity exports. [24] The resulting rent-seeking behaviour from governments often crowds out non-mining industries. [25] This can be seen in Australia's "two-speed economy", where the resource-rich states of Queensland and Western Australia have experienced sustained economic growth because of mining, and the less-resource rich states have had slower growth. [26] The distribution of mining wealth within these states is also uneven. "The mining regions are the source of enormous revenue, yet their residents are disadvantaged and deprived of services". [27] Mining revenue collected by state governments is often not reinvested in the remote areas suffering from the negative effects of mining, such as vastly unaffordable accommodation. [28] Further, as mining is often the only significant industry in these remote communities, concerns have been expressed regarding their fate when natural resource deposits are exhausted. [29]

The current system of royalty charges means that the effective resource charge paid by mining companies is very low relative to other sectors. Imposing a profits-based tax was intended to increase the amount of tax paid by mining companies. Allowing reinvestment [30] of mining revenue in affected communities, infrastructure and non-mining industries will assist in securing Australia's long-term economic growth beyond the resources boom. [31] A profits-based tax is also counter-cyclical, which means that a higher amount of tax is payable in times of economic growth and less tax is due in times of economic downturn. As such, it acts to smooth the business cycle fluctuations in the economy and assists the government in maintaining steadier expenditure levels in the long run. [32]

The profits tax that was originally proposed by the Henry Tax Review was the RSPT. The RSPT was intended to replace the existing mining royalties collected by the state governments with a 40% tax on all profits above the 6% rate of return (the ten-year government bond rate or the risk-free return on capital). A 40% rebate for all losses incurred would have been paid, thereby making the government, in essence, a partner in the project. In contrast to royalty charges, the RSPT would have been payable only if the project became profitable. [33] As the tax amount as a percentage of profits would rise as the commodity price rose and would fall as the commodity price fell, it would have smoothed the amount of tax payable. This would have meant that the RSPT would have been far more neutral than the existing taxation system, as it would not have distorted production decisions.

However, the mining companies objected to this proposal on a number of grounds, including that the rate of tax was too high. They also argued that defining profits as all returns made above the risk-free interest rate ignored the reality that mining companies face a high level of risk, which is reflected in the 12% and above the rates of interest that they commonly pay. [34]

However, the mining industry is a major contributor to the Australian economy. This meant that increasing the tax rate on the mining sector was politically unpopular. As mining companies are powerful stakeholders in the Australian economy, the RSPT did not proceed due to the Australian political climate and was replaced by the more generous MRRT, which is the compromise negotiated between the new Prime Minister and the largest mining companies.

The MRRT involves a 30% tax on all profits over the 12% rate of return. [35] This obviously collects significantly less revenue than the original RSPT. The MRRT reflects the balance struck by the Commonwealth government between the short-term stakeholder interests of the mining companies and Australia's long-term economic growth after its natural resource deposits have been exhausted. The development of the MRRT in Australia reflects the important role that stakeholders play in policy formulation in democracies.

2.2.2. The role of stakeholders in mining tax reform

Democracies must engage in consultative policy formulation to give legitimacy to their decisions. This theory implies that command and control policy formulation has become obsolete, thereby indicating the abolition of omniscient government authorities. In order to be effective, democratic policy formulation usually requires publicity, equality and inclusiveness. [36]

This accords with stakeholder theory, which argues that a government's effectiveness is determined by its ability to

satisfy its stakeholders. The concept of "stakeholder" was originally defined as "any group or individual who can affect or is affected by the achievement of the organisation's objectives". [37]

Accordingly, stakeholder theory describes the process of policy formulation in democracies, [38] as policymakers are required to consider the views of a broad range of stakeholders when formulating and implementing government policy. Democracies are also generally considered to operate under a social contract. [39]

The need for governments to negotiate with a wide variety of stakeholders becomes particularly important when the stakeholders control the resources that the government needs to operate. This is part of resource dependence theory, which is based around the idea that an organization needs resources to operate and is, therefore, forced to negotiate with people, groups and other organizations that own these resources. [40] Such a situation, it is argued, gives rise to a dependency relationship within which resource suppliers can exert influences over the organization. [41]

Both stakeholder theory and resource dependence theory imply a bilateral relationship between the government and the stakeholders, within which the stakeholders participate in the government's decision making process. This could occur by the stakeholders having the power to influence the government's decision making or by having a stake in the government's operations. Such a bilateral relationship also implies that the government should be accountable to the stakeholders in some way. [42]

However, for Clarkson, the focus should be on stakeholder relationships and the way these relationships are managed. [43] The failure to maintain harmonious stakeholder relationships can, therefore, threaten the very existence of the government, [44] as demonstrated by the removal of the Prime Minister of Australia when a wide variety of stakeholders were dissatisfied with the originally proposed RSPT and the apparent refusal of the government to negotiate. [45] Such a view of policy formulation through deliberative democracy is based on the premise that stakeholders' interests are not fixed, but, instead, are subject to discovery and transformation through public debate about joint problems and conflicts. [46] This means that, in the absence of public deliberation, interests cannot be adequately taken into account in decision making. Consensus is, therefore, required, but the pluralism of interests often pushes stakeholders towards conflict. [47]

There are four main justifications for deliberative democracy. First, deliberative democracy requires extensive consultation and negotiation, and decisions cannot be defended merely on the basis of self interest, as this justification is unlikely to survive deliberative scrutiny. Deliberative democracy does not seek to conceal the interests of stakeholders that decisions are based on, but, instead, seeks to encourage their disclosure and transformation through public discussion and consultation. [48] This give and take of reasons in public deliberation is believed to make it less likely that irrational and untenable arguments decide outcomes. Second, under deliberative democracy, decision-making procedures are structured to allow revisions of arguments, decisions and even procedures that either take up features of defeated positions or improve their chances of being heard. Third, deliberative decision making procedures are broadly inclusive, which gives minorities a chance at being heard. [49] Fourth, the consultation process not only ensures that decisions are well-justified, but also that decisions gain legitimacy from the consultation process. This is because a decision gains legitimacy, not because it simply meets the preferences of a majority of citizens, but because it has weathered the test of public justification. [50]

However, the features of deliberative democracy also illustrate why it can be so difficult to formulate effective taxation policy in democracies. With regard to taxation policy, governments and stakeholders necessarily have competing interests. Governments want to maximize taxation revenue without distorting the market (and causing a deadweight loss). On the other hand, stakeholders (the affected companies) want to minimize to the greatest extent possible their taxation liability. This means that they are likely to resist an actual or perceived increase in their taxation liability. Accordingly, the long-term policy objectives of government often conflict with the short-term interests of stakeholders. This makes policy formulation in democracies difficult, as, to be legitimate, policy must be the result of a negotiated agreement. The theory surrounding deliberative democracy assumes that a negotiated consensus is always possible when, in actual fact, the interests of stakeholders may be so divergent that complete consensus is impossible.

This is particularly apparent when some stakeholders are more powerful than others. How do governments identify which stakeholders are the most important? Mitchell, Agle and Wood [51] proposed three factors: (1) the stakeholders' power to influence decision making; (2) the legitimacy of their relationship to the government; and (3) the urgency of their claim. The institutionalization of a relationship can further be seen as a clear indicator of the present status of the importance of that relationship and of the amount of corporate attention it receives. [52]

However, Maessen et al. [53] suggest that a different test should be preferred to determine the relative importance of stakeholders, i.e. the level of involvement (or relative distance) of a stakeholder to a particular enterprise. There are four main groups of stakeholders: (1) primary stakeholders, with structured economic relationships and formal contracts; (2) secondary interest groups with relationships that may have been established by agreements, branding or

advertising (the continuity of such relationships must be re-established over time); (3) tertiary stakeholders that are placed at an even greater distance from the government (this group includes any third party with a potential interest in the government's operations, such as neighbours, regulators and NGOs); [54] and (4) primary non-social stakeholders, such as the natural environment, environmental and animal pressure groups, and future generations. [55] Accordingly, stakeholders with the greatest interest in government policies should have the greatest say in their outcomes. [56]

The consultation processes of deliberative democracies are intended to engage, in a meaningful way, stakeholders in public decision making, thereby reflecting the shift from bureaucratic governance to collaborative governance. In order to do this effectively is one of the key issues facing government today. [57] This reflects government's changing relationships with external actors, [58] who are influenced by the changing nature of frameworks in which decisions occur and the power shifts created by the effort to engage with external actors in problem resolution. [59] Ideally, consultation processes should seek to bring together a range of separate but independent organizations whose contributions are important to policy problem solving. [60] However, these networks have been criticized for the hierarchical control maintained over the policy agenda and processes. [61]

This analysis may cast some light on the recent difficulties faced by the Australian government in attempting to implement the original RSPT. Mining companies are particularly powerful stakeholders in the Australian economy, given their control over capital and their contribution to Australia's GDP. This means that the Australian government's intended long-term policy objective of increasing tax on mining companies to reduce the budget deficit and secure Australia's economic growth beyond the mining boom had to be balanced against the short-term interests of the mining companies and those who share these interests. Failing to do so meant that the RSPT lacked legitimacy and many argued that the government itself also lacked legitimacy. After the removal of Australia's Prime Minister, a new compromise was negotiated with the largest mining companies in the form of the MRRT. The MRRT is generally considered to be a more legitimate policy proposal than the RSPT, as it has been developed by consultation. The MRRT is still criticized in that it was only negotiated with the largest players in the mining industry and, therefore, fails to take into account the interests of the smaller mining companies. However, this is not fatal to its legitimacy.

2.2.3. Challenges in tax policy reform: a global perspective

The Australian government faced a number of difficulties in trying to introduce a profits-based tax on natural resources due to the entrenched nature of the tax concessions provided to mining companies. These tax concessions reflect the entrenched importance of mining to Australia's economy.

Taxation policy affects a wide range of industry sectors and the incentives they face. Accordingly, changing taxation policy can have significant effects on the way companies do business. This is referred to as a "tax culture shock", when taxation policy is changed against the will of the voters and without giving businesses time to adjust.

Nerre describes the effects of a tax culture shock as follows:

a feeling of insecurity concerning the new rules of taxation, of dissatisfaction, of being insulted and similar feelings, equally found with the mass of the taxpayers as well as the tax administration. Furthermore, the tax morale and the tax discipline in the country are expected to decline, the tax resistance of behalf of the taxpayers, on contrary, to rise. Also, on the part of the tax administration, a decline in *working* morale [emphasis in original] will occur because the tax officials see themselves as being confronted with new tax laws and an external pressure for success. [62]

An excellent example of the effects of a severe tax culture shock can be seen in the post-World War 2 tax reforms that occurred in newly democratic Japan between 1946 and 1947. The Japanese taxation system was completely reformed, particularly in respect of personal income tax, which was redesigned with higher and more progressive tax rates from 20 to 85%, and a shift to the individually assessed Pay As You Go system. Prior to these reforms, Japanese tax officials could determine the tax debt on an ad hoc collective basis. [63] These reforms were externally imposed by the United States and challenged the culturally ingrained convictions of the Japanese. [64] In particular, the new system required each individual taxpayer to hand in a tax declaration, which went against the traditional cultural value of collectivism, which even today is deeply embedded. This resulted in a vicious circle of tax evasion and subsequent rises in the tax rates. The new tax system was also attacked as an "evil tax" and "tax exploitation" by opposing political parties. [65]

Even if a severe tax culture shock does not occur, problems can still arise due to a tax culture lag. A culture lag "occurs when one of two parts of culture which are correlated changes before or in greater degree than the other part does, thereby causing less adjustment between the two parts than existed previously". [66] This phenomenon of cultural lag is marked by social unrest and adjustment problems in society and can be particularly acute in taxation reform, as

reforming a tax code is a difficult and complex procedure, and requires support and compatibility with other laws and institutions in the system. [67]

Taxation reform in democracies has always been politically challenging. These challenges in part arise from a range of stakeholders with conflicting interests. Deliberative democracy requires negotiation of a consensus from these conflicting interests. Further, these stakeholder interests are often entrenched in a country's existing "tax culture" that reflects culturally embedded norms and historically developed institutions determine the tax code, which sets both the environment and the constraints for the taxation system. In Australia's resource-based economy, this "tax culture" is reflected in a history of tax concessions for the mining industry. Stakeholders affected by any change in tax policy may include taxpayers, politicians, tax officials, tax advisors and academics. Further, as the taxation culture is part of a country's political culture, these changes may result in political upheaval, and in institutional, social and political conflicts. Such upheavals are largest and unavoidable when a sudden or abrupt transformation of a country's tax culture is attempted. In contrast, with smoother, gradualist approaches to transformation of the taxation system, serious shocks to the political culture may be avoided, although more minor adjustment difficulties can be experienced. [68] The RSPT that was originally proposed in Australia represented a significant tax culture shift away from the history of tax concessions granted to mining companies. It also went against the interests of the mining companies, which are a powerful group of stakeholders in Australia's resource-dependent economy. It is little wonder that the proposal resulted in a significant social and political conflict, which is discussed in further detail in 3.

To summarize, tax reform in democracies is challenging, as the government is required to negotiate a consensus between a wide variety of stakeholders with competing interests.

3. Mining Tax Reform in Australia

3.1. The proposal

3.1.1. Initial comments

Australia currently has a resource-dependent economy. Commodity exports account for a significant proportion of Australia's GDP and are considered to be a major reason why Australia's economy fared comparatively well in the global financial crisis. Mining mainly occurs in remote regions of Australia, bringing well-paid jobs and infrastructure to these areas. This explains why Australia has legislated tax concessions for the mining industry in an attempt to attract valuable mining projects away from other parts of the world.

What then caused the Australian government to consider changing the tax treatment of mining companies? Commodity prices are surging, [69] whilst royalty charges remain relatively constant. [70] Further, the revenue collected from mining companies can be directed at alleviating the problems caused by the natural resource curse. [71] Increasing the taxes on mining companies indicates the recognition that natural resource deposits are finite. Imposing a profits tax is intended to encourage new exploration and, therefore, to encourage the full utilization of Australia's natural resource deposits. Further, putting some of the tax revenue collected from the mining industry into developing other industries may assist to secure Australia's economic growth beyond the mining boom.

3.1.2. Origins of the resource rent tax proposal

The taxation of mineral rents was first proposed by leading economists Garnaut and Clunies-Ross in a seminal 1975 article, [72] which outlined their proposal for a resource rent tax for natural resource projects in developing countries so as to enable more of the net economic benefits of these projects to accrue to the domestic economy. They attempted to define a base for tax that was as close as possible to the true rent. [73]

The main argument in favour of a tax like the MRRT is that it is not distortionary, as it does not result in any change to private investment and production decisions. This is because the ranking of potential projects according to profitability is unchanged and there is no change to the projects that are assessed to be profitable before and after the resource tax is implemented. [74] In contrast, the current system of output-based royalties does not fulfil the criterion of neutrality, as marginal projects will not be assessed as profitable after imposition of the royalty charge.

Charging small mining operations a higher proportion of tax, which occurs under the royalties system, also deters small exploration ventures that face high start-up costs and a high level of risk due to the speculative nature of their operations. The system of royalties does not reflect the high costs of investment and production faced by resource projects. This means that the risk premium for any given project tends to be higher under a royalty than a profits tax. As royalties are levied irrespective of the cost of exploration and production, more risky deposits, or those that are more costly to develop, are not pursued, or are closed earlier than they would otherwise be, thereby distorting production.

Further, the volatility of the commodity prices is a major source of the risks of the mining operation, but the current system of royalties does not recognize the effect of low commodity prices on the mining company, as they are unresponsive to the net cash flow position of the project. [75]

Finally, the static nature of royalty charges means that, over the last decade, as the price of commodities has experienced a massive increase due to the huge demand from China and India, the amount of tax paid by mining companies had remained stable. This means that the effective resource charge paid by mining companies has halved from 34% to less than 14% in 2008-09. [76] In contrast, profits taxes do not have this distortionary effect and are, therefore, considered to be a more efficient option than royalty charges.

3.1.3. The original proposal: RSPT

The RSPT was originally proposed by the Henry Tax Review on 2 May 2010. The intention was to replace the existing mining royalties with a 40% tax on all profits over the 6% rate of return, which is the ten-year government bond rate or the risk-free return on capital. It should be noted that defining super profits as all profits realized over the 6% risk-free rate of return was a significantly lower threshold than that currently applied to the existing petroleum resource rent tax (PRRT), which is set at all profits greater than 21%. [77] The introduction of the RSPT as proposed by the Henry Tax review would have meant that the effective overall tax rate paid by mining companies would have increased from 42% to 57% for mature mining companies. [78]

Any losses could have been carried forward as tax credits or refunded on a reasonable basis at the 40% rate. These tax credits would have been indexed to the inflation rate so they did not lose their real value. This would have meant that the government was effectively a partner in the mining project, bearing 40% of the risk if the project fails and reaping 40% of the reward if the project succeeded. [79] This was assumed by the Henry Tax Review to reduce the risk associated with the project, as some of the risk would have been transferred to the government, [80] thereby reducing the required return on mining investment and allowing the tax to be neutral. The RSPT tax base would have been the value of the resource at the tax point less all allowable costs incurred in getting the resource to the taxing point, for example, exploration costs, mine development costs, and processing and haulage costs. Company tax would have been deductible from the RSPT. [81]

However, the definition of profits would not have allowed deductions for payments: (1) of interest and financing costs, including the cost of issuing shares, the repayment of equity, the payment of dividends, and financial hedging costs; (2) to acquire an interest in an existing exploration permit, retention lease, development licence, production licence, pipeline licence or access authority; payments to acquire interests in projects subject to the RSPT; or (3) of income tax or goods and services tax. [82] The RSPT would not have been a company tax and, therefore, no franking credits would have been deductible for dividend payments. [83] The RSPT would also not have subjected to tax the risk premium associated with the company's risk in a mining project. [84]

The Henry Tax Review also argued that the RSPT could have reduced sovereign risk, as investors would have perceived it to be more stable over the long term. A rent-based tax is likely to be accompanied by lower sovereign risk, as it collects a constant share of the rent under varying economic conditions. In contrast, output-based royalties have higher sovereign risk, as the government has an incentive to make ad hoc adjustments to the royalty rates in response to changes in the value of the resource rent. [85]

The RSPT was based on the assumption that it would have caused no distortion to investment decisions:

“For every \$1 of income transferred to the government through mining royalties there's a further loss to the economy of 70 cents from the disincentive effects for mining production and investment”, he [Mr Murphy] said.

By contrast, the current PRRT has no adverse impact to the economy because for every \$1 it transfers to the government there is no cost, he [Mr Murphy] said. [86]

Mr Murphy also said that on KPMG Econtech's projections, mining industry output would grow solidly over the next two to three years. [87]

These assumptions have been criticized [88] when challenging the conclusion reached by ABAREconomics that:

... it is apparent that switching from output-based royalties to a profit based royalty in Australia would be likely to result in significant efficiency gains although this would be achieved at a higher administrative cost. [89]

On 20 May 2010, Garnaut addressed the University of Melbourne, indicating his support for the RSPT if the following two issues were satisfactorily resolved:

Will investors come to see the loss offsets, and companies' capacity to carry them forward with interest and to redeem them in cash in the case of failure of an investment, as a reliable and permanent feature of the taxation environment? And is it really the case that, with all their imperfections, Australia's financial institutions will fund delayed credits at the Commonwealth's borrowing rate? [90]

3.2. The debate

3.2.1. Political negotiations in the lead-up to the proposal

The mining industry expected the introduction of a profit-based resources tax at least a year before the Henry Tax Review was released. [91] Indeed, the Minerals Council of Australia indicated that it preferred a profit-based tax to royalties charges in its November 2008 submission to the Henry Tax Review, subject to extensive consultation being undertaken. [92]

However, the RSPT was released on 2 May 2010 as more than a proposal: it seemed that the details had been finalized without consultation. This proved to be a PR disaster for the Australian government. The mining industry responded with outrage and called on the Australian government to scrap the RSPT proposal and consult extensively. The Australian government did not indicate its intention to consult on all details of the tax. The mining industry commenced a media campaign against the tax: [93]

The Federal Government's plan to introduce a 40% national mining tax can only be described as revenue grab not taxation reform. It is an unprecedented double-tax that will hit the industry's workforce, the millions of Australians with shares in superannuation or minerals companies and the thousands of small businesses that service the industry. [94]

State politicians, particularly from the resource-rich states of Queensland and Western Australia, also expressed their objections to the tax in very clear terms. In particular, the Queensland Resources Council (QRC) joined with Queensland Premier, Anna Bligh, and Treasurer, Andrew Fraser, to oppose the RSPT. [95]

However, the proposal received in-principle support from economists. [96] The Minerals Council of Australia also generally supported the move away from royalties charges towards a profits-based tax. [97] Where the stakeholders differed was in the details of the design and implementation of the RSPT.

3.2.2. Arguments for the RSPT

3.2.2.1. Background

The introduction of a resources rent tax has a strong theoretical economic foundation. The four main arguments in favour of the RSPT were: (1) the natural resource curse; (2) Australia's "two-speed economy"; (3) encouraging marginal projects; and (4) acting in line with international trends.

3.2.2.2. Natural resource curse

Mining, by its very nature, is cyclical, as natural resources are exhaustible. This means that the mining industry may only continue for another 75 years, after which it will cease to exist as Australia's natural resource deposits are exhausted.

There is evidence to suggest that, despite the short-term benefit to economy of commodity mining, this does not necessarily translate into sustained long-term economic growth. This is referred to as the "natural resource curse", which has been defined as "the socio-economic division, political capture or environmental degradation that results from dependence on extractive industries". [98] The natural resource curse argues that the following flow-on effects of mining can hamper economic growth:

- deindustrialization;
- high commodity price volatility;
- ecological degradation;
- income volatility and uncertainty;
- endowments of commodities may encourage rent-seeking and corruption that has significant negative effects on the quality of domestic institutions;
- natural resource windfalls on government revenues may hamper effective government policy-making through the encouragement of pro-cyclical fiscal policies that entail short-term unproductive spending; and
- reduced incentives to develop non-resource sectors of the economy. [99]

The natural resource curse arises from assuming that revenues and benefits to the economy gained from the mining industry are permanent, thereby overlooking the reality of the cyclical nature of mining and the finite nature of natural resource deposits. The distribution of government revenue from mining tends to be uneven over time due to the natural resource curse, which means that:

- there is uneven inter-generational distribution of revenue flows;
- temporary revenue booms associate with high levels of general economic activity during the construction phase of major resource investments;
- large stepwise increases in revenue when new mines begin production; and
- cyclical fluctuations in revenues in response to variations in demand for the products of established mines on international markets. [100]

This leads to rent-seeking behaviour from governments that privileges the mining sector over other sectors and exacerbates the socio-economic divide in a country. Such a situation has arisen in Australia. [101]

3.2.2.3. "Two-speed economy"

Mining in Australia has led to what is commonly referred to as Australia's "two-speed economy". This entails that the resource-rich states of Queensland and Western Australia have experienced sustained economic growth because of mining, whereas the less-resource rich states have had slower economic growth. [102]

During the construction booms caused by mining, the price of labour and other factors of production rises and, therefore, government revenue and public expenditure rises. Supply bottlenecks in the general or regional investment boom often introduce inefficiencies into private and public programmes. Further, given that Australia has a low population and is currently experiencing a shortage of skilled labour that is likely to continue in the near future, this "two-speed economy" is translated into increased competition for labour for mining, to the detriment of other sectors. The labour scarcity also results in increased wages for mining. Accordingly, output and employment rise in the mining sector and fall in other sectors, thereby leading to a two-speed economy. This will cause problems when the demand for mining declines as Australia's natural resource deposits are exhausted. [103]

The transition from a developing to a developed economy is marked by the transformation from a manufacturing to a service-based economy. [104] Further, commodity prices are notoriously unstable and spending mining revenues immediately generates economic instability in much the same way as the labour and construction boom and slump discussed previously. [105]

Garnaut and Clunies-Ross [106] have suggested three possible solutions to the undesirable timing of mineral production and revenue. One of these is that the government can move the use of mineral revenue over time by varying the levels of fiscal reserves and indebtedness.

The RSPT was intended to implement the third method. In particular, the Commonwealth government has stated that one of the objectives of imposing the RSPT was that:

... revenue from the RSPT will provide opportunities for broader economic reform focused on improving economic performance, productivity and growth in national income. This is particularly important given the demographic challenges Australia faces with an ageing population. [107]

3.2.2.4. Effect of the RSPT on marginal projects

The imposition of the proposed RSPT it was argued would have reduced the risk premium of projects, as the rebate provided by the government would have reduced the losses incurred by private investors if resource projects failed owing to unexpected adverse outcomes, and, therefore, the risk exposure of private investors would have been reduced.

The RSPT as originally proposed by the Henry Tax Review would not have been payable until the government had repaid its share of the project costs, which would have accumulated at the threshold rate, to the private investor (the active partner). With full loss offset, the private investor would have received the value of the government's implicit share in the project costs with certainty, as the government would have been, effectively, partnering in the project with the mining company.

A lower risk premium could have resulted in a lower borrowing rate for mining companies and could also have resulted in some submarginal projects being reassessed as profitable. Accordingly, overall industry output could have increased.

In addition, the reduction in risk associated with the government's 40% guarantee of return on capital could have

increased access to venture capital for small exploration companies. These currently struggle to obtain finance, particularly for their riskier ventures. [108]

3.2.2.5. International trends

The Henry Tax Review cited IMF studies to show that, where countries have specific mineral taxation arrangements, these arrangements are usually profit-based royalties set at around 5% of gross revenue. The Henry Tax Review also argued that, more recently, some developed countries with significant resource endowments have moved towards rent-based taxes. [109]

One such example is the petroleum tax system in Norway, which approximates a rent-based tax. Although the basis for this tax is the company income tax system, the tax applies uplift to expenditure to exempt the normal return from tax and reimburses the tax value of exploration expenditure for companies in a loss position. Norway imposes a total tax rate on petroleum rents of 78%, consisting of a 50% rent-based tax rate and company income tax of 28%, with no deduction at the company income tax level for tax paid under the rent-based tax. [110]

The RSPT would have taken a long-term view of the economy and would have retained revenue from the cyclical mining industry to contribute to the growth of other, more sustainable sectors of the economy. The taxation of profits would have contributed towards a more sustainable economy in a manner that would not have been intended to distort investment decisions of mining companies, as the RSPT would have not changed whether or not a project would be considered to be profitable in the first place.

3.2.3. The mining companies

3.2.3.1. Background

Why did the mining industry respond with such outrage to the proposed RSPT, when profits-based taxes are supported by such strong economic arguments?

There are three main reasons why the mining industry objected to the RSPT. First, they claimed that the RSPT as proposed by the Henry Tax Review, would not have worked in practice as it was based on incorrect assumptions. In particular, the mining companies essentially claimed that the Henry Tax Review and the Australian government had paid inadequate attention as to how the RSPT would have worked in practice, as it was modelled on the assumption that it would not have given rise to distortion and would have allowed mining companies to borrow at the risk-free government bond rate. Second, the mining industry was angered by the Australian government's unwillingness to consult on all the details of the tax. Third, the mining industry argued that, despite the economic arguments advanced regarding the long-term benefit of the RSPT, it was never denied that there would be a detriment to mining companies. Many argued that the detriment to the mining industry would have been so severe that it could not be justified by any supposed long-term benefit. As the mining industry is a major contributor to the Australian economy, imposing a tax based on economic considerations alone is not enough: social and political factors had to be taken into account. [111]

3.2.3.2. Investment in the mining sector

Investment in the mining sector is mainly driven by three factors: (1) expected financial returns, including the expected tax rate; (2) political risk; and (3) access to a skilled labour force. The proposed RSPT directly placed two of these at risk. The RSPT regime would have imposed one of the highest tax rates in the world, excluding certain petroleum taxes. A reduction in financial returns could have made mining companies less ready to invest in Australia. Mining companies generally reinvest profits in exploration and new developments and pay relatively low dividends. A reduction in after-tax profits would have reduced the reinvestment of profits. The RSPT would not have been a company tax and so no franking credits would have been available for the payment of dividends, which would have meant that shareholders would have effectively been taxed twice when they receive payments of dividends. Any reduction in share prices caused by the RSPT could have given rise to significant acquisition activity. [112]

The RSPT was also considered to add uncertainty to investing in Australia by increasing the political risk experienced by mining companies. This could have discouraged foreign investment. [113]

3.2.3.3. Risk and retrospective application

One of the main criticisms levelled against the RSPT was that defining "super-profits" as any returns received above 6% would not have adequately allowed for the risk premium experienced by mining companies, [114] given that the 6% rate is risk neutral, and would not have allowed for deductions in interest payments. According to many, this would have removed the mining companies' incentives to take risks that could have resulted in profits over 6%. [115]

In contrast, the weighted average cost of capital for a mining company is somewhere in the realm of 11% and many believe that the profit threshold should have been raised from 6% to 11%, as this is the rate used by the current resources rent petroleum tax. [116] The mining companies argued that imposing a flat tax rate on the profits of all mining companies would be inappropriate. Unlike the petroleum industry, the mining industry as a whole is comprised of many companies with different risk and return profiles. They argued that it would be inappropriate to impose the same taxation rate on all such companies. [117]

Contrary to the assumptions underpinning the RSPT, the mining companies argued that the 40% government guarantee would not make it easier or cheaper to get financing, as banks would not be attracted by the prospect of a government guarantee. [118] This view was supported by Garnaut, who said that:

... if the cost of capital to some investors for funding the delayed tax credits exceeds the Government's borrowing rate, then the new arrangements, too, will be associated with distortion, and dissipation of economic value. [119]

This view is also supported by Australian Petroleum Production and Exploration Association chief executive Belinda Robinson who stated the petroleum sector was not opposed to the concept of a profit-based tax system per se, but that there was also widespread opposition to the RSPT proposed by the Henry Tax Review, particularly the low profit threshold of around 6% before the 40% rate was applied. In particular, she said that "[n]ot in anyone's wildest economic nomenclature is that equivalent to a super profit". [120]

Accordingly, the receipt of "super-profits" is a normal feature of every industry. All businesses aim to make a return on investments that is higher than the risk-free government bond rate. This generates new capital and induces competitive producers to enter production. [121]

Risk is exacerbated by the problem of uncertainty and imperfect knowledge. [122] In their 1975 article that first proposed the taxation of mineral resource rents, Garnaut and Clunies Ross wrote:

The complexity of the "rent" concept and the government's ignorance in any particular case of the supply price of investment make the balancing of revenue loss through over-liberal approaches to taxation against revenue loss through deterrence of new projects extremely difficult... This approach is less useful the greater the uncertainty about profitability. The problem is greatest when information available to the investor is also superior to that available to the government, but, under conditions of uncertainty, risk aversion introduces problems even with equal information. [123]

The mining industry made much of this view, claiming a number of their projects had been placed on hold due to the uncertainty caused by the tax and that the uncertainty regarding profitability could deter foreign investment. [124] In particular, BHP Billiton Chairman Jack Nasser wrote in a letter to investors "[t]he risk is that Australia could now be seen by the rest of the world as a less stable and less competitive place for long-term investments". [125] Further, the uncertainty caused by the government "changing the tax any time they want", would be "viewed very negatively by the investing world". [126]

The mining industry also believed that the RSPT should not be applied to existing projects. [127]

3.2.3.4. International comparison of resource taxation rates

Under the RSPT as proposed by the Henry Tax Review, Australian mining companies would have been taxed at a rate 45% higher than their nearest competitor, which is the United States, and more than twice the rate of their cheapest competitors in Canada. Even the current rate of tax was at the high end of what was charged by Australia's competitors (see Table). [128]

Table: Total tax burden on mining companies – global

Country	Tax burden (%)
Chile	17
Canada	23
China (People's Rep)	30
Russia	30
Peru	32
South Africa	33

Australia – present	38
Brazil	38
United States	40
Australia – post RSPT	58

Source: Citi Investment Research and Analysis (2010). [129]

This view was supported by mining companies, which believed that the RSPT would have made Australia a less competitive place for mining, [130] instead diverting mining to places with a lower tax rate. In this regard, in Zambia, mining exploration dropped significantly after the increase of mining royalties and company taxes, which resulted in the Zambian government reducing taxes again. Some believe this provides a warning to Australia. [131] However, the Australian government argued that Norway's profits-based tax of 50% has not discouraged oil companies. [132]

3.2.3.5. Effect on superannuation funds and dividends

Deloitte Superannuation Tax Partner, Noelle Kelleher stated that the introduction of the RSPT could have detrimentally affected the after-tax earnings of superannuation funds investing in the established resource sector. In particular:

The resource companies may have reduced profits to pay out in dividends and the RSPT is not a creditable tax for imputation offset purposes. Further, if it decreases the profits of the resource companies then the share price may reflect this. This will reduce the net asset value of superannuation funds. [133]

As the RSPT would not have been a company tax, any dividends paid would not have received franking credits, which would have meant that shareholders receiving dividends would have been taxed twice.

3.2.3.6. Deadweight loss

The RSPT was based on the assumption that the tax would not have given rise to a deadweight loss and consequently would not have reduced the number of projects considered to be profitable. In contrast, royalties give rise to a deadweight loss, as fewer projects are considered to be profitable than otherwise would be. [134]

One of the major criticisms of the economic analysis used to support the tax was that, the deadweight loss from royalties was assumed to be 70 cents for every dollar in royalty revenue earned, whilst the deadweight loss from the RSPT was assumed to be zero. Many argued that both of these assumptions were incorrect. [135]

As the RSPT tax would have been imposed on profits, many believed that this would have given rise to an incentive for mining companies to reduce the size of their projects. In this regard, Mr Albanese of Rio Tinto, stated that:

If the super tax had been in place, I think you can be assured that the Pilbara business would have been a lot smaller business now than it actually is today. The government's claim that it would have gotten \$35 billion of extra taxes over the past decade if it had this tax in place ten years ago ignores that inconvenient reality. [136]

3.2.3.7. Effect on emerging industries

Liquefied Natural Gas (LNG), in the form of Coal Seam Gas (CSG) and Underground Coal Gasification (UCG), [137] will be major industries for Australia over coming years and there were concerns that the uncertainty caused by the proposed RSPT could have delayed the start-up of the industry. [138] In this respect, on 6 May 2010, Santos stated that the tax was an "unnecessary and risky" step at a time when the Queensland LNG projects were advancing toward the approval stage. Santos still expects to make a decision in 2010 to proceed with the project. [139]

The uncertainty was claimed to have the potential to delay investment decisions on tens of billions of dollars worth of LNG projects around the country. Accordingly, industry players urgently called for clarity on the new proposal, which they require before making crucial investment decisions. Some speculated that the RSPT could have given rise to the merger of LNG projects, as each individual project was potentially less viable on its own. [140]

Queensland Premier, Anna Bligh, also expressed her concerns regarding the possibly inequitable effect of the RSPT on what is an emerging industry:

I don't think you can treat an industry that is just barely getting on its feet, like LNG, in the same way as you can treat a company that's been in operation for 20, 30 or 40 years. There's got to be some support for new industries in this. [141]

3.2.3.8. The effect of rising commodity prices on China

There is existing tension with China over near-record-high iron ore prices. China has alleged that the big mining companies are running a price monopoly and, therefore, has threatened a two-month boycott. China raised concerns that the RSPT would have raised commodity prices even further, and reportedly put some investment in Australia on hold amid uncertainty over the new tax. In response, the Commonwealth government has announced that it intends to consult with China over the new tax. [142]

3.2.3.9. Employment and infrastructure

As things currently stand, mining brings a range of indirect benefits to the economy, including jobs and infrastructure and flow on industries, such as small businesses servicing the mining companies. [143] There are concerns that the RSPT would have had a negative effect on jobs by reducing the amount of money available for wages, which are paid out of post-tax profits:

But much of the rents are going to workers in the industry. The domestic pool of workers who have the skill or the inclination to work in the remote mining locations is constrained and as demand rises they are claiming a big part of the rents. [144]

In many remote towns in Australia, mining is the main, if not the only industry. [145] As such, it has been argued that it is undesirable to impose extra taxes on such companies, as they have a positive net effect on their local communities:

Mining Companies have in the past built their own roads, their own railway lines or financed them, their own towns and water supplies, financed schools etc etc. And are willing to do so again, including financing and establishing ports and other facilities. And on top of all of that are slugged unmercifully with taxes and royalties. [146]

It has also been argued that mining companies, which often own large infrastructure assets that are impossible to duplicate (natural monopolies), would have had an incentive to transfer the extra charges imposed on them by the RSPT to others using the infrastructure, i.e. smaller exploration companies. [147]

3.2.3.10. Use of revenue

One of the major arguments in favour of the RSPT was that it would have allowed an economy to achieve inter-generational equity by retaining some of the mining revenue generated in the present for spending in the future. [148]

However, given the 2010 Budget recently proposed by the Commonwealth government, [149] many felt that the revenue from the RSPT would, instead, have been spent on reducing the existing budget deficit incurred from the stimulus package that was the Commonwealth government's response to the Global Financial Crisis:

That's one of the reasons for this totally unjustified slug on miners – they need to take the money from the productive economy because they've spent too much rescuing us from a threat that wasn't nearly as large as they thought. [150]

As such, the RSPT would arguably not have helped to achieve inter-generational equity at all, instead compensating for the past over-spending of the government, at least in the short term.

3.3. The development of the MRRT

3.3.1. The Australian government's response

The proposed introduction of the RSPT attracted a great deal of criticism from the mining industry, in particular, with regard to the apparent unwillingness to negotiate key details of the RSPT with mining companies, specifically, the 40% tax rate and its application over the 6% rate of return (the risk-free government bond rate). [151] In response to the mining industry's media campaign criticizing the tax, the Australian government launched its own advertising campaign supporting the tax. This move by the Australian government was heavily criticized. [152] The Australian government's popularity fell to 47% to 53% on a two-party preferred basis on 23 June 2010, which put the Australian Labour Party in an election-losing position for the first time since 2006. [153]

On 23 June 2010, it was reported that the Prime Minister's chief of staff had talked to over half the Australian Labor Party (ALP) caucus to gauge the support for Kevin Rudd, the Prime Minister at the time. Later that evening, it became clear that Kevin Rudd had lost the support of the Australian Workers Union and the entire ALP right faction, which had swung behind Julia Gillard, the deputy Prime Minister, and at 7:30 p.m. that night it was announced that Julia Gillard was in a meeting with Kevin Rudd discussing a leadership challenge. It was then announced that a leadership ballot

had been scheduled for 9 a.m. the following morning. By 9:30 a.m. the next morning (24 June 2010), Kevin Rudd had announced that he would not contest the leadership ballot and stood down from his position as Prime Minister, leaving Julia Gillard to take his place. In the subsequent Cabinet reshuffle, Kevin Rudd was not given a portfolio. It was popularly supposed that a key reason for the leadership change was Kevin Rudd's proposed introduction of the RSPT. Mining magnate Andrew Forrest publicly congratulated Julia Gillard on her election, saying her appointment was a reflection of community concern about the tax. [154]

In response to the announcement of Kevin Rudd standing down from his position of Prime Minister, mining stocks rose, thereby anticipating that Julia Gillard would be more willing to negotiate with the mining companies on the RSPT than her predecessor, Kevin Rudd, had been. [155]

3.3.2. The modified proposal: MRRT

In her first press conference as Prime Minister, Julia Gillard indicated her willingness to consult with mining companies, pledged to halt the AUD 38 million government-funded advertising campaign supporting the tax and called on mining companies to do the same. The mining companies responded by cancelling their advertising campaigns. [156]

Although investors were initially sceptical of a quick resolution to the mining tax impasse, Julia Gillard's compromise on the mining tax was announced on 2 July 2010, just over a week after she became Prime Minister.

Negotiations only took place with the three biggest mining companies, i.e. BHP Billiton, Rio Tinto and Xstrata. Smaller mining companies criticized this decision, as they were concerned regarding their exclusion from the negotiations because bigger miners could not negotiate on behalf of smaller companies: "the business models are so vastly different". [157] This resulted in criticisms by smaller mining companies that the tax is discriminatory and possibly unconstitutional, as it has been designed in consultation with three big companies and not the wider industry. [158]

On 2 July 2010, it was announced that the MRRT will replace the RSPT proposal. The MRRT involves a 30% tax on all profits over the 12% rate of return. [159] This is obviously far more generous to the mining companies than the RSPT proposal, which would have been a 40% tax on all profits above the 6% rate of return (the government bond rate). In response, the major mining companies announced the reinstatement of the projects that they had previously put on hold. [160]

Unlike the RSPT, which would have been intended to apply to all minerals, the new MRRT will only apply to iron ore and coal, which are the commodities predicted to increase the most in price. [161] Other minerals will be exempt from the tax. This particularly benefits the nickel mining and processing industry, which the miners have long argued is inappropriate to include in the resources tax due to the complicated and integrated nature of nickel mining and processing operations. [162] All new offshore petroleum and gas projects will be brought under the current PRRT at a tax rate of 40%. [163] Under the RSPT, the offshore petroleum and gas projects would have had a choice as to which regime would apply. [164] Other key changes made to the PRRT include new capital expenditures will be immediately deductible, state royalties will be fully creditable and companies will be able to elect to use market value as the starting base for project assets. [165]

Project assets will be defined in line with the definition in the Income Tax Assessment Act to include tangible assets, improvements to land and mining rights. [166] Taxable profit will be calculated on an individual taxpayer's direct ownership interest in the project, by reference to the value of the commodity, determined at its first saleable form less all costs to that point, less a 25% extraction allowance, and arm's length principles on all transactions pre and post-saleable form. The starting base for project assets will either be book value or market value at the election of the taxpayer. [167]

There are transitional arrangements for existing projects. Where market value is used to calculate starting base, there will be no uplift. Depreciation will be based on an appropriate effective life of assets, not exceeding 25 years. However, where book value is used to calculate the starting base, depreciation will be accelerated over the first five years. The undepreciated value will be uplifted at the long-term government bond rate plus 7%. [168]

Concerns regarding retrospectivity have also abated with miners being able to claim the market value of their existing assets, being able to access faster depreciation rates for new investment and new investment made after the introduction of the tax being capable of being written off immediately. MRRT losses will be transferable to offset the MRRT profits the taxpayer has realized on other iron ore and coal operations, and carried-forward losses will be indexed at the allowance rate equal to the ten-year government bond rate plus 7%. The MRRT will be an allowable deduction for income tax. All capital expenditure incurred post-May 2010 will be added to the starting base and depreciated against mining operations from 1 July 2012 and all post-1 July 2012 expenditure will be immediately deductible for MRRT on an incurred basis. Non-deductible expenditure will be broadly consistent with the PRRT. If a project interest is sold, any

undepreciated starting base and carried forward MRRT losses will be transferred to a new owner. [169]

All state and territory royalties will be creditable against the MRRT liability, but not transferable or refundable (unlike the RSPT). Conversely, any royalties paid and not claimed as a credit will be carried forward at the uplift rate of the long-term government bond rate plus 7%. [170]

Overall, the actual tax rate on mining companies imposed by the MRRT is set to be approximately 46% on their raw profits, thereby giving an effective company tax rate of 22.5% (30% less 25% extraction allowance). [171] The exclusion of all minerals other than iron ore and coal, as well as companies realizing less than AUD 50 million in profits, means that only 320 companies (as opposed to 2,500) will be captured by the tax. Official figures state that the proposed revenue from the scheme will be reduced from AUD 12 billion to AUD 10.5 billion. Henry notes that this smaller-than-expected drop in revenue is due to revised commodity price forecasts between the modelling used for the original RSPT and the new MRRT. [172] Whilst the first set of forecasts were obtained from the Australian Bureau of Agriculture and Resource Economics (ABARE) for the Federal Budget every year, the second set of forecasts were internal to Treasury and involved upgraded commodity price estimates. Other estimates place the reduction in revenue up to AUD 35 billion over the next decade, which means that the Commonwealth government has given the mining industry AUD 7.5 billion in tax concessions. [173] In order to partially compensate, unlike the RSPT that offered a 40% rebate in the event of a loss, the MRRT does not offer tax credits for losses. [174]

There are some key differences in the way the MRRT will operate compared to the RSPT. In particular, the operating margin will allow for an immediate deduction for operating costs and certain investment costs. The deductions under the MRRT will also be more generous than under the RSPT. Further, the MRRT allowance will be the value of the MRRT losses uplifted at 13%. These will be expected to arise in the early stages of a project, where project development costs may be immediately deducted for MRRT purposes. The uplifted royalty offset of 13% will apply to any royalties that have been paid, but not yet credited against an MRRT liability. Finally, mining companies will be able to choose whether they bring in existing projects at the market value or book value. This means that the MRRT will be likely to result in a lower tax liability overall. However, the MRRT will not include an exploration rebate, which could have been of benefit to small speculative ventures. [175]

In this regard, it should be noted that the Minerals Council of Australia has announced its support for the new MRRT. [176]

However, to pay for the reduction in the mining tax, which means much less revenue raised, the other tax concessions proposed by the Henry Review can no longer proceed. In particular, the company tax rate of 30%, which is one of the highest among OECD Member countries, will not be reduced to 28%, although the proposed increased superannuation guarantee of 12% will not be postponed. Accordingly, Smart Company comments that "[t]he compromise from the government [with the mining companies] has come at a cost for the wider business community". [177] Other promises that were to be funded by the RSPT have also been cut due to the reduced revenue gained from the new MRRT. These include the exploration rebate for miners, which was forecast to raise AUD 1.1 billion. The AUD 700 million infrastructure fund intended to compensate the states for infrastructure developments lost as a result of the RSPT is also expected to be cut. [178]

However, the fledgling magnetite industry in Western Australia has demanded that it be excluded from the operation of the MRRT by claiming that the government is ignoring smaller, emerging miners in the lead up to the election. It has also been argued that the 12% uplift rate penalizes smaller mining companies, as they have higher funding costs than larger, more profitable operations. [179]

Julia Gillard has responded to these concerns by claiming that she will be consulting with smaller miners and also that the changes to the MRRT mean that fewer small mining companies will be affected by the tax, particularly because the MRRT's application to iron ore and coal targets only the most profitable sectors. [180]

Concerns regarding reductions to state royalties remain. Western Australia has expressed particular concern with regard to the new MRRT in claiming that the tax will increase the proportion of the state's contribution raised to 70% of the total revenue raised, which is an increase from 33.3% under the RSPT. [181]

Fortescue Mines wants interest deductibility to be included in calculating the tax, an increase in the extraction allowance from 25 to 30% and an increase in the exclusion threshold from AUD 50 million to AUD 100 million. [182] Henry also announced his disappointment in the modifications made by the MRRT with regard to the RSPT. [183]

3.3.3. Mining tax policy reform

The difficulties faced by democracies in reforming tax policy can be illustrated by Australia's recent attempt to

significantly increase the amount of tax paid by mining companies by introducing the RSPT.

The Australian economy's resilience to the recent global financial crisis is credited to the ongoing demand for commodity exports from China, India and Japan. This means that mining companies are important stakeholders and their interests must be considered when developing changes to taxation policy.

Democracies engaged in policy formulation must negotiate with a variety of stakeholders to ensure that their policies are legitimate. This requires democracies to go beyond economic considerations and take the social and political interests of affected stakeholders into account when developing policies. The Australian government's perceived failure to take the interests of the mining industry into account when developing the RSPT resulted in political controversy and the removal of the incumbent Prime Minister. The tension between the government and the mining industry ended when the MRRT was negotiated. The MRRT is perhaps less sound according to pure economic theory, but has more legitimacy as a policy, as it took the interests of the largest mining companies into account. Some opposition still remained from the smaller mining companies, as they were not consulted regarding the MRRT.

However, the requirement for democracies to reach a negotiated consensus when developing policies is particularly difficult for taxation reform. The interests of governments and stakeholders are often vastly divergent. The objective of the government "consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing, and without damaging the ability of the goose to lay eggs". [184] In contrast, companies naturally seek to minimize the amount of tax that they paid. The conflict between the long-term policy objectives of the government and the short-term interests of stakeholders is reflected in the difficulties uniformly faced by governments in attempting to reform taxation policy.

The RSPT proved to be no exception. The original justification for imposing a profits-based tax on natural resources was the Natural Resource Curse and the "two-speed economy" so as to secure Australia's economic growth beyond the mining boom. However, mining companies form a very important part of the Australian economy and, therefore, their interests must be taken into account. These conflicting interests mean that there will always have to be some kind of trade-off between short-term and long-term objectives, as reflected by the eventual compromise reached in the form of the MRRT.

4. Conclusions

Reforming mineral tax policy is an important but challenging task for any government. This article discusses theories and examples of tax policy reforms and its challenges in mineral tax reform in the context of a democracy, such as Australia, whose economy is heavily reliant on natural resources.

The article first discusses the role of governments in negotiating tax policy reform with stakeholders. The literature suggests that tax policy reform is a particularly challenging task in democracies, as the objectives of governments and stakeholders often conflict. The article then provides an example of the problems faced by the Australian government in attempting to significantly increase the tax rate on mining companies. Stakeholder theory has been used to argue that the legitimacy of a democratic government depends on how well it can satisfy the interests of its stakeholders. Accordingly, stakeholder theory provides a basis for explaining why mining companies were so influential in developing the mineral resource rent tax in Australia. This indicates that the government of Australia, as a democratic and resource-rich nation, is required to negotiate with the mining industry to develop policy by consensus. The findings of the article have implications for a number of groups involved in taxation policy reform, including governments, academia, industry bodies and practitioners.

However, it should be appreciated that the article has limitations. First, its scope is limited to Australia. Accordingly, there is scope for a similar study to be carried out in other jurisdictions and in other instances of tax policy reform. Second, the article is not applicable to non-democracies.

It is suggested that the following conclusions can be drawn from the article:

- (1) Reforming mineral tax policy is an important task for governments, particularly in the current economic climate. However, this is well-acknowledged to be challenging.
- (2) There is a need for policymakers, tax administration and treasuries to understand the challenges they face in formulating long-term policy objectives that also satisfy the short-term interests of stakeholders.
- (3) Other stakeholders also have roles, particularly government MPs and oppositions. This is because tax policy reform is important for the long-term sustainability of the economy.
- (4) However, democracies must ensure they meet stakeholders' expectations. This can usually be achieved through effective stakeholder engagement and consultations.
- (5) Finally, a trade-off can always be expected between short-term stakeholder interests and long-term policy objectives, which is good as long as this moves forward the ultimate goal of better socio-economic policy outcome.

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- The authors wish to thank Prof. Malcolm McIntosh, Director, Asia Pacific Centre for Sustainable Enterprise, Griffith University, Australia for his comments on an earlier version of this article.**
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