16 April 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

Dear Sir/Madam,

RALPH COMMITTEE REVIEW OF BUSINESS TAXATION
DISCUSSION PAPER 2 "A Platform for Consultation"

Delta Gold N.L ("Delta") is an Australian gold mining and exploration company active primarily in Australasia. In the past decade Delta has been responsible for the discovery, and involved in the development, of two of Australia's largest and most successful gold mines. Delta ranks amongst the top 10 gold producers in Australia and is currently one of the lowest-cost gold producers in the world.

Mining is a significant industry in Australia. For example in 1997 mining contributed just over 7% of the national GDP, $29 billion in value and 37% of total merchandise exports. The industry represented 20% of new capital investment in the country and was responsible for some 250,000 jobs both directly and indirectly (source: What the Mining Industry Means to Australia, Minerals Industry, February 1998). Many of these jobs are also in rural Australia. Therefore it is crucial that reform does not adversely affect this industry.

Delta is a member of the Australia Gold Council. As such, we have seen the Council's submissions on the taxation of financial arrangements (prepared jointly with the Minerals Council of Australia) and on the Discussion Paper. We support the comments made in both submissions.

Delta is supportive of the requirement for reform of business taxation and, notwithstanding our membership of the Australian Gold Council, welcomes the opportunity to respond directly to some of the issues raised in the abovementioned Discussion Paper.

In evaluating the proposals raised in Discussion Paper we have commented both on the potential impact to Delta and on what we consider to be the potential impact to the Australian Resources Sector and the Australian Economy.

1. Proposal

Deferred Company Tax Regime

Comments
Delta is a member of the PricewaterhouseCoopers company tax regime coalition and fully endorses comments made in that submission.

2. Proposal

Corporate Tax Rate of 30%

Comments
As the owner of two low cost mature mines the proposed reduction in the corporate tax rate is welcomed. However, when evaluating the other proposed changes which will allow the lower rate to be achieved and specifically the proposed reduction in depreciation rates, concerns arise for the industry.

Generally we feel that the other proposed changes will have a greater negative impact for the Resources Sector as a whole which will outweigh the positive impact of the reduction in the corporate tax rate. This may have a negative impact on investment in the Australian Resources Sector resulting in companies preferring to develop mining operations in countries with more favourable taxation systems.

In addition the Discussion Paper does not in any way suggest how transitional provisions may apply to the proposals. It has therefore not been possible to fully evaluate the proposals and their likely impact. Many of the positive aspects of some of the proposed changes could well be negated depending on the operation of transitional provisions. Therefore it is imperative that the community at large be consulted before transitional provisions are drafted.

3. Proposal

Reduction in accelerated depreciation rates for wasting assets

Comments
As one of the most capital intensive industries in Australia, it is considered that the resources sector will be affected most by this proposal.

The loss of accelerated depreciation rates may well result in initially marginal mining projects and expansions of current projects not being initiated. This may occur because the rate of return on the investment in a project may not be sufficient initially to justify the risk associated with the outlay of capital.

The rate of return will be affected because, with a reduction in depreciation rates, tax payments will be accelerated thereby reducing the present value of the after-tax cash flow from a project.

The rate of return on a project is critical in allowing a company to attract financiers or equity to fund the project.

It is therefore considered important that, whatever changes to the taxation system are implemented, they do not further push out the point at which a project becomes feasible. The Committee should be aware that what is often commenced as a marginal project often becomes a much bigger project. This is due to the fact that, once a project is underway, the full extent of the deposit is known more fully thus normally increasing the economic life of the project. If this occurs the economic benefits to Australia improve also.

We have a real concern that by potentially decreasing the return on investment of long life wasting assets there will be less investment in such assets in Australia. Funds that may be used to develop initially marginal projects or to extend existing projects in Australia may be used to develop other mines either here or overseas. This could have a significant impact on rural Australia and may not have been factored into the Committee's estimate of costs.

Although less corporate income tax may be collected in the earlier years under the current system, tax is still paid as a result of the mine through payments to employees, sub-contractors, etc. It also ensures the viability of rural Australia as the resources sector is an economic wealth generator.

It is our view that should this proposal be implemented, the Resources Sector should be afforded special consideration as alluded to in the Discussion Paper.

It has previously been recognised that the Resources Sector in Australia warrants special treatment. Speaking to the introduction of the *Income Tax Assessment Bill (No 2) 1968* the then Treasurer, Mr McMahon said:

> *"On the other hand, it has long been accepted that the special circumstances of the mining industry, including the wasting nature of ore deposits and the …need often faced by mining companies to provide……, should be appropriately recognised through special provisions in the taxation law. The need for this recognition … is of particular importance in the case of the Australian economy because of the growing contribution the mining industry is making to export earnings and to the development of remote areas of the country."*

In our opinion, the validity of these comments has not changed.

However, should the proposal to reduce the accelerated depreciation rates be adopted it may be made more palatable for the Resources Sector if "Blackhole" expenditure (as noted on page 114 para D.14 of the Discussion Paper) became tax deductible. This is discussed in the following section.

4. Proposal

Deductibility of "Blackhole" expenditure

Comments
If implemented this is a welcome move. As noted above, if accelerated depreciation rates are to be removed, we believe it is imperative these costs (as noted on page 114 para D.14 of the Discussion Paper and discussed below) be deductible for tax purposes when incurred or over the life of the mine (however determined for tax purposes). These costs can be significant for the resources industry.

The major costs in this area are payments to the previous project owners where no notice is given under Division 330 to transfer undeducted allowable capital or exploration expenditure and goodwill on acquisition. Currently the non-deductibility of these costs are a major drawback in evaluating the viability of a project.

It is noted that the Discussion Paper raises the option of allowing a tax write-off for goodwill. This is welcomed by Delta Gold and should be examined further. However, there is no more discussion regarding one of the mining industry's largest "black holes" – expenditures incurred on acquiring exploration and mining tenements.

Currently there is no tax write-off allowed for expenditure incurred on purchasing a mining tenement. This does not reflect the true nature of a mining tenement which is a wasting asset in its purest form. The value of a mining tenement decreases in proportion to the depletion in mineral reserves. On this basis, a tax write-off on an amortisation basis should be allowed.

In addition, it is noted that Delta's major global competitors are based in the United States where a tax deduction is allowed for such costs. When competing for acquisitions, Delta finds itself significantly disadvantaged because of this. Further, it makes Australian mining companies more vulnerable to takeover by companies able to benefit from such tax deductions.

Allowing goodwill and non-Division 330 acquisition costs to be deductible could increase the incentive for Australian companies to expand their investment in the Resources Sector and ultimately benefit the Australian economy.

5. Proposal

Deductibility of exploration expenditure

Comments
Exploration expenditure is referred to in the Paper but not addressed in any detail. However it has been rumoured that consideration is being given to changing the immediate deduction to a system of allowing deductions over an effective life.

An immediate deduction for all exploration expenditure is essential to maintain the incentive for resource companies to undertake exploration activities. It is considered that the removal of this incentive would further decrease an already diminishing exploration industry in Australia which may lead to decreased investment in Australia with flow on economic effects, especially to rural Australia.

As you will be aware exploration is the lifeblood of the resources sector. It is no different in principle to the development or refining of new products for the manufacturing sector or staff training/new product development for the services sector. These costs are deductible and there is no reason why exploration should also not continue to be.

Further to the economic arguments in favour of its retention, amortisation would create many difficulties including increased compliance costs and timing of deductions should an exploration project be unsuccessful.

In addition, Australian companies, in an attempt to become global players, are exploring offshore. Offshore exploration expenditure by Australian resident companies is currently quarantined which can result in a tax deduction never being received for these costs. We believe that to be compatible with our overseas competition, this issue should be addressed and the quarantining of deductions removed so as to allow an immediate deduction for these expenses to Australian companies.

6. Proposal

Valuation of trading stock

Comments

The critical issue will be to ensure that whatever option, if any, is implemented, there should be no taxation of unrealised gains. This is contemplated by Option 2 of the Discussion Paper requiring all stock to be valued at net realisable value.

Should an alternative system be introduced the impact of transitional provisions will be vital.

The treatment of obsolete stock is also important as it would appear that under Option 2 *"all"* stock must be valued which would not allow a deduction for obsolete stock.

Further, expenditure on extracting minerals from the land is currently immediately deductible. However, because the minerals do not become trading stock until severed from the land, there is presently no requirement to bring to account the year-end value of work performed. The proposal to include these costs as part of trading stock or alternatively capitalise and depreciate them for tax purposes (which, for the resources industry, can be quite significant depending on the depth of the ore) over the life of the ore body is opposed by us as it may reduce the after-tax benefit of available tax deductions and, in conjunction with the points raised elsewhere in this response, further hinder the development of initially marginal projects.

7. Proposal

Consumable Stores & Spare Parts to be treated as trading stock

Comments
This will be another negative for the Resources Sector. Due to their location, mining operations often have a high level of consumables and stores on hand so that, for example, if repairs are required or access is hindered by inclement weather, any down time is limited. Due to the often significant investment in these items, the carrying cost of such items should not be increased by adverse tax treatment.

Should such a proposal be implemented, the drafting of the transitional provisions would be vital.

8. Proposal

Scrip for scrip rollover relief

Comments
We view this proposal as a positive for the Resources Sector.

Currently there is a potential economic inefficiency in the CGT treatment of share-swap mergers, such that potential CGT liabilities can arise, even though the transaction may not involve any cash with which to pay the tax. This can lead to mergers not proceeding or the purchase price being increased to enable the vendor to sell sufficient shares so as to pay their CGT liability.

The proposal would bring Australia into line with many other countries which potentially encourage group restructures, mergers and takeovers through the taxation system. Overall, this proposal should see greater efficiency and rationalisation for the Resources Sector, resulting in a positive effect for the Australian economy through, for example, the joining of resources to develop previously unviable projects, and perhaps allowing the development of more Australian based global resource companies.

9. Proposal

Collection of tax liabilities on behalf of non-residents

Comments
We are of the opinion that the proposal to collect tax liabilities of non-residents involving non-resident withholding tax on rents, gains on realisation of assets and income from the provision of services in Australia needs to be reconsidered.

This proposal will significantly increase the already excessive compliance burden on companies and share registries as it will be very difficult to monitor and trace all payments made to non-residents, especially in the case of the realisation of assets. The increase in compliance will result in wasted company resources which would be more effectively used in more productive areas.

10. Proposal

Taxation of financial arrangements

Comments
We welcome the attempt to clarify this area and generally support the current proposals in place of previous options. We have seen the joint response prepared by the Australian Gold Council and the Minerals Council of Australia concerning this topic and concur with the comments made in that response.

Notwithstanding this, we would like to express our view on the following two matters:

(a) Due to the nature of the products produced by the resources sector, an exact matching of hedging instruments with expected delivery dates is not practicable. Under the current taxation system, such hedges are only taxed when they are closed out either by delivery or the entering into of an equal and opposite contract. Thus tax is only paid once the profit or loss on the whole transaction is known.

It is therefore critical that whatever hedging system is adopted does not advance the taxation point from that which exists currently.

(b) The implied proposal (refer page 183) to quarantine normal/ordinary income tax losses arising from financial transactions is most unreasonable. Under this proposal, there would appear to be no matching of losses on the underlying financial instruments with gains on the sale of the hedged commodities. Further, there is no discussion in the Paper as to how, and against what, any such quarantined loss could subsequently be offset. We strongly oppose this proposition as its effect on the Resources Sector could be adverse and significant.

11. Proposal

Consolidation of group tax returns

Comments
Given that one of the objectives of the Committee is to facilitate simplification of the tax system, we do not view this as a practical proposal as it will create significant extra administrative work. It will still be necessary to complete individual company tax returns every year and then prepare a consolidated return every year. The last task could be quite time consuming. Records will also need to be kept to ensure the appropriate treatment of companies entering and leaving groups.

It is noted this consolidation proposal is meant to be optional. However, the ramifications of not electing would be that members would be taxed as separate taxpayers (ie. no loss grouping or CGT rollover would be available). Thus the option to elect becomes compulsory. Further, the optional election is irrevocable and would include any new companies introduced into a group.

It is also proposed that a group must have a resident parent company. This is very restrictive and may go against how that group has chosen to function eg. by business/commodity lines rather than geographical lines. For example two Australian resident sister companies, both with subsidiaries and a common overseas parent, would be treated as two separate groups and be unable to transfer losses, etc. between each group even though they are all part of the same overall group.

If this proposal is implemented then it should be ensured that there are no costs of putting a new holding company in place eg. stamp duty exemptions will be available.

Yours faithfully,

TERRY BURGESS
Managing Director & CEO

<u>Prepared by Delta Gold NL</u>

Contact: Fiona Robertson – General Manager Finance
Phone: (02) 9903 4010
Fax: (02) 9959 4111