Review of Business Taxation - Submission to the Second Discussion Paper, *A Platform for Consultation*

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1. EXECUTIVE SUMMARY AND CONCLUSIONS

The Minerals Council of Australia has welcomed the Review of Business Taxation and the Commonwealth Government's preparedness to pursue tax reform - including the Government's separate goal of improving the efficiency of Australia's indirect tax system through the introduction of a broad-based consumption tax.

The mining and minerals processing sector is not only Australia's principal export earner but also has important supply and demand linkages to other sectors, spending over $12 billion a year within Australia on goods and services inputs. It is a vital part of Australia's high technology development and provides significant R&D and employment spillover benefits to other industries (for example, manufacturing, construction, environmental and waste management, process engineering and design). It has accounted for a fifth of Australia's business investment in recent years.

For Australia to capitalise on its minerals growth potential, maintaining an internationally competitive investment and taxation framework is critical in the face of continued long-term price pressures. In this context, a trade-off to achieve a lower company tax rate at the expense of other business tax arrangements would have significant effects on cash flows and investment economics in the minerals industry.

The Council emphasises that it is the overall tax burden which, by definition, represents the combination of all business tax rates and measures, and not just the company tax rate (or any other single tax measure) that is used in assessing project viability. The overall tax position in Australia (that is, direct, indirect and de facto and actual royalty taxation imposed by Commonwealth / State / local Government) relative to Australia's competitors affects competitiveness and project viability.

The Minerals Council's Approach To Responding To A Platform for Consultation

The Council's submission is divided into six Chapters. In addition to this Executive Summary, each Chapter begins with a series of Key Points that seek to highlight the main 'message' the Council wishes to convey to the Review in each area. **The Table at the end of this Executive Summary presents a summary of the Council's views on selected business tax reform issues.**

The key concerns for the minerals industry raised by the Review are:

- The three Entity Taxation Options
  - The Council is not persuaded by the need for reform in this area and the status quo should be retained.
  - The Council is totally opposed to the DCT option. If it is demonstrable that some change is necessary, although less problematic, the RDWT option still presents some major problems for industry. It should be modified to address industry concerns through additional consultation and other, more acceptable, options should also be explored.

- The trade-off of current depreciation arrangements and other ‘tax expenditures’ (for example, immediate deductibility of exploration expenditure, the current arrangements for wasting assets and other allowable capital expenditures and the R&D tax incentive) for a lower company tax rate.

  - If key tax expenditures were removed as a trade-off towards a lower company tax rate (through imposition of the “revenue neutrality” requirement), the investment climate in Australia for major projects would become less competitive.

  - Such a move would place a burden of taxation on new investment and discourage investment at a time when business investment in general and in the minerals industry in particular is forecast to fall significantly.

  - The Council opposes any suggestion that a move to a lower company tax rate through complete removal of so-called ‘tax expenditures’ could be compensated for by application of major project facilitation through the Department of Industry, Science and Resources’ *Invest Australia* (the “Mansfield Investment Incentive Process”).

  - Immediate deductibility of expenditure on exploration and prospecting is critical for the future of the Australian minerals industry and must be retained.

- The Council strongly opposes any change to the taxation treatment of overburden removal. Any change to this treatment would impact severely and adversely on working capital requirements for minerals companies and the economic viability of individual mining operations.

- The taxation of financial arrangements proposals. The Council is providing a separate submission on this issue.

- Taxation of entity groups – consolidation: except for one or two areas, the current grouping provisions achieve the objectives outlined by the review.

Any suggestion that the benefits of the Government’s indirect tax reform measures should be traded-off on an industry basis against reduced benefits that would otherwise accrue due to business tax reform is strongly resisted on efficiency grounds.

Australia’s indirect taxation and taxation of company income should be determined with a view to achieving the most efficient and equitable structure for the taxation system as a whole, while raising the revenue required to meet Australia’s economic and social objectives over the long-term.

The Council will consider the final recommendations and Exposure Draft Legislation provided by the Review to the Government against the overall objective of achieving an internationally competitive investment and operating framework in Australia which encourages new investment and the continuing development of a profitable and sustainable minerals industry.

The International Competitiveness Of The Australian Tax System

According to a recent study,[1] and taking into account project financing considerations, if the company tax rate is reduced to 30 per cent and the 'accelerated' component of the depreciation for plant is removed, Australia may have a tax regime worse than any of its main commodity producing competitors in terms of impact on internal rates of return for major project investments. It is noteworthy that the Review itself has found the resources sector is favourably taxed in all of the jurisdictions surveyed.

It is clearly advantageous for Australia to have the lowest company tax rate consistent with meeting the overall objectives of Government. But this does not imply that the sole objective of taxation policy should be to achieve a "headline" company tax rate lower than those of our trading partners.

The Taxation Treatment Of The Australian Mineral Industry

In common with a limited number of other activities (including primary production, life insurance and superannuation) there are explicit provisions within the taxation legislation dealing with aspects of mining operations. This recognises the distinctive characteristics that distinguish the minerals industry from most other industries and that, in almost every case, substantially increase the level of business risk.

Minerals companies cannot survive without committing investment in new projects. This includes expenditure on costly infrastructure specific to individual mining / processing operations, together with significant exploration and research and development expenditures.

The industry is highly capital intensive and there are long lead-times before the generation of sales income and production dependent cash-flows. Major international minerals companies place investments where they can maximise their rate of return while minimising risk in a high-risk industry.

Having regard to the industry's distinctive characteristics, arguments for retaining certain tax treatment for the minerals industry and more generally (eg the R&D incentive) can be considered.

This consideration reveals:

- the minerals industry faces a range of non-deductible expenditures. The Review's proposal to address this is strongly endorsed;

- the provision allowing an immediate deduction for exploration and prospecting expenditure recognises the high levels of risk associated with exploration, encourages the discovery of new deposits, and provides a competitive fiscal regime; and

- the allowable capital expenditure provisions allow for deductions for capital expenditure incurred in the minerals industry that would not otherwise be deductible (analogous to plant). The Council supports continued write-off uplift for such expenditures in the context of wider reform proposals, which should take the form of a

[1] PricewaterhouseCoopers (1999), 'Mining worse off under Ralph', in *The Australian Financial Review*, 8 March.

cap on effective life.

The Taxation Treatment Of Wasting Assets, Goodwill And Trading Stock

The current taxation of wasting assets lacks a coherent and consistent framework. The Council is pleased the Review introduces concepts of assets and wasting assets that represent real reform. In addition, the Review's discussion assumes any change will apply prospectively to new asset expenditures only. This is extremely important to minimise sovereign risk and is consistent with past practices of Government.

Any changes in the taxation treatment of wasting assets, whether positive or negative, have implications for project investment economics and for financing of long lead-time projects. It is particularly crucial that reform in this area promotes the international competitiveness and sustainability of the minerals sector. It should also recognise the role of the resources sector in spear heading Australia' remote and regional infrastructure development.

If the Government decides there should be a significant winding back of the treatment of minerals sector wasting assets, it will be necessary to consider other options to ensure project viability is not damaged. In developing such options, the distinctive characteristics of the industry discussed in Chapter 2 and the principles set out at the beginning of Chapter 4 should be borne in mind.

The Council's specific comments on the various options raised by the Review in the context of wasting assets are summarised at the beginning of Chapter 4 of this submission.

The Council strongly supports and endorses the Review's initiative in relation to *non-deductible expenditures*. The Council recommends that the appropriate write-off treatment for individual items will require detailed input from business.

The Council supports the Review's recognition of *goodwill* and similar *intangible rights* as costs that should be amortised for tax purposes as wasting asset items.

The Council considers it is not necessary to change the existing basis of *valuation of trading stock* for taxation purposes for the minerals industry.

The Council rejects the Review's proposal in relation to *overburden removal*, which would have a substantial adverse impact on industry working capital requirements and the economic viability of individual mines. The Council's view is that the treatment of overburden removal is correctly an operating expense that is immediately deductible when incurred because no enduring (or wasting) asset is created. In addition, the Council is concerned at the nature of the suggestions in relation to *consumables and spare parts* and does not believe that a change in the basis of the current treatment is warranted.

International Taxation Issues

The proposed Non-Resident Investor Tax Credit could make it more difficult to negotiate lower dividend withholding tax rates for non-portfolio dividends with additional countries. For this reason the Council is not in favour of the proposal.

It is very important that, if the suggested approach to taxing non-residents on disposal of indirect interests in Australian assets (including a suggestion that the tax liability could be

enforced against the asset) is adopted, it be restricted to situations where the non-resident does have control.

The Council welcomes the Review's suggestion that imputation credits could be allowed for withholding tax deducted from foreign dividends.

Removal of the active business exemption contained in the Foreign Investment Fund (FIF) rules would result in greatly increased compliance costs. The Council considers that this measure would also be inequitable because it would result in the accruals taxation of income of an FIF which may never actually be received by way of dividend. For these reasons the Council is opposed to the removal of the active business exemption.

The Council is opposed to the introduction of additional rules to limit the deductibility of interest incurred by Australian resident companies. The current rules already prevent the deduction of interest from general income where the interest can be traced to a source of exempt foreign income.

The fixed gearing ratio discussed by the Review would cause problems for some companies in the minerals industry unless a very high gearing ratio is stipulated.

The proposed extension of thin capitalisation rules to third party debt is a very significant measure and will have considerable impact on many taxpayers. There are often sound commercial reasons (often related to the risk profile of the investment) for the use of third party debt. It is inequitable to disallow an interest deduction on such debt.

Other Issues

Anti-avoidance Provisions: There can be no dispute that there is an over reliance on specific anti-avoidance provisions in the taxation legislation. As identified by the Review, these provisions add significantly to the complexity of the law and hence compliance costs.

There has been a recent trend in Australian income tax anti-avoidance provisions to require a lower threshold of anti-avoidance purpose versus the 'dominant purpose' test underlying Part IVA of the *Income Tax Assessment Act 1936* (ITAA36). The Council believes that any move to lower the hurdle for the operation of the anti-avoidance provisions is inappropriate and would lead to even greater taxpayer uncertainty. The current ITAA36 Part IVA general anti-avoidance provisions have, through various Court cases, been shown to have real power and have been effective in striking down unacceptable taxpayer activity.

The Council encourages the review and removal of specific anti-avoidance provisions (for example, franked dividends rules) - in particular where it is clear that the review will remove some of the structural flaws in the current taxation legislation. Consultation with taxpayers should be a mandatory aspect of such review.

Capital Gains Tax: The Council notes the need for tax reform of the capital gains tax system is real. The Council supports the recommendation on scrip-for-scrip rollover relief - currently where a share for share merger, takeover, or deconsolidation occurs the capital gains tax provisions are triggered. Allowing a scrip-for-scrip rollover relief whereby the original cost base of shares is maintained without triggering a capital gain would assist the minerals industry in developing new projects and expanding existing projects as well as establishing and maintaining minerals consortiums.

Consolidated Returns: The problems raised by the Review as a result of the non-taxing of a wholly owned group as a single entity are very questionable. Except for one or two areas the current grouping provisions achieve the objectives outlined by the Review. Many of the proposals outlined by the Review in this area would increase compliance and other costs for taxpayers. In addition, many of the proposals have not been fully explored or analysed by the Review to date. If the Review maintains that a consolidation regime is an essential element of the tax reform package then it is equally essential that:

- implementation is deferred; and
- consultation is undertaken with industry bodies to determine ways of removing the unworkable elements of the regime.

Interest Deductibility: The Council supports the continuation of a tax deduction of interest where the associated borrowings are to derive assessable income that is broadly defined to also include capital gains.

Transitional Arrangements: The Council believes the transition to implement comprehensive business tax reform will be difficult to achieve in any meaningful way in the timeframe proposed (that is, for the 2000-01 income tax year). For many companies with substituted accounting periods, that may mean business income tax changes would impact from 1 January 2000.

The Council suggests considerable thought be given to delaying the implementation of some of the reform measures. It is clear that a better outcome can be achieved through a staged or progressive implementation in consultation with the business community. This will ensure a better outcome for both the Government and business.

Revenue assumptions: In this Submission, comments on the options raised by the Review are made without full knowledge of the revenue implications of the full range of measures. This is particularly important given the overall context of a revenue neutral trade-off of various features of the present tax system for a reduction in the company tax rate.

Table: Summary of the Minerals Council of Australia's Views on Selected Business Tax Reform Issues (in the order presented in the Submission)

ISSUE	THE COUNCIL'S VIEW
A "trade-off" to achieve a lower company tax rate	A trade-off to achieve a lower company tax rate at the expense of other business tax arrangements would have significant effects on cash flows and the investment economics in the minerals industry and is not supported.
Entity taxation proposals	The Council is totally opposed to the DCT option. The case for reform has not been made and the status quo should be retained. If it is demonstrable that some change is necessary, the Council recommends: the RDWT option be modified to address industry concerns through additional consultation; and other, more acceptable, options be explored.
Wasting assets	Any changes in the taxation treatment of wasting assets, whether positive or negative, have implications for project investment economics and for financing of long lead-time projects. It is particularly crucial that reform in this area promotes the international competitiveness and sustainability of the minerals sector.

Non-deductible expenditures	The Council strongly supports and endorses the Review's initiative in relation to non-deductible expenditures. The Council recommends that the appropriate write-off treatment for individual items will require detailed input from business.
Goodwill	The Council supports the Review's recognition of goodwill and similar intangible rights as costs that should be amortised for tax purposes as wasting asset items.
Trading Stock	The Council considers it is not necessary to change the existing basis of valuation of trading stock for taxation purposes for the minerals industry.
Overburden removal	The Council's rejects the Review's proposal, which would have a substantial adverse impact on industry working capital requirements and the economic viability of individual mines. The Council supports continuation of the present recognition of this operating expense as immediately deductible when incurred.
Consumables and Spare Parts	The Council is concerned at the nature of the suggestions in relation to consumables and spare parts and does not accept that a change in the basis of the current treatment is warranted.
International taxation issues	The Council does not support the proposed Non-Resident Investor Tax Credit. The Council welcomes the Review's suggestion that imputation credits could be allowed for withholding tax deducted from foreign dividends. The Council is opposed to the removal of the active business exemption. The Council is opposed to the introduction of additional rules to limit the deductibility of interest incurred by Australian resident companies. The fixed gearing ratio discussed by the Review would cause problems for some companies in the minerals industry unless a very high gearing ratio is stipulated. The proposed extension of thin capitalisation rules to third party debt is a very significant measure and will have considerable adverse impacts on many taxpayers.
Anti-avoidance provisions	The Council encourages the review and removal of specific anti-avoidance provisions (for example, franked dividends rules) - in particular where it is clear that the Review will remove some of the structural flaws in the current income tax legislation.
Capital gains tax	The Council supports the proposed scrip-for-scrip rollover relief.
Consolidated returns	The problems raised by the Review as a result of the non-taxing of a wholly owned group as a single entity are very questionable. Except for one or two areas the current grouping provisions achieve the objectives outlined by the Review.
Interest deductibility	The Council supports the continuation of a tax deduction of interest where the associated borrowings are to derive assessable income that is broadly defined to also include capital gains.
Transitional arrangements	The Council suggests considerable thought be given to delaying the implementation of some of the reform measures. It is clear that a better outcome can be achieved through a staged or progressive implementation in consultation with the business community. This will ensure a better outcome for both the Government and business.
Immediate deduction for exploration and prospecting expenditure	It is critical for the future of the industry that expenditure on exploration and prospecting remains immediately deductible. The provision recognises the high levels of risk associated with exploration, encourages the discovery of new deposits, and provides a competitive fiscal regime.

Immediate deduction for rehabilitation expenditure	Expenditure on rehabilitation should remain immediately deductible.
The R&D incentive	The Council endorses retention of the incentive to restore levels of investment in R&D to assist adoption / development of leading edge technologies.

TAXATION, THE AUSTRALIAN MINERALS INDUSTRY AND AUSTRALIA'S POTENTIAL: KEY POINTS

- Taxation is a key Government policy instrument. It is the major source of Government revenue. Improvement to our taxation system is an important area of microeconomic reform. **The Minerals Council of Australia has welcomed the Review of Business Taxation and the Government's preparedness to pursue tax reform**.

- The minerals industry is a significant contributor to Australia's economic and trade performance. It is not only a large exporter but also has important linkages to other sectors of the economy. The industry is also a vital part of Australia's high technology development.

- **The industry frequently operates in remote and regional areas** with poor transport, energy, communications, town and port facilities that must be upgraded, enhanced, or built. Industries operating near existing infrastructure services do not have to bear this significant cost impost.

- Australia is one of the world's principal producers and suppliers of ores, concentrates and refined metals with a modern and efficient processing sector. The industry has responded to recent difficult circumstances by instituting major changes to the way it operates in order to be better placed to meet the challenges in the years ahead.

- To compete in the global market requires minerals companies to gain access to the best assets possible, whether in Australia or overseas. A 1993 study that examined the factors that are taken into account in minerals investment decision-making processes found that, with the exception of 'geological potential', all are associated with the regulatory system (including taxation arrangements).

- According to a recent study (PricewaterhouseCoopers, 1999), if the company tax rate is reduced to 30 per cent and the 'accelerated' component of the depreciation for plant is removed Australia would have a mining tax regime worse than any of its main commodity producing competitors. It is also noteworthy that the Review itself has found the resources sector is favourably taxed in all of the jurisdictions surveyed.

- **It is clearly advantageous for Australia to have the lowest company tax rate consistent with meeting the overall objectives of Government. But this does not imply that the sole objective of taxation policy should be to achieve a "headline" company tax rate lower than those of our trading partners. It is the overall burden of company tax (including the statutory rate of company tax and other factors such as rates of depreciation, investment allowances and grants, royalties, the equity discount rate, the rate of inflation and the taxation of dividends) which is relevant.**

2. TAXATION, THE AUSTRALIAN MINERALS INDUSTRY AND AUSTRALIA'S POTENTIAL

> *"The current structure of taxation in Australia is inefficient, impeding productive investment and imposing considerable costs on the community. While some of the necessary changes seem self-evident, the interdependencies and complexities of the taxation system suggest that fundamental reform is required. Indeed, many of the problems with the current arrangements reflect past ad hoc approaches to tax policy development."* [2]

2.1. INTRODUCTION

Taxation is a key Government policy instrument. It is the major source of Government revenue. The way in which it is applied has significant equity and efficiency implications for individuals and organisations. In addition, taxation can and often does have an important impact on marginal investments and their financing, as well as on locational decisions both within a country and across frontiers.[3]

Improvement to our taxation system is, therefore, an important area of microeconomic reform. **The Minerals Council of Australia (the Council) has welcomed this Review of Business Taxation (the Review) and the Commonwealth Government's preparedness to pursue tax reform** - including the Government's separate goal of improving the efficiency of Australia's indirect tax system through the introduction of a broad-based consumption tax.[4]

The Council supports the application of the objectives and principles for business tax reform (outlined in the Box 1.1) to assessing any proposed change to the business taxation environment. Supplementary principles are also outlined in relation to specific reform areas assessed throughout the Submission.

Box 1.1 Objectives and Principles for Business Tax Reform

Objectives for Business Tax Reform

Tax reform should improve international competitiveness and fairness in taxation and should contribute to a climate favourable for investment, job creation and savings.

Principles of Business Tax Reform

- The business tax system should be simple, transparent, stable and minimise uncertainty.
- The tax system should not favour or disadvantage particular business structures over others.

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[2] Productivity Commission (1996), *Stocktake of Progress in Microeconomic Reform,* AGPS, Canberra, p. 114.
[3] OECD (1991), *Taxing Profits in a Global Economy: Domestic and International Issues*, Paris, p.12.
[4] see, for example, Minerals Council of Australia (1999a), *Review of Business Taxation - Submission to the First Discussion Paper, A Strong Foundation*, Canberra, January, and Minerals Council of Australia (1999b), *Submission to the Inquiry of the Senate Select Committee of the 39th Parliament of Australia on the New Tax System*, Canberra, February.

- Taxation for the purpose of raising revenue should not favour particular industry sectors or firms over others. At the same time potential should be preserved for the use of taxation measures to assist in achieving particular industry and social objectives. Such objectives should be justified on the basis of transparent and rigorous criteria and on the condition that the tax system provides a suitable instrument for achieving the stated objectives.

- The tax system should avoid the double taxation of business income and provide relief for all business expenses.

- The tax system should not impede organisational restructuring.

- The business tax system should be internationally competitive and supportive of increased national savings.

2.2. THE IMPORTANCE OF THE AUSTRALIAN MINERALS INDUSTRY

The Minerals Council represents companies responsible for around 90 per cent of Australia's mineral production. The industry is a significant contributor to Australia's economic and trade performance, generating about 36 per cent of total Australian exports of goods and services (around 46 per cent of merchandise exports).

Australia enjoys a comparative advantage in mining and early-stage mineral processing of some minerals. This is reflected in a large trade surplus (value of exports minus value of imports) in mineral commodities. Overseas markets for minerals are important to Australia because of the income they earn - providing the means for economic growth and development of associated and new industries and to pay for imported goods and services that Australia does not have a comparative advantage in producing.

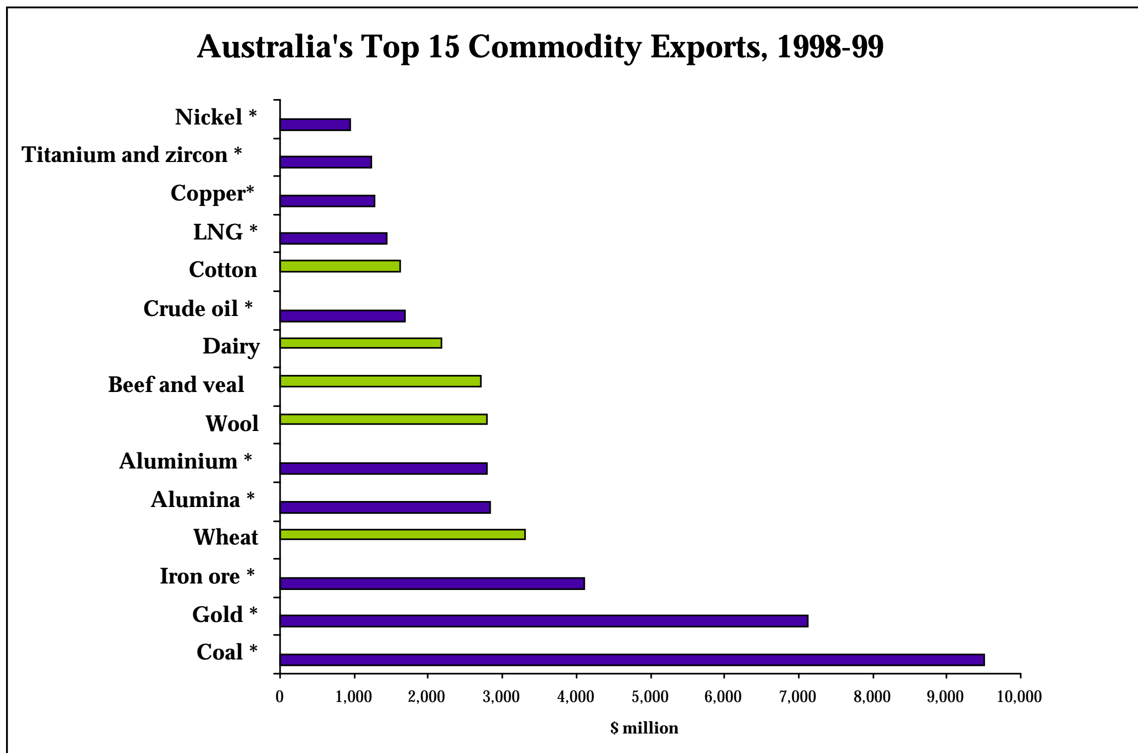
By exchanging what Australia is good at producing (such as minerals commodities) for what it is not good at producing (such as elaborately transformed manufactures), trade in goods and services enables Australians to enjoy a higher standard of living than would otherwise be the case.

According to the Australian Bureau of Agricultural and Resource Economics (ABARE),[5] eight of the top fifteen merchandise exports in 1998-99 will be minerals-based (see Chart 1.1). The industry is not only a large exporter but also has important linkages to other sectors spending over $12 billion a year within Australia on goods and services inputs and providing minerals for further processing.

Moreover, the industry is a vital part of Australia's high technology development. It is one of the most technologically developed in the world. Significant sums are spent by the industry on research and development (R&D). In addition, there are many instances where its R&D activity provides spillover benefits to other industries (for example, to equipment manufacturing, building and construction, environmental and waste management and process engineering and design).

[5] Australian Bureau of Agricultural and Resource Economics (1999), *Australian Commodities: Forecasts and Issues, March Quarter 1999*, Vol. 6, No. 1, AusInfo, Canberra, p. 21.

Chart 1.1



* = Mining and minerals processing exports.

Source: ABARE (1999).

The mining and minerals processing industry:

- directly contributes approximately $36 billion to Australia's GDP and makes a large indirect contribution
  - for example, Austmine's more than 115 R&D-focused Australian mining support companies have a commitment to supply innovative and cost efficient products, technologies and services to international mining firms.[6] Their combined exports of over $1 billion is larger than, for example, Australia's earnings from wine exports.
- accounts for around 450,000 jobs in Australia (directly and indirectly); and
- directly represents 20 per cent of total business investment in Australia.

The minerals industry frequently operates in remote and regional areas with poor transport, communications, town and port facilities which must be upgraded, enhanced, or, more generally, built to maximise economies for the transport of mineral products. Industries operating near existing infrastructure services do not have to bear this significant cost impost. The exploration and development of the minerals industry has underpinned much of the infrastructure development in remote and regional Australia.

Many remote and regional towns were originally developed by, or developed because of, the minerals industry. Many of Australia's major cities and regions, such as Broken Hill and Kalgoorlie, and in more recent times others such as Mount Isa, Roxby Downs,

[6] http://www.austrade.gov.au/INDUSTRYCAPABILITY/index.asp?pageid=20708 (accessed 6 April 1999).

Karratha, Weipa, Gladstone, Newman and the Bowen Basin area have been established. In addition, many of the major ports for minerals exports (such as Port Hedland and Hay Point / Dalrymple Bay) are based in remote and regional areas. The map at **Attachment A** illustrates the major minerals operations in Australia. The remote and regional nature of the industry can be clearly seen on this map.

Much of Australia's accumulation of physical and human capital has occurred as a result of developing and putting our natural resources to productive use. By using these resources productively in the future, Australia will continue to build infrastructure, develop its research capacity and enhance its skills.

For example, over the ten years to 1997-98 Australia's mine production (which was already significant in the world context in 1987-88) has increased by over 70 per cent and smelting and refining production by about a fifth - and this will increase further with the expansions of Olympic Dam, Worsley, Wagerup, Tomago and Mount Isa smelters / refineries.

As one of Australia's most important and internationally competitive industries, tax reform holds out the prospect for the minerals industry to be able to make an even greater contribution to Australia's development in the future.

The globalised minerals industry is fiercely internationally competitive and long-term prices are in decline. In addition, the minerals industry is characterised by high levels of capital investment and long lead-times before the generation of sales income and production dependent cash flows. It is one of Australia's most capital-intensive industries and must regularly replenish this capital investment.

Despite the fact that Australia is one of the world's principal producers and suppliers of ores, concentrates and refined metals with a modern and efficient processing sector, industry costs have risen and profitability has fallen over the past few years (Charts 1.2).

Chart 1.2

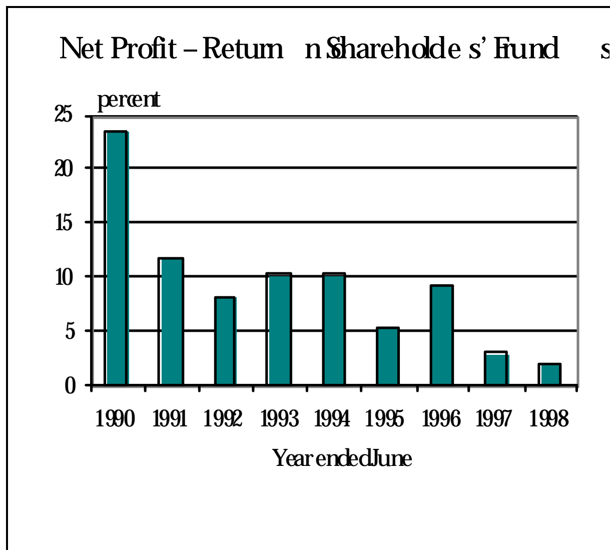
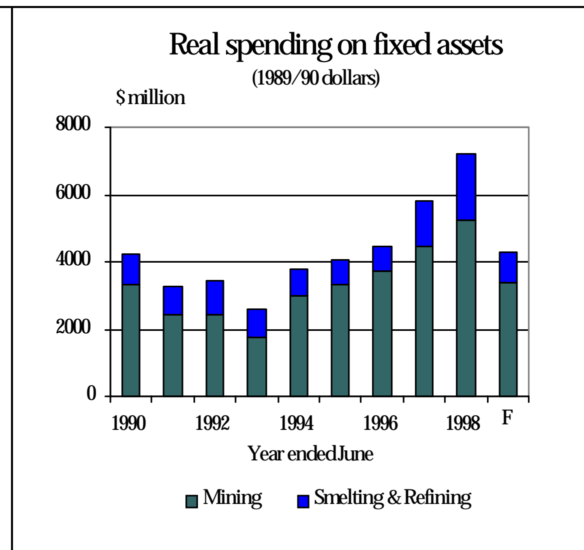


Chart 1.3



Source: PricewaterhouseCoopers (1998)

In recent years, the industry has undertaken significant capital investment (Chart 1.3). The industry has responded to recent difficult circumstances by instituting major changes to the way it operates in order to be better placed to meet the challenges in the years ahead.

The share of exploration and mining assets in total assets employed has fallen from 71 per cent in 1996-97 to 68 per cent in 1997-98 (and will fall further in 1998-99). This share had been stable at 75 per cent over the previous five years. This illustrates how industry has responded to the improved environment for downstream activity brought about by microeconomic reform.

2.3. THE INTERNATIONAL COMPETITIVENESS OF THE AUSTRALIAN TAX SYSTEM

> *"To redesign a tax system in a manner which does not take sufficient account of international factors would be to risk a declining revenue base, poorer economic outcomes, inadequate foreign investment in Australia and a poor competitive position for Australian enterprises and Australian based multinationals."*[7]

2.3.1. Taxation And The Decision To Invest

The diversity of taxation measures employed by Government, and their complex interaction, complicates assessments of tax structures. In the time available, it was not possible to undertake a comprehensive review. However, it is possible to draw on some recent studies.

Australia is one of the world's principal producers and suppliers of ores, concentrates and refined metals with a modern and efficient processing sector.

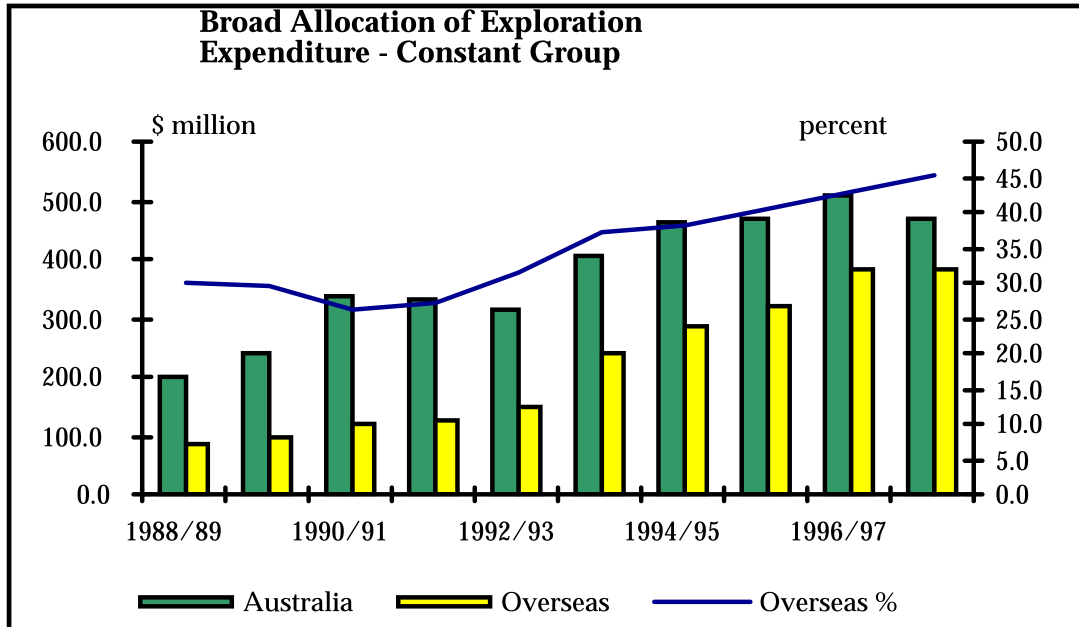
This status, of course, has been hard-won.

Minerals companies face challenges peculiar to their industry. Exploration to discover economically recoverable ore bodies is an unavoidable first step. Then resource development, proximity to markets, infrastructure and political risk all figure in investment decisions. Overall, however, it is geology which dictates the geographic location of mines. Furthermore, because the resource begins to deplete as soon as mining commences, minerals companies cannot survive without committing to investment in new projects.

Until recently many countries had mineral (including exploration) regimes that were not attractive to international investment. However, that is all changing and many of these countries, particularly in South America, Africa and Asia, are now actively inviting international participation in their minerals industries. As a result of this new competitive reality, the attractiveness of the Australian continent for world-class mineral deposit exploration has diminished in relative terms.

[7] Review of Business Taxation (1998), *An International Perspective,* AusInfo, Canberra, December, p. 3.

Chart 1.4



Source: PricewaterhouseCoopers (1998)

As shown in Chart 1.4, Australia's major minerals producers are responding to this new paradigm by increasing their overseas exploration expenditure as a proportion of their total expenditure. The proportion of assets held overseas is also increasing.

Clearly, to compete in the global market requires minerals companies to gain access to the best assets possible, whether in Australia or overseas. A study conducted in 1993 by Otto and Bakkar for the United Nations, surveyed 39 transnational mining companies to establish which factors were taken into account in the investment decision-making process. The ranking of these criteria (shown below) for both the exploration and mining stages with the exception of 'geological potential', all are associated with the regulatory system.

In considering the role of public policy in regulating the minerals industry, it is useful to keep in mind the type of considerations which companies apply in setting exploration and mining priorities globally. Some of the criteria to be considered include:

- geological prospectivity;
- host country land access and investment rules;
- whether there is a developed legal system;
- whether the mining law is well defined and emphasises ownership of resources and the rights and conditions attaching to exploration and mining activities;
- **the taxation rules governing how the host country shares the benefits of production;**
- land use and environmental policies;
- stability of rules and perceptions of country risk.[8]

[8] Johnson, C. (1990), 'Ranking countries for mineral exploration', *Natural Resources Forum*, 14 (3), August, pp 178-86; and Otto, J. and Bakkar, P. (1993) 'Minerals investment conditions in Asian regions - a checklist for success', *International Seminar on Minerals Sector in India*, Hyderabad, February.

Table 1.1 Ranking of Decision Criteria in Setting Exploration and Mining Priorities Globally (Ranking by Level of Importance)

Exploration Stage	Mining Stage	Decision Criteria Based On:
1	na	Geological potential for target mineral
na	3	Measure of profitability
2	1	Security of tenure
3	2	Ability to repatriate profits
4	9	Consistency and constancy of mineral policies
5	7	Company has management control
6	11	Mineral ownership
7	6	Realistic foreign exchange regulations
8	4	Stability of exploration / mining terms
9	**5**	**Ability to predetermine tax liability**
10	8	Ability to predetermine environmental obligations
11	10	Stability of fiscal regime
12	12	Ability to raise external financing
13	16	long term national stability
14	17	Established mineral titles system
15	na	Ability to apply geological assessment techniques
16	13	Method and level of tax levies
17	15	Import-export policies
18	18	Majority equity ownership held by company
19	21	right to transfer ownership
20	20	Internal (armed) conflicts
21	14	Permitted external accounts
22	19	Modern mineral legislation

Source: Otto and Bakkar (1993).

Of course, in practice, different companies will attach differing priorities to these conditions that may also differ according to country-specific considerations.

2.3.2. International Comparison Of Tax Regimes For Minerals Investment Returns

A recent study by the Colorado School of Mines analysed the impact of 1996 country taxation regimes on the economics of two stylised model mines (producing copper and gold respectively) with given capital investment, production levels, mineral price, debt / equity ratio and operating costs.[9] The results are shown in Table 1.2.

> *"While the minimum rate of return required by companies differs, it is probable that most firms would consider an IRR of less than 12 per cent [for these model projects] as marginal or sub-economic."*[10]

PricewaterhouseCoopers (PwC) in Australia, has utilised a similar model - developed by their Canadian office - to obtain initial recalculations for seven of the countries covered in the earlier Colorado study. These seven countries represent major mineral provinces.

[9] Colorado School of Mines, Institute for Global Resources Policy and Management, (1997), *Global Mining Taxation Comparative Study,* Colorado.

[10] Colorado School of Mines, Institute for Global Resources Policy and Management (1997), *Global Mining Taxation Comparative Study*, Colorado, p. 45.

The results suggest that **if the company tax rate is reduced to 30 per cent and the 'accelerated' component of the depreciation provisions for plant is removed, Australia, already equal second last for both the model copper and gold mines in the Colorado simulations, would have a tax regime *worse* than any of its main commodity producing competitors**.[11] The Council is separately undertaking an updating of the gold and copper model.

Table 1.2 Comparative Tax Measures - Copper and Gold Model Mines

Country	Gold Model (a)	Copper Model (a)	Ranking by PwC (b)	Marginal Effective Tax Rates at Country Specific Company Rate (c)
	IRR	*IRR*		
Chile	19	16	1	6.1
Argentina	19	16	2	N/A
Indonesia	16	15	3	N/A
South Africa	16	14	4	N/A
Australia (Western Australia)	12	12	7	19.5 (d)
Canada (Ontario)	12	11	5	8.5
USA (Nevada for Au, Arizona for Cu)	10	12	6	-33.3

Sources: (a) Colorado School of Mines, Institute for Global Resources Policy and Management (1997), *Global Mining Taxation Comparative Study*; (b) PricewaterhouseCoopers (1999), "Mining worse off under Ralph", *Australian Financial Review*, 8 March, p. 4; and (c) Review of Business Taxation (1998), *An International Perspective*, Table 7.3.
(d) We understand the RDWT option would increase this to around 28 per cent for 20-year projects.

It is also noteworthy that the Review itself has found the resources sector is favourably taxed in all of the jurisdictions surveyed.[12]

It is clearly advantageous for Australia to have the lowest company tax rate consistent with meeting the overall objectives of Government. But this does not imply that the sole objective of taxation policy should be to achieve a "headline" company tax rate lower than those of our trading partners. It is the overall burden of company tax (including the statutory rate of company tax and other factors such as rates of depreciation, investment allowances and grants, royalties, the equity discount rate, the rate of inflation and the taxation of dividends) which is relevant.

Moreover, examining just the headline company tax rate (and changes to it) ignores the project financing implications of changes to taxation arrangements. Box 1.2 illustrates the impact on a specific minerals industry project of changes to business tax arrangements and overlays on these changes project financing considerations. **In summary, the cash flows in the critical early years are significantly more robust under the current tax arrangements than if there is a trade-off of accelerated depreciation in favour of a 30 per cent company tax rate. This is a factor that would strongly influence a financier or indeed the Board of a company when a decision is made on whether to invest in a project.**

[11] Potentially offsetting the stricter tax regime is the fact that Australia, in common with USA and Canada, has a more secure political system and mature economy.
[12] Review of Business Taxation (1999), *A Platform for Consultation,* AusInfo, Canberra, December, p. 95.

Box 1.2 Impact on a Specific Minerals Industry Project of Changes to the Company Tax Rate and Capital Allowances (incorporating Project Financing considerations)

The pre-financing cash flows for a mining and mineral processing project based on a real life hard rock mine, with capital expenditure of $500 million, were modeled, assuming:

- commodity prices adjust in line with industry conditions;
- 70 per cent of the initial capital cost is project-financed by banks;
- repayment of the loan commences $1^1/_2$ years after the start of mine production; and
- the loan is repaid over 8 years.

Capital expenditure includes the initial project development costs, including power and water infrastructure, and sustaining capital over an initial mine life of 15 years.

The modeling analysis, after considering other scenarios, focussed on the following two key alternatives (all other taxation parameters remain unchanged in each case):

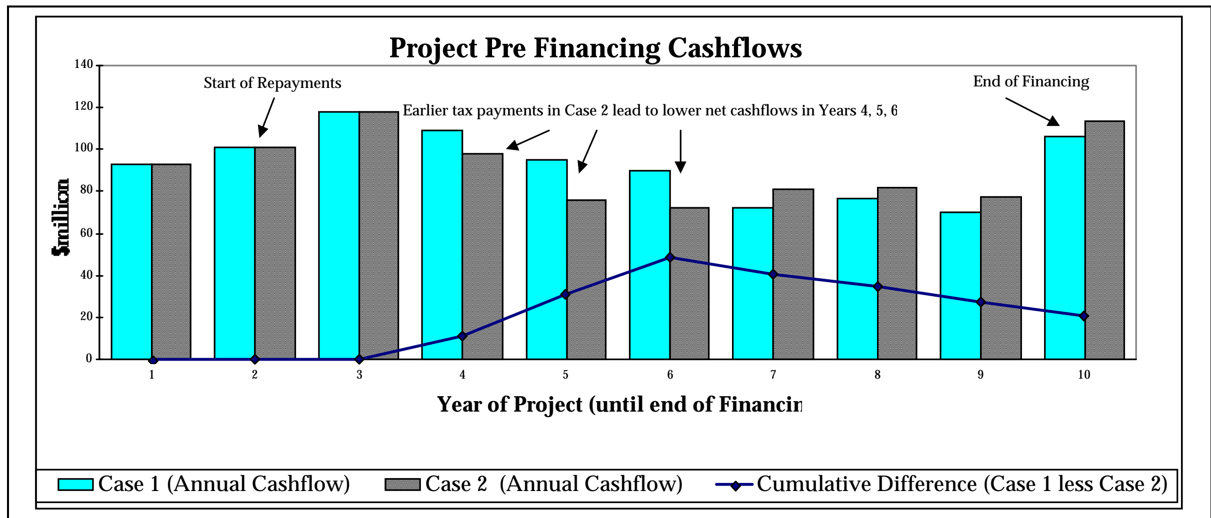
- the current taxation arrangements, that is 36 per cent company tax rate, accelerated depreciation and allowable capital expenditure write-off over the lesser of 10 years or the life of mine (Case 1); and
- a company tax rate of 30 per cent with plant and machinery and allowable capital expenditure depreciable over the effective life of the assets. Book depreciation was taken to represent this write-off period (Case 2).

A summary of key cash flow data is set out in Chart 1.5 for both Case 1 and Case 2. The pre-financing cash flows for the first half of the mine life were greater under Case 1 than Case 2. Case 1, by ‘accelerating’ depreciation, and thus generating a greater amount of tax losses in initial project years, defers the start of payment of tax by approximately 3 years.

Case 1’s pre-financing cash flows are more favourable to financiers where the repayment of a loan for project capital is secured over the project’s assets without recourse to the borrower. The pre-financing cash flows over the first half of the loan repayment period give greater coverage of debt service and thus have a higher capability to withstand adverse cyclical fluctuations without a loan default.

The Loan Life Ratio for Case 2 is less than this ratio for Case 1 in each of the first 4 years of loan repayment. The Debt Service Ratio for Case 1 is better than this ratio for Case 2 in years 4, 5 and 6 of loan repayment. The Payback period for Case 1 is better than for Case 2 and in fact this ratio for Case 2 is **longer than the normal acceptability range**.

Chart 1.5


Project Pre Financing Cashflows
Start of Repayments
Earlier tax payments in Case 2 lead to lower net cashflows in Years 4, 5, 6
End of Financing
$million
140
120
100
80
60
40
20
0
1
2
3
4
5
6
7
8
9
10
Year of Project (until end of Financin
Case 1 (Annual Cashflow)
Case 2 (Annual Cashflow)
Cumulative Difference (Case 1 less Case 2)

THE TAXATION TREATMENT OF THE AUSTRALIAN MINERAL INDUSTRY: KEY POINTS

- In common with a limited number of other activities (including primary production, life insurance and superannuation) there are explicit provisions within the taxation legislation dealing with aspects of mining operations. This recognises their distinctive characteristics.

- Capital expenditure deductions available to the minerals industry can be categorised as: non-deductible expenditures; expenditure claimed outright; expenditure written-off over the life of the mine or ten years (whichever is the lesser); plant - deducted at the general rates of depreciation; and infrastructure.

- In examining this taxation treatment, it is helpful to understand the main characteristics that distinguish the minerals industry from most other industries and that, in almost every case, substantially increase the level of business risk.

- Having regard to these categories of capital expenditures and the industry's distinctive characteristics, arguments for retaining certain tax treatment for the minerals industry and more generally can be considered.

- This consideration reveals: the minerals industry faces a range of **non-deductible** expenditures; the provision allowing an immediate deduction for **exploration and prospecting** recognises the high levels of risk associated with exploration, encourages the discovery of new deposits, and provides a competitive fiscal regime; the **R&D incentive** was one of the most important tax reforms of the 1980's, has played a key role in supporting high technology development in the minerals industry and has brought net benefits to the Australian economy; the **allowable capital expenditure** provisions allow for deductions for capital expenditure incurred in the minerals industry that would not otherwise be deductible (analogous to plant); the current **depreciation rates** and effective life provisions for plant generally were introduced to provide greater flexibility in the selection of an appropriate depreciation rate and simplify the operation of the depreciation provisions.

3. THE TAXATION TREATMENT OF THE AUSTRALIAN MINERALS INDUSTRY

"The list of capital expenditures deductible by mining activities is unarguably more extensive than most industries, but justifiably because many of the eligible expenditures are rarely incurred by other activities." [13]

3.1. CATEGORISING THE CAPITAL EXPENDITURE DEDUCTIONS AVAILABLE TO THE MINERALS INDUSTRY

In common with a limited number of other activities (including primary production, life insurance and superannuation) there are explicit provisions within the ITAA97 dealing with aspects of mining operations.

It is useful to characterise capital expenditure deductions available to the minerals industry under the following five categories:

- non-deductible business expenditures (or 'black holes') (see Section 4.2.9 and Appendix C.1);
- expenditure claimed outright (for example, exploration, R&D, overburden removal, rehabilitation, environmental, mine closure costs);
- development expenditure written-off over the life of the mine or ten years (whichever is the lesser) - for example, allowable capital expenditure, expenditure incurred on housing and welfare);
- plant - deducted at the general rates of depreciation in common with other industries (for example, haul trucks, water trucks, shovels, stackers, reclaimers, draglines, and so on); and
- infrastructure (for example, ports, railways, roads, towns and dredging).

3.2. THE DISTINCTIVE CHARACTERISTICS OF THE MINERALS INDUSTRY

In examining this taxation treatment, it is helpful to understand the main characteristics that distinguish the minerals industry from most other industries and that, in almost every case, substantially increase the level of business risk. These characteristics are outlined briefly in Box 2.1. More detail can be found in **Attachment B**.

[13] Industry Commission (1991), *Mining and Minerals Processing in Australia*, Report No. 7, Vol. 3, AGPS, Canberra, February, p. 96.

Box 2.1 A Summary of the Distinctive Characteristics of the Minerals Industry (in order of importance to business tax considerations)

- A mine is a **wasting asset**, as is all direct and indirect infrastructure associated with that mine. Thus, the industry requires **high-risk funds***,* which are best obtained from cash flows, to be applied in the search for new ore deposits.
- Mining operations are **capital intensive**.
- **Replacement and incremental investment** is high (a higher proportion of new investment than in other industries) in order to maintain production.
- High cash flows are necessary in the early years to service debt financing and **high loan repayments.**
- **Mine locations** are frequently in remote, inhospitable areas with poor transport, energy, communications, town and port facilities.
- Mining companies are often required to provide major **social, industrial and transport infrastructure.**
- **Reliance on international markets** exposes the industry to fluctuations in demand, prices and exchange rates.
- **Development costs** are high. A large amount of debt funds required to develop any new major mining project. The period between the realisation of positive cash flows and the initial investment is generally lengthy, limiting the ability to service and repay debt in the early years of a project.
- Each mine is **unique**. The mine and associated processing facilities must be designed to cater for the unique features of each ore body.
- **High wages** and good conditions are necessary to compensate labour for the nature of the work and often the isolated location.
- **Mine closure costs** must be recovered.
- **Mining companies bear the risk of exploration and development**, but the benefits for the Australian economy in terms of employment and export earnings are substantial and long-term.

3.3. THE IMPORTANCE OF CERTAIN CAPITAL ALLOWANCES TO THE MINERALS INDUSTRY

Having regard to these categories of capital expenditures and the industry's distinctive characteristics, **Attachment C** provides a summary of the arguments for retaining certain tax treatment for the minerals industry and more generally, in the case of the plant depreciation provisions and R&D incentive.

Each provision has been considered in terms of the objective of / rationale for the provision, the effects / benefits of the provision and the general implications for the minerals industry of the reduction or abolition of the provision. A number of key points emerge from these considerations:

- The provision allowing an immediate deduction for **exploration and prospecting** expenditure recognises the high levels of risk associated with exploration and aims to

encourage the discovery of new deposits and provide a competitive fiscal regime.

- The immediate deductibility of exploration expenditure acknowledges that such expenditure is an ongoing and necessary expense of a minerals company. Exploration expenditure represents monies expended that are a loss until the prospect is proved to be economically viable. Until this point, it is not appropriate to defer the deductibility of these expenditures as the taxpayer is actually expending monies at a time at which there is no related capital asset present.

- Exploration typically has a very high failure rate and does not lead to creation of continuing asset value.

- There are a number of arguments that support the need for the current taxation treatment of exploration expenditure to be retained. They include market failure, economic efficiency, and competitiveness.

- In 1975, the Asprey Committee concluded that all exploration and prospecting expenditure should be immediately deductible against income derived from any source.

- In 1991, the then Industry Commission (IC) found that although immediate deductibility of exploration expenditure may involve an element of assistance, this 'concession' is the least distorting tax treatment in terms of the efficient allocation of resources (see Section C.2);

The Council recommends that foreign exploration expenditure by Australian companies should be deductible against Australian income, with appropriate claw-back rules for successful exploration.

- **Post-production rehabilitation** expenditures are not a 'tax expenditure'.

  - Rehabilitation expenditures for mining and petroleum operations are generally tax deductible. It is the practicalities of the situation, rather than any other factor, which prevent a mining or petroleum operation from being fully rehabilitated before cessation of extractive operations.

  - To the extent that it is the immediate, rather than expensed, nature of the deduction which gives rise to a suggestion that a tax expenditure exists, there is no administratively feasible period over which deductions can be made once a mining or petroleum operation has ceased (see Section C.3).

- The **R&D incentive** was one of the most important tax reforms of the 1980's.

  - The scheme has brought net benefits to the Australian economy. Evidence of this can be found in various Bureau of Industry Economics (BIE) and IC evaluations.

  - The rapid real growth of business expenditure on R&D since the mid-1980's is also evidence of the scheme's success.

  - In addition, a recent study of business expenditure on R&D suggests that the tax incentive is an appropriate way of assisting R&D. In fact, this study found the R&D incentive to be "... *super efficient*"[14] (see Section C.4).

- The **allowable capital expenditure (ACE)** provisions allow for deductions for capital expenditure incurred in the minerals industry that would not otherwise be deductible.

  - The provision recognises the distinctive circumstances applying to the mining and petroleum industries.

  - The ACE deduction provides a deduction similar to the general depreciation deductions for expenditure that would not otherwise be deductible for tax purposes because it does not fit within the definition of plant.

  - The expenditure is not of a type which would be incurred by companies other than mining, quarrying and petroleum companies, and so the deduction provisions are limited in their application to companies operating in those industries (see Section C.5).

- The current **depreciation rates** and effective life provisions for plant generally were introduced to provide greater flexibility in the selection of an appropriate depreciation rate and simplify the operation of the depreciation provisions.

  - The aim of the provisions are to reduce the effective tax rate on domestic investment in plant and equipment, to encourage domestic investment in plant and equipment (in preference to other forms of investment, including Australian investment abroad) and improve the international competitiveness of Australia's business tax system.

  - The depreciation rates are particularly focussed on assets with long effective lives.

  - The depreciation provisions are generally available across <u>all</u> industry (see Section C.6).

3.4. REVENUE ASSUMPTIONS IN *A PLATFORM FOR CONSULTATION*

In this Submission, comments on the options raised by the Review are made without full knowledge of the revenue implications of the full range of measures. This is particularly important given the overall context of a revenue neutral trade-off of various features of the present tax system for a reduction in the company tax rate.

[14] In the sense that R&D managers within firms do not appear to fully discount for the effects of the 'claw back' of the R&D incentive through the current dividend imputation system. See Business Council of Australia (1999), *Survey of Research and Development Expenditure by Australian Business*, Melbourne, p. 15.

The Review provides estimates of some of the more important options. However, even where estimates are provided there is an important qualification:

> *"… some costings need to be viewed as indicative. In some cases the costings rely on assumptions about the extent of the relevant tax base and behavioural responses to the change in tax treatment being examined. The revenue impact may need to be modified if further information becomes available during the consultation process."*[15]

While, as a part of the consultation process, the Review secretariat has been helpful in explaining the basis of the indicative revenue estimates, it is understandable that some disquiet over some of the costings remains. This is particularly so in view of the historical experience with highly conservative estimates of revenue under, for example, the capital gains tax and fringe benefits tax.

One point made in the face of this disquiet is that experience shows that while there is considerable room for error in respect of any given number, there are always 'swings and roundabouts' so that losses in one area tend to be offset by gains in others.

While this defense provides some consolation when there is a large number of small costings to deal with, it is less comforting when there is a heavy reliance on a single costing (the long-term behavioural response to the removal of 'accelerated' depreciation in the face of a 30 per cent company tax rate). This explains why the costing of the removal of 'accelerated' depreciation has attracted considerable attention.

Of a possible reduction in the company tax rate of 6 percentage points, the revenue benefit from the removal of 'accelerated' depreciation would account for over 4.5 percentage points. If other elements of the move to an effective life basis for capital write-offs are taken into account, the contribution amounts to around 5 percentage points.

In assessing the impact of the possible lower company tax rate financed largely from the removal of 'accelerated' depreciation - and given 'grandfathering' of write-off rates - it is being generally assumed that the relationship between the cost of reducing the company tax rate and the removal of 'accelerated' depreciation is sustainable over the long-term. To the extent there is support for the trade-off of 'accelerated' depreciation for a lower company tax rate, this support should be interpreted as being **predicated on the sustainability of this relationship**.

[15] Review of Business Taxation (1999), *A Platform for Consultation,* AusInfo, Canberra, February, pp. 800-801.

ENTITY TAXATION PROPOSALS: KEY POINTS

- The Review presents three options for the potential reform of entity taxation (a fourth, unstated option, would be the status quo): deferred company tax (DCT); resident dividend withholding tax (RDWT); and taxing unfranked inter-entity distributions.

- DCT brings forward the point of taxation of unfranked distributions of profit from the shareholder to the company, resulting in a **reduction** in reported after-tax company profits. A big issue for minerals companies is that DCT eliminates **at the company level** the benefit of tax-preferred income that is distributed, thereby resulting in double taxation. In addition, DCT cannot be offset in future years.

- For minerals companies, where provisions such as 'accelerated' depreciation are important, some projects that would have been viable under current tax treatment may not be viable under DCT.

- Unless changes are made, DCT would not be creditable on the tax returns of many foreign shareholders. **If the current dividend withholding tax were replaced, foreign portfolio investors would be much worse off**.

- RDWT would eliminate some of the DCT problems in respect of non-resident shareholders. It would therefore be less unattractive than DCT to Australian companies that currently have or expect to have significant overseas shareholders.

- However, the RDWT would not overcome the following concerns: the benefit of tax-preferred income would be eliminated at the point of distribution to a domestic investor thereby resulting in double taxation; and the impact on inter-entity dividends received by public companies. The minerals industry in particular has large timing tax differences that may lead to double tax of profits.

- The option of taxing unfranked inter-entity distributions would eliminate DCT problems in respect of non-resident shareholders and resident individual shareholders. The benefit of tax-preferred income would be eliminated at the point of distribution to a domestic entity, thereby resulting in double taxation. This loss of benefit would be permanent, as there is no ability to offset future company tax against this tax. The inability to offset this tax against future company tax severely disadvantages the minerals industry in particular over other industries and could result in double taxation on their profits.

- The most significant disadvantage of this option, when compared to the RDWT, is that there is no mechanism proposed to refund the tax payable on the dividends where these are on-paid to non-resident shareholders. The RDWT does contain such a mechanism.

- **The Council is not persuaded by the need for reform in this area of the kind outlined by the Review. Therefore the status quo should be retained.**

- **The Council, in consort with broad industry groupings, is totally opposed to the DCT option.**

- **If it is clearly demonstrable (that is, a stronger case for change is made than has been made by the Review) that some change is necessary to enhance Australia's growth prospects and international competitiveness, the Council recommends: the RDWT option be modified to address industry concerns through additional consultation; and other, more acceptable, options also be explored.**

4. ENTITY TAXATION PROPOSALS

4.1. IMPLICATIONS OF THE THREE OPTIONS FOR THE MINERALS INDUSTRY

4.1.1. Option 1: Deferred Company Tax

Deferred Company Tax (DCT) brings forward the point of taxation of unfranked distributions of profit from the shareholder to the company. This results in a **reduction** in reported after-tax company profits (see Table 3.1 at line 11) and the amount that can be distributed to shareholders.

The after-tax rate of return on projects on which some currently tax-free profit is distributed will therefore be reduced. For minerals companies, where provisions such as 'accelerated' depreciation are important, some projects that would have been viable under current tax treatment will not be viable under DCT.

- This also exposes a flaw in the internal logic of the Review's analysis. The Review claims that it is acceptable to eliminate tax preferences at the point of the shareholder because it is the action of companies that are being targeted (for example, accelerated depreciation so that companies invest more). But DCT will reduce post-tax rates of return at the company level. **Even if current accelerated depreciation arrangements are maintained, the value of them to companies will generally be reduced by DCT**.

- **Companies could overcome this by reducing profit distributions** (that is, retain more profits, only distributed profits will be subject to DCT). In the example in the attached table, retaining completely what would have previously been unfranked distributions would eliminate the additional tax paid. (Behavioural responses such as this could severely 'dent' the Review's estimates of the revenue benefits from DCT).

- Changes to distribution patterns of this kind may have adverse implications for both market sentiment and shareholder confidence in affected companies.

- Scope for reducing distributions may be limited in the short term by current shareholder requirements, **but it will generally be in the shareholders' interests to retain more earnings**. The incentives for retaining profits will be increased further if the rate of capital gains tax for individuals is moved below the top marginal tax rate.

- Unless changes are made, DCT would not be creditable on the tax returns of many foreign shareholders. **If the current dividend withholding tax (DWT) were replaced, foreign portfolio investors would be much worse off**. (They would have tax paid by the company on the dividends they receive but not even get recognition under double tax agreements for the 15 per cent tax currently paid through DWT).

Another big issue for minerals companies is that DCT eliminates **at the company level** the benefit of tax-preferred income (such as income benefiting from 'accelerated' depreciation deductions) that is distributed, thereby resulting in double taxation. This loss of benefit would be permanent, as there is no ability to offset future company tax against DCT. Tax is currently payable by shareholders on such distributions; DCT means tax will be payable

at the company level (see Table 3.1, line 10), thereby resulting in double taxation.

An option raised by the Review is for the Australian Taxation Office (ATO) to refund to foreign shareholders a 'supplementary dividend' that would increase the part of total tax paid recognised internationally as DWT.

- Foreign shareholders receiving currently franked dividends **would be in the same position as they are now**.

- But those receiving currently unfranked dividends **would be worse off** (the refund would not fully compensate for the company tax that would need to be paid under the DCT).

4.1.2. Option 2: Resident Dividend Withholding Tax

The Resident Dividend Withholding Tax (RDWT) would work like DCT for resident shareholders, but would differ in one important respect. Reported after-tax company profits would not be reduced (see Table 3.1, line 11 - the RDWT would be applied to distributions by the company to resident shareholder).

RDWT would eliminate the above DCT problems in respect of non-resident shareholders. It would therefore be less unattractive than DCT to Australian companies that currently have or expect to have significant overseas shareholders. (Lines 20 and 21 of Table 3.1).

However, the RDWT would not overcome the following concerns that minerals companies have with DCT.

- The benefit of tax-preferred income (such as income benefiting from accelerated depreciation) would be eliminated at the point of distribution to a domestic investor thereby resulting in double taxation. **This loss of benefit would be permanent**, as there is no ability to offset future company tax against the RDWT. This is because the minerals industry in particular has large timing tax differences.

- The impact on inter-entity dividends received by public companies would adversely affect company profits and cash flow.

4.1.3. Option 3: Taxing Unfranked Inter-Entity Distributions

This option would eliminate DCT problems in respect of non-resident shareholders and resident individual shareholders.

Reported after-tax company profits would not be reduced (but entities receiving currently unfranked distributions would have a higher tax liability).

The benefit of tax-preferred income (such as income benefiting from accelerated depreciation) would be eliminated at the point of distribution to a domestic entity, thereby resulting in double taxation. This loss is permanent, as there is no ability to offset future company tax against this tax.

The inability to offset this tax against future company tax severely disadvantages the minerals industry in particular over other industries and could result in double taxation on

their profits.

The most significant disadvantage of this option, when compared to the RDWT, is that there is no mechanism proposed to refund the tax payable on the dividends where these are on-paid to non-resident shareholders. The RDWT does contain such a mechanism.

Table 3.1 The Impact Of DCT And RDWT On Minerals Industry Companies

	Current System*		Deferred Company Tax		Resident DWT	
	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
	$	$	$	$	$	$
1 Income	130.00	130.00	130.00	130.00	130.00	130.00
2 Accounting depreciation	-50.00	-50.00	-50.00	-50.00	-50.00	-50.00
3 Accounting R&D expenditure	-20.00	-20.00	-20.00	-20.00	-20.00	-20.00
4 Accounting profit	60.00	60.00	60.00	60.00	60.00	60.00
5 Tax adjustments						
6 Additional depreciation	-50.00	50.00	-50.00	50.00	-50.00	50.00
7 Additional R&D write-off	-5.00	-5.00	-5.00	-5.00	-5.00	-5.00
8 Taxable income	5.00	105.00	5.00	105.00	5.00	105.00
9 Company tax paid	-1.80	-37.80	-1.80	-37.80	-1.80	-37.80
10 DCT paid			-11.62			
11 Reported after-tax profit	58.20	22.20	46.58	22.20	58.20	22.20
12 of which:						
13 retained (20% of profit)	11.64	4.44	9.32	4.44	11.64	4.44
14 distributed	46.56	17.76	37.27	17.76	46.56	17.76
15 distributed franked:						
16 resident (50%)	2.50	8.88	2.50	8.88	2.50	8.88
17 non-resident (50%)	2.50	8.88	2.50	8.88	2.50	8.88
18 distributed unfranked:						
19 Resident DWT paid					7.48	
20 resident (50%)	20.78	0.00	16.13	0.00	13.30	0.00
21 non-resident (50%)	20.78	0.00	16.13	0.00	20.78	0.00
22 Unused franking credits	0.00	31.41	0.00	31.41	0.00	31.41

* Table prepared on basis that all domestic shareholders are individuals. This column therefore also applies to the option of an inter-entity tax on unfranked distributions.

Year 1 shows accelerated depreciation, which is fully utilised by Year 2.

Distribution shown as 'unfranked' to demonstrate impact. After payment of DCT such distributions will be regarded as franked.

4.1.4. 3.1.4. Conclusions

(a) **The Council is not persuaded by the need for reform in this area of the kind outlined by the Review. Therefore the status quo should be retained.**

(b) **The Council, in consort with broad industry groupings, is totally opposed to the DCT option for the particular concerns outlined above.**

The Council is not persuaded that the other two options are acceptable as double taxation can occur due to tax preferences and the large timing differences that are common in the minerals industry. This double taxation could be overcome in Option 2 by allowing RDWT to be recognised as a prepayment of future company tax in the same way as currently Franking Deficit Tax is a prepayment of future company tax. A further amendment necessary to the RDWT would involve exempting, from the RDWT, inter-entity dividend received by public companies.

(c) In light of these concerns, if it is clearly demonstrable (that is, a stronger case for change is made than has been made by the Review) that some change is necessary to enhance Australia's growth prospects and international competitiveness, the Council recommends:

- **the RDWT option be modified to address industry concerns through additional consultation; and**

- **other, more acceptable, options also be explored.**

THE TAXATION TREATMENT OF WASTING ASSETS, GOODWILL AND TRADING STOCK: KEY POINTS

- The Council is pleased the Review introduces concepts of assets and wasting assets that represent real reform. T**he Review's discussion assumes any change will apply prospectively to new asset expenditures only**. This is extremely important to minimise sovereign risk and is consistent with past practices of government.

- Any changes in the taxation treatment of wasting assets, whether positive or negative, have implications for project investment economics and for financing of long lead-time projects. **It is particularly crucial that reform in this area promotes the international competitiveness and sustainability of the minerals sector**.

- ***If the Government decides there should be a significant winding back of the treatment of minerals sector wasting assets, it will be necessary to consider other options to ensure project viability is not damaged.***

With regard to the options canvassed in *A Platform for Consultation*:

- **Entitlement to a deduction should be based on the cost actually incurred by a taxpayer to gain the economic interest**;

- **The cost base of an asset for tax deduction purposes should represent the actual cost of the asset to the purchaser;**

- **Capital write-off should commence in the year plant is first installed and ready for use *provided* the present expenditure basis of deduction for minerals industry *capital development* expenditures continues**. This is particularly relevant for long-lead time construction project financing;

- Minerals industry development assets to be written-off for tax on the basis of their separate lives rather than over the life of the more broadly defined "life of property" as at present. This is consistent with principles in the Review. The inherent variability in estimation of resources mine life over time, leads the Council to the view that **the statutory life approach is a practical and preferred basis**. **A cap on effective life of ten years for major project development assets would be practical and appropriate**;

- **The Council supports a continuation of the present self-assessment approach in establishing effective live** complemented by "safe harbour" rates published by the Commissioner as guidelines. The immediate write-off for small items should be increased. Both diminishing value and prime cost write-off methods to be available and taxpayers be able to write-off the residual amount when it reaches the written-down value of $2,000;

- **The Council strongly supports and endorses the Review's initiative in relation to non-deductible expenditures. The appropriate write-off treatment for individual items will require detailed input from business;**

- **Goodwill and intangible rights should be amortised for tax purposes as wasting assets;**

- **The Council strongly opposes any change to the taxation treatment of overburden removal. Any change would impact severely and adversely on working capital requirements for minerals companies and the economic viability of individual mining operations;**

- There should be no **change to the basis of valuation of trading stock** or the current treatment for consumables and spare parts **for taxation purposes;**

- **Appropriate transitional arrangements are necessary for substantially committed projects.**

5. THE TAXATION TREATMENT OF WASTING ASSETS, GOODWILL AND TRADING STOCK

Box 4.1 General Principles For The Taxation Of Wasting Assets

The Council supports application of the following tax principles:

- **all wasting business assets, both tangible and intangible, should be eligible for tax write-off[16].**
- **a deduction should be available to a taxpayer irrespective of the commercial form in which the expenditure is made.**
- **a deduction should be available to the taxpayer who actually incurs / bears the economic cost of the expenditure.**
- **all business expenditures should be immediately deductible unless otherwise specified, including:**
    - **non-deductible ('black-hole') areas of business expenditure which should be eliminated; and**
    - **minerals industry exploration, mining rights, development and mineral transport expenditure.**

5.1. INTRODUCTION

This Chapter focuses on responding to the detail of the Review's taxation treatment of physical assets and goodwill proposals. **It does not directly address the issue of a "trade-off" involving "accelerated" depreciation**.

The current taxation of wasting assets lacks a coherent and consistent framework. The Review introduces concepts of assets and wasting assets that represent real reform. In addition, the Review's discussion assumes any change will apply **prospectively to new asset expenditures only**. This is extremely important to minimise sovereign risk and is consistent with past practices of Government.

Clearly, any changes in the taxation treatment of wasting assets, whether positive or negative, have implications for project investment economics and for financing of long lead-time projects. Given the distinctive characteristics of minerals activities and their importance in the economy, including through vitally important supply and demand relationships with Australian manufacturing and service sectors, **it is particularly crucial that reform in this area promotes the international competitiveness and sustainability of the minerals sector.**

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[16] At present, a range of business expenditures cannot be deducted for tax, including intangibles such as goodwill and premiums on purchase of business assets. The proposal addresses industry arguments in support of base broadening and elimination of tax distortions in commercial decision-making. It also, correctly, eliminates the notion of particular tax expenditure deductions on wasting business assets being 'concessional' in nature.

The Council notes that reliance is placed by the Review in this area on comparison with accounting principles and treatment in support of certain recommendations. However, this appears to be inconsistent and possibly selective.

There is also a presumption that accounting policies provide clear guidance to taxpayers in all circumstances. This is not the case with different accountants and auditors applying standards and principles differentially depending on the taxpayers individual circumstances and application of the concept of materiality.

5.2. ENTITLEMENT TO DEDUCTIONS

5.2.1. Who May Deduct?

The Review considers two options for who is eligible for the deduction.

The Council supports Option 1, which bases entitlement to deduction directly on the cost actually incurred by a taxpayer to gain the economic interest.

- This provides clear and unequivocal treatment of expenditure for tax purposes, including expenditures in relation to non-legal ownership interests such as leasehold fixtures, capital contributions to another person's assets, exploration "farm-in" expenditures and disproportionate expenditures on assets between parties in partnerships in unincorporated joint ventures.

- **Option 2 is rejected on the grounds it would involve complex deeming of expenditures to taxpayers, issues of consistency in accounting application between taxpayers and would introduce economic tax distortions in a range of commercial business contexts.**

5.2.2. What Should Be The Cost Base For Deductions?

The cost base of an asset for tax deduction purposes should represent the actual cost of the asset to the purchaser. This would include buildings and the acquisition of tangible and intangible mineral rights and assets in the wasting assets framework and is consistent with the principle that all expenditures be deductible.

The idea of reducing the cost base by the estimated asset residual value is regarded as impractical in a majority of contexts from a valuation perspective. In the minerals sector, the majority of assets are held for their effective life and generally involve relatively low residual values and minimal tax recoupment on disposal.

5.2.3. When Should Deductions Commence?

The Council supports capital write-off commencing in the year plant is first installed and ready for use. This is reasonable for plant that is unitised and has a discrete "ready-for-use" date and continues the present general treatment of plant.

It is important for companies to be in a position to commence or continue to write-down for tax, assets which are installed and capable of operating, but which for operating, market or other general business reasons are brought into production progressively or temporarily taken off line.

In considering the amount of deductions allowable in the initial year, a full deduction in the first year would be the most appropriate outcome in terms of simplicity for company systems administration.

The position for minerals industry capital development expenditures is not as straightforward, however, as such development can occur over very long construction periods, and can be continuous in the course of subsequent operations. The present expenditure basis of deduction recognises this position, and is particularly relevant in a policy sense for long-lead time construction projects financing.

5.2.4. Over What Period Should Assets Be Written-Off?

The Review advocates wasting assets be written off over their effective life in line with the decline in their economic worth. It is proposed this be applied across all classes of wasting assets.

This is appropriate where it is possible to approximate effective lives for plant based on physical criteria and for many intangibles based on the known term of underlying rights.

Application to the minerals industry in relation to development expenditures is more difficult to determine up front as mine or field life is a function of external and project related variables of a technical and economic nature.

At present, the general depreciation provisions apply to plant and a different system applies for non-plant resource sector expenditures that would otherwise be non-deductible. Depreciation for plant applies across all asset life bands, with a skewed benefit to longer life assets. In the case of non-plant minerals industry related expenditures, some ‘acceleration’ may apply where project life exceeds ten years. Note that deceleration applies in the case of certain mineral transport plant subject to statutory ten year write-off under the mineral transport provisions.

The Review appears to suggest that acceleration in the case of resources related expenditures is approximately half that for general plant.

It would be appropriate for minerals industry development assets to be able to be written-off for tax on the basis of their separate individual lives rather than over the life of the more broadly defined “life of property” as at present. This is consistent with principles in the Review. While in some cases the mine life as a whole may exceed ten years, in many cases substantial amounts of development expenditure have an effective life of less than ten years but their deduction is deferred until a ten year period because it is governed by the life of the overall mine rather than the asset being acquired.

Particular considerations apply in relation to effective life for resource projects. Mine life is generally dependent on economically recoverable minerals reserves, which is a function of a range of technical and economic variables of a project and external market nature. These not only impact estimated life at the start of a project, but also substantially impact estimates of mine life (both positive and negative) on an ongoing basis.

The present life of ten years is regarded as a reasonable compromise in relation to longer life projects, allowing for the inability to write-off development assets over their individual

effective life where this is shorter than the overall mine life. **The inherent variability in estimation of resources mine life over time leads the Council to the view that the statutory life approach is a practical and preferred basis.**

The recent gold and nickel commodity price falls, for example, illustrate how economic conditions can change rapidly. This effects mine cut-off grades, mine lives, exploration programs and perhaps mine viability - with a number of gold and nickel mines having closed over the past year.

The Council therefore recommends that a cap on effective life of ten years for major project investment would be practical and appropriate.

5.2.5. How Should The Period Of Write-Off Be Assessed?

The Council's preferred approach is retention of both current Options 1 and 2.

The ATO's published schedule of rates is not comprehensive or current. In the past it has been necessary for certain industries and taxpayers to seek separate rulings on relevant assets and rate variations reflecting particular use applications. The present self-assessment approach is seen as working effectively.

The Council therefore supports a continuation of the present self-assessment approach in establishing effective lives. A statutory schedule approach for individual assets is not likely to be comprehensive or fit individual circumstances of use. There is still a place for "safe-harbour" rates to be published by the Commissioner as guidelines.

5.2.6. Should There Be An Immediate Write-Off For Small Items?

The Council supports an increase in the *de minimus* write-off value to $2,000 from the current $300. Consideration could be given to providing for a higher figure of, say, $5,000 available to large organisations with the $2,000 being for small business (that is, the test would be the relative quantum of expenditure).

5.2.7. What Write-Off Method Should Apply?

The Review appears to favour the diminishing value basis of depreciation. While the diminishing value basis may provide a better approximation of the decline in value of certain classes of assets, this is unlikely to be the case for other asset classes in a capital allowance system.

The prime cost approach can provide a better outcome in some circumstances, particularly for many shorter life assets. Prime cost may also be simpler, with less administration, particularly regarding the long deduction tail under the diminishing value method. It is noted that as part of the Tax Law Improvement Project the ITAA97 converted various previous diminishing value mining deduction provisions to the prime cost method to eliminate this effect.

Therefore, the Council recommends:

- **retention of the current regime with a once-off election. This includes intangible assets. The position under the prime cost method in relation to second-hand**

purchasers may be addressed to allow write-off to a new purchaser over the original effective life. Many taxpayers already self-assess on this basis; and

- **the taxpayer be able to write-off the residual amount when it reaches the written-down value of $2,000.**

5.2.8. Disposals Of Wasting Assets

The Review proposes removal of the balancing charge offset on the disposal of an asset. The Council feels that while the ability to offset the tax cost base of other plant assets can be an advantage in some circumstances, the provision is limited to depreciable plant and also limited in a practical sense where assets typically have low residual values on disposal.

The Council would prefer to see the revenue cost of this provision reflected in general uplift on depreciation rates for plant. It is noted that some continuing provision for offset in the case of insurance recoupment / replacement assets may remain appropriate.

5.2.9. Non-Deductible Expenditures

The Review addresses the treatment of present non-deductible (black hole) expenditures, and recognises the inconsistency of not allowing their treatment in a manner consistent with other expenditures. There is a wide range of outgoings necessarily incurred in the course of a minerals project which are currently non-deductible.

Indeed, a range of expenditures across the broad spectrum of business activity, including in the minerals industry, currently do not qualify for any form of deduction. This is one of the Council's principles for business tax reform (see Box 1.1), which states:

> *"The tax system should avoid the double taxation of business income and provide relief for all business expenses.*

The black hole expenditures that impact on the minerals industry are considered in more detail in **Attachment C**.

There is a question as to how the tax system should implement the Review's preference for removing non-deductible expenses.

The Council strongly supports and endorses the Review's initiative in this area. The Council recommends that the appropriate write-off treatment for individual items will require detailed input from business.

5.2.10. Sale Of Information

The Review focuses on the non-taxable treatment of receipts from isolated sales of exploration information. The one other matter is excess mining deductions, which is seen as an anomaly in relation to the general loss provisions.

It has been anticipated that the Government will move on the treatment of sales of information, following the recent Taxation Ruling TR 98/3, to address present asymmetric

treatment.[17] **The Council considers that it may be preferable for any change to treat gains on "one off" sales of information as an assessable capital gain and provide appropriately symmetrical treatment (that is, receipts are assessable capital gains and the purchasers are entitled to a deduction).**

5.3. TREATMENT OF GOODWILL

The Council supports the Review's recognition of goodwill and similar intangible rights as costs that should be amortised for tax purposes as wasting asset items. It is noted that many countries already allow similar deduction treatment, typically over periods of five to twenty years.

In relation to the taxation of incremental gains, these are brought to tax currently on realisation. In accord with the Review discussion on this aspect, there would be very real practical difficulties in attempting to bring notional increment in value of acquired and internally generated goodwill to tax on an unrealised basis, from a valuation standpoint. In this regard, it is better to be consistent with the realisation basis upon which the general scheme of taxation legislation is based.

5.4. TREATMENT OF SUBSTANTIALLY COMMITTED PROJECTS (BASED ON ORDERS PLACED OR CONTRACTS LET)

Commitment to many projects will have been made on the premise of the existing tax treatment for allowable capital expenditure and depreciation continuing to apply.

The projects and their associated expenditure on plant and facilities will be at varying stages of completion at the time agreed changes flowing from the Review are due to commence.

Specific areas of concern which require transitional arrangements and suggestions to give effect to them include:

- Expenditure commitments incurred under contracts let or orders placed prior to a prescribed date, to establish or expand mines or acquire new or replacement plant and equipment, be subject to transitional arrangements.

- Current rates of allowance or depreciation be applied to expenditure incurred up to the legislation implementation date or a prescribed date.

- Current rates of allowance or depreciation to apply to expenditure under projects committed prior to a prescribed date.

- That the unclaimed portion of existing plant depreciation and allowable capital expenditure at commencement date continue under existing arrangements.

Such transitional arrangements are required to maintain equity between taxpayers.

[17] Australian Taxation Office (1998b), *Taxation Ruling TR 98/3: Income tax: treatment of receipts for dealing with or disclosing mining, quarrying or prospecting information*, March.

5.5. SHOULD SPECIAL RULES APPLY TO THE RESOURCES SECTOR?

This issue has been discussed in part in Chapters 1 and 2, the above sections of this Chapter and **Attachment C**.

There has been a definite attempt in many countries to reduce the rate of tax on company income. This has not been at the expense of removing some 'accelerated component' in depreciation scales. In addition, from the comparative effective tax rate tables provided in Chapter 7 of the Review's information paper, *An International Perspective*, the resources sector is favourably taxed in all of the jurisdictions surveyed - particularly those with significant minerals industries.

Minerals companies cannot survive without committing investment in new projects. This includes expenditure on costly infrastructure specific to individual mining / processing operations, together with significant exploration and research and development expenditures.

The industry is highly capital intensive and there are long lead-times in developing projects. Major international minerals companies place investments where they can maximise their rate of return while minimising risk in a high-risk industry.

Because a large quantity of debt funds is required to develop any new minerals project, the size of borrowings associated with most of these projects is beyond the capacity of the Australian capital market to finance. Much of the debt funding, therefore, has to be borrowed from overseas lenders, with currency and other risks.

Borrowings by the mining and minerals processing sector are estimated to have been $12 billion at 30 June 1998.[18] The proportion of foreign denominated debt is typically over 50 per cent and can be above 60 per cent depending on the attractiveness of Australian dollar denominated debt. This reflects relatively lower interest rates in overseas financial markets and the advantage of a natural hedge given that most of the industry's revenue is denominated in foreign currency.

Australia also benefits from investment overseas, because of the flow back of profits, interest and dividends to Australia, the development of markets for the Australian minerals industry and related industries' (for example, services to mining) inputs and the technical, managerial and market know-how which are obtained.

In summary, the Australian minerals sector is – as indeed Australia more broadly is - a significant net importer of capital with growing outbound investment. In taxing income with an international dimension, Australia needs to be mindful of other countries' practices in this area.

If the Government decides there should be a significant winding back of the treatment of minerals sector wasting assets, it will be necessary to consider other options to ensure project viability is not damaged. In developing such options, the distinctive characteristics of the industry discussed in Chapter 2 and the principles set out at the beginning of this Chapter should be borne in mind.

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[18] PricewaterhouseCoopers (1998) *Minerals Industry Survey '98,* Undertaken for the Minerals Council of Australia, Canberra, December.

5.6. TRADING STOCK

The Review considers three options for possible amendment of the present tax trading stock provisions, with a view to limiting current flexibility in the timing of tax income. The Council is not aware of abuses in relation to the existing provisions, and believes they should be retained.

The accounting based options approaches produce valuation outcomes inconsistent with tax principles of valuation of mining trading stock. In particular, accounting approaches include in "cost value" a range of deferred costs that do not relate to the cost of production of trading stock (for example, transport and handling of finished product, selling and realisation), but are merely general business operating expenses.

The tax meaning of "cost" for the mineral industry has recently been agreed with the ATO and is detailed in Taxation Ruling 98/2.[19] It is appropriate to maintain this agreed position for the minerals industry.

The Council considers it is not necessary to change the existing basis of valuation of trading stock for taxation purposes for the minerals industry.

5.7. NON-TRADING STOCK INVENTORY

5.7.1. Overburden Removal

Background

Overburden removal or "stripping" is currently deductible as a production operating expense when incurred.

In Australia, open cut mining accounts for a significant proportion of gold and iron ore production and over 70 per cent of production of black coal.

- In the coal industry, for example, large open cut strip mines can be a number of kilometers long and up to a kilometer wide. Most open cut mines follow a broadly similar model, although the technology and equipment needs differ depending on the overburden depth and the precise characteristics of the mine.

  – For example, at some mines, due to the depth of the coal seams, up to three steps are necessary in stripping. The first could involve a bucket wheel and associated equipment to remove the first 25 to 30 metres of overburden. The second involves further stripping by truck and shovel and / or excavator to remove sufficient further overburden to enable a dragline - in stage three - to complete the process and reveal the coal seam to be extracted.

- For open pit gold mines there can be considerable amounts of overburden to be removed before gold bearing ore is exposed. In addition it is extremely difficult to

[19] Australian Taxation Office (1998a), *Taxation Ruling 98/2: Income tax: miscellaneous trading stock issues affecting the general mining, petroleum mining and quarrying industries*, March.

quantify where waste ends and mineralised ore begins and how much ore there is to amortise the waste over, particularly where the mineralisation is often one or two grams per tonne (invisible to the naked eye). The categorisation of land as waste or ore often changes as mine plans develop. A change in the cost of extraction, changes in technology or a rise in commodity prices may change the classification and allow a return of income from what was previously considered waste.

Decisions on overburden removal, then, are driven by operational requirements, such as:

- maintaining operational continuity at the mine site;
- for practical mine engineering and integrated mine planning purposes; and
- operational requirements for the utilisation of major items of equipment (for example, draglines, bucket wheel assemblies and excavators). Mine planning considerations dictate such heavy equipment stay in the one place for the maximum time for simple economic and operational reasons.

Taxation Ruling 95/36 acknowledged, in relation to overburden removal

> *"By necessity the overburden to be removed is always larger than the area of the seam to be mined to allow for side wall stability or for the required angle of the spoil line. All this overburden removal is part of the method of extraction and is an operating expense*."[20]

Furthermore, the excavation of decline tunnels and in some cases the construction of access roads are similarly operational expenses and immediately deductible.

The Review's Position

The Review does not distinguish between initial and ongoing overburden stripping. It states that overburden stripping can involve significant amounts being expended *"...well in excess of immediate needs"*.[21] This view misunderstands the operational requirements of open pit and strip mining discussed above.

Within this context, decisions on overburden removal are driven by operational and other requirements (such as maintaining operational continuity at the mine site) and not by possible taxation consequences.

While certain costs are treated by some companies as deferred costs for accounting profit and loss reasons, it is important to maintain the integrity of underlying tax principles in terms of tax treatment of these and other expenditures.

In summary, initial overburden stripping is immediately deductible for tax purposes. As discussed above, the economics of mining operations involving open pit and strip mining requires careful mine planning to maximise the efficiency of the ore extraction process. The treatment of overburden removal should therefore be as an operating expense - that is, immediately deductible when incurred.

[20] Australian Taxation Office (1995), *Taxation Ruling TR95/36 Income tax: characterisation of expenditure incurred in establishing and extending a mine*, p. 10.

[21] Review of Business Taxation (1999), *A Platform for Consultation*, AusInfo, Canberra, February, p. 130.

The Council strongly opposes any change to the taxation treatment of overburden removal. The Council's view is that the treatment of overburden removal is correctly an operating expense that is immediately deductible when incurred *because no enduring (or wasting) asset is created*. Any change to this treatment would impact severely and adversely on working capital requirements for minerals companies and the economic viability of individual mining operations.

5.7.2. Consumables And Spare Parts

The Review suggests that expenditure on consumable and spare parts be treated for tax in a manner similar to trading stock.

Expenditure on spares in the initial and insurance categories is currently not immediately deductible on purchase (they are amortised over the same period as the equipment to which they relate).

Expenditure on consumables and spares, other than in the initial and insurance categories is incurred in the course of operations as expenditure of an operating nature and is properly deductible on an as incurred basis in the same manner as all other operating expenses.

The current treatment of trading stock does not in the Council's view provide support for treatment of consumable stores and spares in the manner suggested in the Review.

The Council is concerned at the nature of the suggestions and does not believe that a change in the basis of the treatment of consumables and spares that are immediately deductible is warranted.

INTERNATIONAL TAXATION ISSUES: KEY POINTS

- The proposed Non-Resident Investor Tax Credit could make it more difficult to negotiate lower dividend withholding tax rates for non-portfolio dividends with additional countries. **For this reason the Council is not in favour of the proposal.** The Council has consistently argued that the Government should be vigorously negotiating the minimum possible dividend withholding tax rates in Double Tax Agreements (DTAs) both when new DTAs are negotiated and when renegotiating existing DTAs.

- Current anti-streaming rules prevent Australian based multinationals from ameliorating the high cost of foreign withholding taxes by not allowing the streaming of foreign profits directly to foreign investors. Amendments to allow this streaming to occur would result in additional franking credits being available to be paid to Australian investors.

- It is very important that, if the suggested approach to taxing non-residents on disposal of indirect interests in Australian assets (including a suggestion that the tax liability could be enforced against the asset) is adopted, it be restricted to situations where the non-resident **does** have control.

- **The Council welcomes the Review's suggestion that imputation credits could be allowed for withholding tax deducted from foreign dividends**.

- Removal of the active business exemption contained in the Foreign Investment Fund (FIF) rules would result in greatly increased compliance costs. The Council considers that this measure would also be inequitable because it would result in the accruals taxation of income of an FIF which may never actually be received by way of dividend. **For these reasons the Council is opposed to the removal of the active business exemption**.

- Replacement of the active income test for non-portfolio investments with one based on the controlled foreign company (CFC) measures would result in problems for taxpayers. Currently, it is often very difficult to obtain sufficient details to determine whether the CFC active income test is passed in respect of a CFC. **Therefore, the Council is opposed to the redesign of the active income test.**

- **The Council is opposed to the introduction of additional rules to limit the deductibility of interest incurred by Australian resident companies**. The current rules already prevent the deduction of interest from general income where the interest can be traced to a source of exempt foreign income.

- **The fixed gearing ratio discussed by the Review would cause problems for some companies in the minerals industry unless a very high gearing ratio is stipulated.**

- The proposed extension of thin capitalisation rules to third party debt is a very significant measure and will have considerable impact on many taxpayers. There are often sound commercial reasons (often related to the risk profile of the investment) for the use of third party debt. **It is inequitable to disallow an interest deduction on such debt.**

- **The Council supports, in principle, the need for adequate documentation to be available to support the tax deductibility of expenditure, particularly in relation to tax havens.** However, it is important to note that investment in or through tax havens can occur for genuine business reasons. Any new documentation requirements should not add to the compliance cost and complexity of operating in or through a tax haven for genuine business reasons.

6. INTERNATIONAL TAXATION ISSUES

6.1. INVESTMENT IN AUSTRALIA BY NON-RESIDENTS

6.1.1. Australian Tax Levied On Non-Residents Investing In Australian Entities

The Council notes the suggestion that a Non-Resident Investor Tax Credit (NRITC) could be introduced. This would be advantageous for foreign shareholders who whilst able to claim a credit for withholding tax deductions in their country of residence are not able to claim a credit for underlying taxes paid in Australia. Typically this will restrict the advantage of the NRITC to portfolio shareholders although precisely which shareholders will benefit depends upon the tax laws in their country of residence and their individual circumstances.

The Council notes the comment by the Review that the NRITC could make it more difficult to negotiate lower dividend withholding tax rates for non-portfolio dividends with additional countries. However, the Council has consistently argued that the Government should be vigorously negotiating the minimum possible dividend withholding tax rates in Double Tax Agreements (DTAs) both when new DTAs are negotiated and when renegotiating existing DTAs. For example, our current treaty with USA places Australian based multinationals at a competitive disadvantage, in that tax paid profits are remitted from Australia with no dividend withholding tax while the tax paid profits remitted from the USA to Australia have an additional 15 per cent non creditable dividend withholding tax imposed to the corporate recipient. **For this reason the Council is not in favour of the NRITC proposal.**

6.1.2. Streaming

Currently, anti-streaming rules prevent Australian based multinationals from ameliorating the high cost of foreign withholding taxes by not allowing the streaming of foreign profits directly to foreign investors. Amendments to allow this streaming to occur through an expansion of the foreign dividend account would be a more appropriate treatment having regard to international competitiveness.

6.1.3. Indirect Transfers Of Australian Assets Held By Non-Residents

The Council notes that the discussion of a possible method for taxing non-residents on disposal of indirect interests in Australian assets includes a suggestion that the tax liability could be enforced against the asset. It is very important that this suggestion if adopted should be restricted to situations where the non-resident does have control.

In particular, a shareholding of 10 per cent or more in a public Australian company which is held by a foreign shareholder would be a taxable Australian asset and therefore could be within the scope of any new rules relating to disposals by non-residents. It would be unreasonable if there were implications for the Australian company in the event that the foreign shareholder disposed of that shareholding and did not account for tax on any capital gains.

6.2. FOREIGN SOURCE INCOME OF RESIDENTS

6.2.1. Foreign Tax Credits Flow Through

The Council welcomes the Review's suggestion that imputation credits could be allowed for withholding tax deducted from foreign dividends. If such a credit is provided then this should apply to withholding taxes deducted from dividends irrespective of whether the dividends are exempt from tax under Section 23AI or Section 23AJ of the *Income Tax Assessment Act 1936* (ITAA36).

Whilst the need for preventing tax avoidance is recognised, this proposal should not be restricted to countries with which Australia has a DTA, since Australia's treaty network is not extensive. The alternative of capping the amount of the credit to a reasonable amount, for example 15 per cent, is more equitable.

6.2.2. Problems With The Active Business Exemption In The Foreign Investment Fund Measures

Foreign investments by Australian minerals industry companies are typically in companies that carry on an active business. The active business exemption contained in the Foreign Investment Fund (FIF) rules is therefore important to the industry.

Removal of the active business exemption is acknowledged by the Review as resulting in greatly increased compliance costs. The Council considers that this measure would also be inequitable because it would result in the accruals taxation of income of an FIF which may never actually be received by way of dividend. **For these reasons the Council is opposed to the removal of the active business exemption**.

Replacement of the active income test for non-portfolio investments with one based on the controlled foreign company (CFC) measures would result in problems for taxpayers. Currently, it is often very difficult to obtain sufficient details to determine whether the CFC active income test is passed in respect of a CFC. It will be very difficult or impossible to obtain adequate details in respect of an FIF due to the smaller shareholding compared with a CFC. **Therefore, the Council is opposed to the redesign of the active income test**.

The Council also believes that the same active business exemption should apply to portfolio and non-portfolio investments. This is because the distinction between the two is purely arbitrary, being based on whether the relevant shareholding is greater or less than 10 per cent. In reality, a shareholder with a 9 per cent interest in a company has access to exactly the same type of information as a shareholder with, say, a 15 per cent interest.

The Council suggests that if changes are required to the FIF rules to prevent abuse then these changes should be very focused and targeted at 'real life' tax avoidance techniques. A broader tightening of the rules which will increase compliance costs and result in accruals taxation of active business income is not merited.

6.3. ALLOCATING WORLDWIDE TAXABLE INCOME BETWEEN COUNTRIES

6.3.1. Deductibility Of Interest For Offshore Investments

The Council notes the Review's comments that the imputation system provides an incentive for company tax to be paid in Australia rather than overseas and strongly agrees that this is the case. In order to maximise the Australian tax payable foreign subsidiaries of Australian minerals industry companies are often geared to the extent possible having regard to the local thin capitalisation rules together with the commercial circumstances of the particular subsidiary.

The Council is opposed to the introduction of additional rules to limit the deductibility of interest incurred by Australian resident companies. The current rules already prevent the deduction of interest from assessable income where the interest can be traced to an exempt source of foreign income.

There is a real risk in the capital-intensive minerals industry that any further limitation would impact on companies that are highly geared because of their particular circumstances in Australia.

If it is considered necessary to introduce new rules to limit interest deductions in cases where Australian companies are highly geared then it is essential that the type of test allows considerable flexibility and is commercially sound. This is particularly important in respect of the minerals industry because domestic companies can at some times become very highly geared due to the high levels of capital expenditure required to develop new mines in Australia.

The fixed gearing ratio discussed by the Review would cause problems for some companies in the minerals industry unless a very high gearing ratio is stipulated. It is also difficult to see how the amount of interest for which a deduction would be denied could be calculated using a fixed ratio. For example, a group may fail the fixed ratio but have only minor foreign interests and in these circumstances it would be unreasonable to deny deductibility for any significant proportion of the interest incurred. There may be sound commercial reasons (often involving different risk factors) for different levels of gearing across a group. The use of a fixed gearing ratio may result in tax considerations impinging on commercial decision-making, an outcome counter to much of the Review's focus.

6.3.2. Thin Capitalisation Provisions For Onshore Investment

The proposed extension of thin capitalisation rules to third party debt is very significant and will have considerable impact on many taxpayers. As such, it is a measure that should only be undertaken after full consideration including extensive consultation with industry of the effect it may have on inbound investment. There are sound commercial reasons (often related to the risk profile of the investment) for the use of third party debt. **It is inequitable to disallow an interest deduction on such debt.**

If third party debt is brought within the thin capitalisation rules it is essential that the threshold for foreign control be increased substantially. If it is not, then the thin

capitalisation rules may impose a restriction on deductibility of interest on third party debt of Australian companies with only limited foreign ownership. The application of the thin capitalisation rules to existing investments would amount to retrospective taxation.

If rules extend to third party debt then a carry forward of disallowed interest should be allowed to a year when the thin capitalisation rules are not breached rather than a permanent disallowance. This is because interest paid to third parties cannot be construed to be a hidden dividend and would have properly been allowed at an earlier time but for the thin capitalisation rules.

6.3.3. Disallowing Deductions In The Absence Of Sufficient Information

The Council supports, in principle, the need for adequate documentation to be available to support the tax deductibility of expenditure and does not oppose the proposition that where expenditure involves tax havens particular attention may be required to the documentation requirements.

It is however important to note that investment in or through tax havens may occur for genuine business reasons. For example, mineral deposits are sometimes situated in a country that might be regarded as a tax haven. Any new documentation requirements should not add to the compliance cost and complexity of operating in or through a tax haven for legitimate business reasons.

OTHER ISSUES: KEY POINTS

- There can be no dispute that there is an over reliance on specific anti-avoidance provisions in the income tax legislation. As identified by the Review, these provisions add significantly to the complexity of the law and hence compliance costs.

- There has been a recent trend in Australian income tax anti-avoidance provisions to require a lower threshold of anti-avoidance purpose versus the 'dominant purpose' test underlying Part IVA of the *Income Tax Assessment Act 1936* (ITAA36). **The Council believes that any move to lower the hurdle for the operation of the anti-avoidance provisions is inappropriate and would lead to even greater taxpayer uncertainty**. The current ITAA36 Part IVA general anti-avoidance provisions have, through various Court cases, been shown to have real power and have been effective in striking down unacceptable taxpayer activity.

- The Council encourages the review and removal of specific anti-avoidance provisions (for example, franked dividends rules) - in particular where it is clear that the review will remove some of the structural flaws in the current income tax legislation.

- **The Council notes the need for tax reform of the capital gains tax system is real**. The Council supports the recommended scrip-for-scrip rollover relief - currently where a share for share merger, takeover, or deconsolidation occurs the capital gains tax provisions are triggered. Allowing a scrip-for-scrip rollover relief whereby the original cost base of shares is maintained without triggering a capital gain would assist the minerals industry in developing new projects and expanding existing projects as well as establishing and maintaining minerals consortiums.

- The problems raised by the Review as a result of the non-taxing of a wholly owned group as a single entity are very questionable. **Except for one or two areas the current grouping provisions achieve the objectives outlined by the Review. If the Review is clearly of the view that a consolidation regime is an essential element of the tax reform package then it is equally essential that: implementation is deferred; and consultation be undertaken with industry bodies to determine ways of removing the unworkable elements of the regime.**

- Interest is currently tax deductible in Australia except the extent to which it is incurred in deriving exempt income or it is private or domestic in nature. This position has been confirmed in the March 1999 High Court decision in *Steele v Deputy Commissioner of Taxation*. The Council supports the continuation of a tax deduction of interest where the associated borrowings are to derive assessable income that is broadly defined to also include capital gains.

- The Council believes the transition to implement comprehensive business tax reform will be difficult to achieve in any meaningful way in the timeframe proposed (that is, for the 2000-01 income tax year). For many companies with substituted accounting periods, that may mean business income tax changes would impact from 1 January 2000.

- **The Council suggests considerable thought be given to delaying the implementation of some of the reform measures**. It is clear that a better outcome can be achieved through a staged or progressive implementation in consultation with the business community. This will ensure a better outcome for both the Government and business.

7. OTHER ISSUES

7.1. ANTI-AVOIDANCE PROVISIONS

There can be no dispute that there is an over reliance on specific anti-avoidance provisions in the income tax legislation. As identified by the Review, these provisions add significantly to the complexity of the law and hence compliance costs.

The Council is concerned with past ATO / Treasury practice in their apparent willingness to recommend to Government the enactment of specific anti-avoidance provisions where it would have been appropriate to rely on the general anti-avoidance provisions. In the absence of reform it is expected that further layers of anti-avoidance legislation would include an even greater reliance on “legislation by press release”. It is particularly frustrating to the overwhelming majority of compliant taxpayers who are forced to wade through the many complex and convoluted anti-avoidance provisions in an attempt to ensure that no anti-avoidance provisions are inadvertently breached.

One of the main factors which frequently give rise to amendments and anti-avoidance provisions (to close real or perceived loopholes), is that the initial drafting and even its policy design and intent, is developed **without genuine consultation with the taxpaying community**. This leads to legislation that is unworkable and frequently does not deliver the results intended by Government.

Clearly, what is required is genuine consultation with taxpayers by Treasury and the ATO in all aspects of taxation legislation, from policy design and drafting of legislation, through to regular technical and administrative reviews of the effectiveness of the legislation as enacted.

7.1.1. Structural Solutions

The Council supports the Review’s proposition that a more systematic approach is required to deal with avoidance issues. The Council also agrees that a better structure and design for tax law will reduce, and hopefully eliminate, the need for specific anti-avoidance provisions.

The Council welcomes and encourages the review of specific anti-avoidance provisions as described by the Review[22] and recommends **consultation with taxpayers should be a mandatory aspect of such review.**

7.1.2. A General Anti-Avoidance Rule

The Council also agrees with the proposition that **a general anti-avoidance provision is a provision of last resort** (not a primary taxing provision), and accordingly should only be used in extraordinary circumstances and not everyday situations. It is very important that the anti-avoidance provision be drafted with sufficient clarity to provide taxpayers with certainty. This is crucial in a self-assessment environment.

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[22] Review of Business Taxation (1999), *A Platform for Consultation*, AusInfo, Canberra, February, p. 519.

There has been a recent trend in Australian income tax anti-avoidance provisions to require a lower threshold of anti-avoidance purpose versus the 'dominant purpose' test underlying Part IVA of the ITAA36. The Council believes that any move to lower the hurdle for the operation of the anti-avoidance provisions is inappropriate and would lead to even greater taxpayer uncertainty.

Of great concern is the GST draft anti-avoidance provisions that, although based on the dominant purpose test, contain additional provisions that may impute an anti-avoidance motive even if the taxpayer has no other commercial alternative. **The adoption of anti-avoidance provisions along these lines would create a significant and unacceptable level of uncertainty for taxpayers.**

The Council is aware of instances where foreign tax regimes are removing their anti-avoidance provisions as greater reliance is being placed on the structural integrity of their tax systems. However, we believe that there is a requirement for a general anti-avoidance provision in the Australian taxation legislation.

The current ITAA36 Part IVA general anti-avoidance provisions have, through various Court cases, been shown to have real power and have been effective in striking down unacceptable taxpayer activity. **There is, therefore, no requirement for any change to the current general anti-avoidance provision as 'dominant purpose' has proven to be the correct level for a provision of last resort.**

In summary, the Council encourages the review and removal of specific anti-avoidance provisions (for example, franked dividends rules) - in particular where it is clear that the review will remove some of the structural flaws in the current income tax legislation.

7.2. CAPITAL GAINS TAXATION

Capital gains are taxed in Australia generally at marginal tax rates after allowance for inflation.

This has meant that Australia subjects capital gains to high rates of tax as compared to its major trading competitors. The flow-on effect of this is a discouragement of investment and national savings, restriction in capital mobility and a lack of incentive for high-risk new projects.

The Council notes the need for tax reform with capital gains tax is real.

The Review acknowledges these negatives in the existing capital gains tax system and its scrip-for scrip recommendation is supported by the Council.

Currently where a share for share merger, takeover, or deconsolidation occurs the capital gains tax provisions are triggered. Allowing a scrip-for-scrip rollover relief whereby the original cost base of shares is maintained without triggering a capital gain would assist the minerals industry in developing new projects and expanding existing projects as well as establishing and maintaining minerals consortiums.

The introduction of scrip-for-scrip rollover relief would be welcomed and should provide significant positive tax reform in this area.

Other issues include:

- the need for a symmetrical treatment of capital gains and losses; and
- the need to remove of the present ‘quarantining’ of capital losses.

7.3. CONSOLIDATED RETURNS

7.3.1. Arguments Presented By The Review

The Review argues that the non-taxing of a wholly owned entity group as a single entity has resulted in a number of tax problems for that group.

The Review also argues that the taxing of a wholly owned entity group as a single entity would improve significantly the taxation of this entity group in that it would:

- simplify the tax system and reduce compliance costs;
- promote economic growth which allow business to adopt organisational structures based more on commercial rather than tax considerations; and
- promote equity by improving the integrity of the tax system.

However, the problems raised by the Review as a result of the non-taxing of a wholly owned group as a single entity are very questionable.

7.3.2. Compliance Costs And Organisational Structures

The current tax grouping provisions **do not** create tax impediments to business organisation nor are compliance costs high. In fact, an original design feature of the loss transfer provisions was low compliance costs. Except for a few areas (for example, non-grouping of franking credits) the current system is working well. It should also be noted that many entity groups would not consist of wholly owned group companies. That is, there will be a number of partly owned group companies. As such their Consolidated Annual Accounts will be of limited assistance, and accordingly an additional level of consolidation would be required involving selected elimination entries.

In relation to this additional compliance costs question, one only needs to look at countries such as the USA where people specialise in preparing consolidated tax returns. The time to develop, test and implement tax software to cater for a consolidation regime should not be underestimated.

The remaining problems raised, such as loss duplication, are in general the subject of current specific tax anti-avoidance provisions which are designed to eliminate these problem areas.

7.3.3. Forfeiture Of Losses

A number of problems arise in relation to entities entering a consolidated group. A major concern relates to the treatment of tax losses. There is considerable uncertainty and concern that these pre consolidation losses, either at the point of entry and / or departure, could be lost as a tax deduction. This is clearly not an equitable or acceptable result. In addition, the forfeiture of losses on entry would have a significant negative profit and loss impact where the losses had previously been tax effected.

7.3.4. Inter-Company Dividends

The current rebate system ensures that there is not multiple taxation of dividends flowing between companies. This system is effective only because companies within a corporate group are treated as separate legal entities. **The proposed consolidation regime would remove this distinction and create an inequitable result for consolidated groups that are in an overall tax loss position**. Where a dividend is received from outside the corporate group this dividend is required to be offset against that group's tax losses. As a result, significant tax losses would be wasted unless this issue can be adequately addressed. Several solutions are possible including a dividend received deduction.

7.3.5. Election?

The Review proposes that the consolidation regime is an option. However, the onerous and inequitable conditions attached to the election for corporate groups to take up the non-consolidation option **do not make it a viable alternative**.

7.3.6. Credit For Tax Paid - Additional Foreign Tax

The consolidation regime proposes that the Australian Holding Company be regarded as being liable for the Australian tax paid by the corporate group. As a consequence, a credit for the tax paid may not be allowed in certain foreign jurisdictions, such as the USA, under their CFC rules regime.

7.3.7. Other Issues

The proposal that all group entities be jointly and severally liable for the group's tax liabilities should end on exit. Otherwise tax considerations might force companies to sell assets when it would make more sense commercially to sell shares.

Groups would prefer to be able to choose between aggregating individual entity tax returns and using modified equity accounts.

Consideration should be given to reducing the threshold for consolidation to less than 100 per cent as in the case of a number of comparable countries.

Rollover relief should be extended to entities that are CFC's of Australian groups.

7.3.8. Conclusion

Except for one or two areas[23] the current grouping provisions achieve the objectives outlined by the Review. If the Review is clearly of the view that a consolidation regime is an essential element of the tax reform package then it is equally essential that:

- implementation is deferred ; and
- consultation be undertaken with industry bodies to determine ways of removing the unworkable elements of the regime.

A further option which should be considered is to change the current grouping provisions to eliminate deficiencies such as non-grouping of franking credits and, if needed, strengthen the non-abuse areas. This would potentially achieve all the objectives as well as overcoming all problem areas as set out in this grouping proposal without creating new problems.

7.4. INTEREST DEDUCTIBILITY

Interest is currently tax deductible in Australia except the extent to which it is incurred in deriving exempt income or it is private or domestic in nature. This position has been confirmed in the March 1999 High Court decision in *Steele v Deputy Commissioner of Taxation*.

The Council supports the continuation of a tax deduction of interest where the associated borrowings are to derive assessable income that is broadly defined to also include capital gains.

The Council would not support any exclusion from the above treatment and believes that the current tax legislation adequately covers situations where interests should not be tax deductible.

7.5. TRANSITIONAL ARRANGEMENTS

The Council understands that the timetable for reform is currently envisaged to commence from the start of the 2000-01 income year. For many companies with substituted accounting periods the reforms become effective from 1 January 2000 or earlier. Clearly the transition to implement comprehensive business tax reform will be difficult to achieve in any meaningful way in this timeframe.

The Council suggests considerable thought be given to delaying the implementation of some of the reform measures. It is clear that a better outcome can be achieved through a staged or progressive implementation in consultation with the business community. This will ensure a better outcome for both the Government and business.

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[23] see Preston, A. (1995), 'Some Systemic Issues in Business Income Taxation', *Economic Roundup, Winter 1995*, AGPS, Canberra, pp. 77-78.

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9. ATTACHMENTS

A. MAP: AUSTRALIAN MINING & MINERALS OPERATIONS AND SIGNIFICANT MINERALS DEPOSITS

B. DETAIL ON THE DISTINCTIVE CHARACTERISTICS OF THE MINING AND MINERALS PROCESSING INDUSTRY

- **Reliance on international markets** which exposes the industry to:
  - fluctuations in demand, prices and exchange rates: many metal prices are cyclic in the short to medium term, making mines financially vulnerable.[24] Prices for metals have been falling in real terms for many years.
  - currency fluctuations that impact because export price contracts are typically fixed in US dollars (offset to some extent by borrowings, which are usually in the same currency, and hedging arrangements).
  - changes in market access conditions through tariffs, quotas and other government policy instruments; and
  - competition from alternative suppliers and alternative materials.
- **Mine locations** are frequently in remote, inhospitable areas with poor transport, energy, communications, town and port facilities which must be upgraded, enhanced or, more generally, built to maximise economies for the transport of low value, high volume products. The exploration and development of mineral and energy resources have underpinned much of the infrastructure development in Australia.
- **Replacement and incremental investment** is high in order to maintain production levels after the early years because of declining head grades and deeper mining levels.
- High cash flows are necessary in the early years to fund **high loan repayments** because lenders perceive the high risk in mining and lend on short-term bases.
- Mining companies are often required to provide **social and industrial infrastructure** that would normally be provided by Government for other industries.
- Each mine is **unique**. The mine and associated processing facilities must be designed to cater for the unique features of each ore body. The actual mineral recovery procedures adopted differ widely.
- **Development costs** are high. A large amount of debt funds required to develop any new major mining project has to be borrowed from overseas lenders, with currency and other risks. The reason for this is that the size of most of the projects is beyond the capacity of the Australian capital markets to finance. Furthermore, costly investigation and proving up of each ore body is necessary to reduce risks associated with

24 Such fluctuations can be quite severe. For example, in USA dollar terms the price of mineral commodities exported by Australia declined by approximately 20 per cent in the five years to 1994. Fortunately the decline in prices was more than offset by the increased volumes of minerals exported but that would not have been possible had the industry not placed such an emphasis on continuous improvement.

development.

- Mining operations are **capital intensive**. This partly explains the industry's high productivity but carries with it the disadvantage of heavy interest and loan repayment commitments.

- **High wages** and good conditions are necessary to compensate labour for the nature of the work and often the isolated location. Operating costs are consequently high.

- A mine is a **wasting asset**. Thus, the industry requires **high-risk funds**, which are best obtained from cash flows, to be applied in the search for new ore deposits. The establishment, expansion and replacement of operations depend on the success of this unique, costly (it typically costs US$50 million to find a "world class" deposit), high-risk exploration activity.

- **Mine closure costs** must be recovered. These include severance costs for labour and rehabilitation costs (for example, revegetation costs).

- While new minerals projects are expensive and risky to find and develop, once the minerals companies have borne the risk the benefits to the Australian economy are extremely high in terms of long-term employment and export earnings.

C. DETAIL ON CAPITAL ALLOWANCES AND OTHER TAX MEASURES IMPORTANT TO THE MINERALS INDUSTRY

As noted in Section 2.1, it is useful to characterise capital expenditure deductions available to the minerals industry under the following five categories:

- non-deductible business expenditures (or 'black holes');
- expenditure claimed outright (for example, exploration, R&D, rehabilitation, environmental, mine closure costs);
- development expenditure written-off over the life of the mine or ten years (whichever is the lesser) - for example, allowable capital expenditure, expenditure incurred on housing and welfare);
- plant - deducted at the general rates of depreciation in common with other industries (for example, haul trucks, water trucks, shovels, stackers, reclaimers, draglines, and so on); and
- infrastructure (for example, ports, railways, roads, towns and dredging).

This Attachment provides more details on each of these categories of capital expenditure provisions. Each provision has been considered in terms of the objective of / rationale for the provision, the effects / benefits of the provision and the general implications for the minerals industry of the reduction or abolition of the provision.

C.1 NON-DEDUCTIBLE BUSINESS EXPENDITURE ('BLACK HOLES')

The ITAA36 and ITAA97, in general, provides that expenditure incurred in carrying on a business to derive assessable income is allowable as an outright deduction in the year it is incurred, unless the expenditure is of a capital nature. In relation to expenditure of a capital nature, it is necessary to look to a specific provision that will allow an item to qualify for a deduction.

In recent years, the Government has made some important amendments to the deduction provisions to allow certain capital items, such as environmental expenditures, to be deductible. However, there is a significant range of expenditures which is necessarily incurred by companies in earning assessable income but which is not presently tax deductible in any form.

In 1995, the Council undertook a survey of 29 overseas tax jurisdictions concerning the tax treatment of expenditures that are not deductible in Australia.[25] The survey looked at the major areas of non-deductible expenditure in each phase of a mining project - Pre-incorporation, Exploration and evaluation, Development and operation and Closure. Table C.1 outlines each of these areas (which are quite extensive) in more detail.

[25] Minerals Council of Australia (1995), *Non-Deductible Business Expenditure*, Canberra.

The majority of these expenditures are generally deductible, either outright or over time, in most of the tax jurisdictions surveyed. The jurisdictions covered include industrialised countries and developing countries - with an emphasis on mineral exporting countries.

The Council argued at the time, and continues (as it has argued consistently throughout this submission) to argue that Australia's taxation system must be competitive with the tax regimes of our major trading partners and the newly industrialised Asian countries. To this end, the Council would warmly welcome amendments to the income tax law to eliminate non-deductible business expenditures. This would also provide a more appropriate base for company income tax, enhance the competitiveness and growth of Australian industry, provide greater certainty to taxpayers and substantially reduce compliance costs.

The 1995 survey suggests that for 1993-94, non-deductible expenditure of the Australian minerals industry is estimated at about $98 million. This suggests that the above benefits can be achieved at little cost to revenue.

Table C.1: Major items of non-deductible business expenditure

Pre-incorporation phase	
	Pre-incorporation costs
	Legal and consulting costs to establish a business.
Exploration and evaluation	
	Equity capital raising costs (including prospectus and underwriting costs)
	Goodwill and premiums in relation to acquisition
	Costs of acquiring mining lands, leases and mineral rights from former owners of mining interests
	Payments to defend native title land / assets
	Pre exploration costs
	Compensation to landholders for rights to use/enter property
	Costs of certain feasibility studies on aborted downstream projects
	Payment by lessee to cancel an onerous lease
	Work "outside boundaries" - work on land owned by other parties (usually local Government) on condition of planning approval being granted
Development and operation	
	Contributions to regional infrastructure (eg roads and ports)
	Further payments to defend native title land / assets
	Certain rehabilitation costs (for example, beautification costs during operations)
	Demolition costs
	Costs associated with the removal and relocation of business operations
	Payments to dispose of a liability (payment to settle a dispute over a capital contract)
	Payment by lessee to cancel an onerous lease
	Settlement payments to conclude unfavourable legal cases / contracts
	Legal and compensation costs in defending / preserving business practices
	Payment of compensation and rectification costs paid from past acts of subsidiaries
	Payment under a letter of guarantee in support of the act of a subsidiary
	Takeover defense costs
Closure	
	Demolition costs
	Mine closure costs (ability to carry back deductions)
	Carry back of losses
	Capital expenditure write-off limits

Source: Minerals Council of Australia (1995).

C.2 EXPLORATION & PROSPECTING EXPENDITURE

C.2.1 What Is The Objective / Rationale Of The Provision?

Subdivision 330-A of the ITAA97 provides for the immediate deduction (that is, in the year incurred) of expenditure on prospecting and exploration by eligible mining (including petroleum) or quarrying operations. The provision was first introduced in 1947, in recognition of the fact that, in order to continue operating, mining operations must engage in exploration and prospecting.[26] Such expenditure was regarded as a normal business expense.

The provision also recognises the high levels of risk associated with exploration and aims to encourage the discovery of new deposits and provide a competitive fiscal regime. The immediate deductibility of exploration expenditure acknowledges that such expenditure is an ongoing and necessary expense of a minerals company.

C.2.2 What Are Some Of The Effects / Benefits Of The Provision?

The deductibility of exploration and prospecting expenditure can also be seen as an attempt to correct the non-neutral implications of company income tax on the expected rate of return to exploration compared to other activities. Successful exploration expenditure results in a productive asset. Unsuccessful exploration does not. The low success rate of exploration means that only a small part of exploration expenditure would be deductible in the absence of Subdivision 330-A. This would result in a reduction in the post-tax expected rate of return on exploration compared to the post tax return on a less risky investment with a similar pre-tax expected return. The current treatment of exploration costs recognises the distinction between identification of asset potential and asset creation.

C.2.3 What Are Some Of The Arguments For Retention Of The Provision?

There are a number of arguments that support the need for the current taxation treatment of exploration expenditure to be retained. They include: market failure; economic efficiency; and competitiveness.

Exploration has a number of attributes that may lead to market failure in the absence of Government intervention. It has both public good and positive externality attributes.

The immediate deductibility of exploration costs provides some recognition that market failure does not allow an investor to internalise the benefits of exploration, which in association with risk may result in **less than optimal market allocation** of resources for the minerals industry. Exploration rarely leads to a mine being developed and it typically costs approximately US$50 million to discover and assess the feasibility of a world class ore body. This typically takes five to fifteen years to develop from initial discovery (depending, among other things, on the size of the mine).

Minerals companies are required to provide certain results of exploration activities to Commonwealth and State and Territory Governments (in respect of areas under their respective jurisdictions). Exploration activity is inherently risky, the outcomes uncertain, information unevenly distributed and strongly skewed in favour of companies with

[26] Chifley MP, the Hon B. (1947), *Income Tax Assessment Act 1947, House of Representatives Second Reading Speech*, at www.ato.gov.au/atolaw/getFrame?docid=srs/sitab472/00001 (accessed 26 March 1999).

accumulated experience in regions of interest. Once a discovery is made the prospectivity of that area may increase. This increased prospectivity leads to greater activity and increased cost of obtaining adjacent areas. The initial investor does not receive any preferential treatment when bidding for adjacent areas.

In 1975, the Asprey Committee, in the *Taxation Review Committee - Full Report,*[27] concluded that **all exploration and prospecting expenditure** should be immediately deductible against income derived from any source. **This conclusion was based on the Committee's view that the expenditure is a normal operating expense of a mining enterprise and should be treated as such.**

In 1991, the then IC, as part of its inquiry report *Mining and Minerals Processing in Australia,*[28] noted that while successful exploration expenditure is of a 'capital' nature (except for specialist exploration companies), failure to permit deductibility of unsuccessful exploration expenses may distort investment decisions. The IC concluded that

> *"… although immediate deductibility of exploration expenditure may involve an element of assistance, this 'concession' is the least distorting tax treatment in terms of the efficient allocation of resources."*

The IC also supported the broadening of eligible expenditure beyond the existing definition to include all 'properly attributable' (for example, remote sensing and desktop research) exploration expenditure.

By contrast, the submission to the inquiry by ABARE regarded this provision as 'assistance' to the industry. The ABARE view was that all (both successful and unsuccessful) exploration produces a productive asset (therefore, the expenditure is 'capital' in nature) that should be depreciated over time. The IC **disagreed** with this view and concluded as quoted above.

Although some competing minerals countries (for example, the USA) do not allow all exploration expenditure to be immediately deductible, the USA does allow non-USA exploration expenditure to be deductible against USA mining income. This is not the case in Australia.

C.2.4 What Would Be The General Implications For The Minerals Industry If The Provision Was Reduced Or Abolished?

Removal or reduction of the tax expenditure would have an immediate and negative impact on the level of exploration activity, particularly in frontier areas. A potential consequence of removing the immediate deductibility provision would be to adjust the risk basis for investment. In broad terms, this may shift investment away from exploration to other, lower risk, activities and more specifically, would direct exploration away from poorly understood areas towards areas of known prospectivity. Many potentially valuable regions may remain under-explored, potentially leading to a misallocation of minerals industry activity. In the long-run this would have a detrimental impact on Australia's existing stocks of minerals and therefore on levels of production.

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[27] Asprey, K. (Chairman) (1975), *Taxation Review Committee - Full Report*, AGPS, Canberra, January, pp. 293-294.
[28] Industry Commission (1991), *Mining and Minerals Processing in Australia*, Report No. 7, Vol. 3, AGPS, Canberra, February, pp. 335-337.

C.3 REHABILITATION-RELATED EXPENDITURE

Section 330-435 of the ITAA97 allows an immediate deduction against income from any source, on or after 1 July 1991, for expenditure on rehabilitation.

Post-production rehabilitation expenditures are a not a 'tax expenditure'. Rehabilitation expenditures for mining and petroleum operations are generally tax deductible. It is the practicalities of the situation, rather than any other factor, which prevent a mining or petroleum operation from being fully rehabilitated before cessation of extractive operations. To the extent that it is the immediate, rather than expensed, nature of the deduction which gives rise to a suggestion that a tax expenditure exists, there is no administratively feasible period over which deductions can be made once a mining or petroleum operation has ceased.

The current arrangements should continue and this item should not be referred to as a 'tax expenditure'.

C.4 RESEARCH AND DEVELOPMENT INCENTIVE

C.4.1 What Is The Objective / Rationale Of The Provision?

In general terms, Section 73B of the ITAA36 provides for a deduction (broadly, of 150 per cent for expenditure incurred before 7.30pm EST on 20 August 1996 and 125 per cent for expenditure incurred after that time) for expenditure on R&D activities.

The R&D incentive was one of the most important tax reforms of the 1980's. There is no doubt that this scheme has bought net benefits to the Australian economy. Evidence of this can be found in various BIE and IC evaluations. The rapid real growth of business expenditure on R&D since the mid-1980's is also evidence of the scheme's success.

C.4.2 What Are Some Of The Effects / Benefits Of The Provision?

While critical research projects will be carried out as necessary business support, the provision has proved a useful additional stimulant. The ability to write-off capital expenditure on prototype, pilot plants and research facilities is a significant benefit in capital intensive minerals projects, reducing risk.

To increase the level of investment in R&D is one of the stated objectives of the scheme. However, the market failure argument for justifying Government support depends not solely on its stimulant effect, but also on whether R&D activities produce spillover benefits to industries which do not undertake the R&D themselves (positive externalities) or whether potential users cannot be denied access to the benefits of R&D outcomes (public goods).

C.4.3 What Are Some Of The Arguments For Retention Of The Provision?

Identifying and measuring external benefits of R&D is extremely difficult, since by definition they are not recorded within the accounting frameworks of those who undertake the R&D. They can be generated or dissipated outside Australia, but what is important for domestic policy is not whether free-riding on overseas or Australian R&D occurs, but

whether sufficient domestic spillover benefits and public goods are generated to justify the public encouragement of R&D within Australia.

A 1995 study by the BIE of 16 Australian firms undertaking R&D, using the 150 per cent tax concession and recently having significantly improved products or processes, indicated that such support was warranted on grounds of knowledge spillovers (know-how that links from innovating firms), downstream spillovers (savings to Australian using industries and customers which do not directly recompense the innovator) and general community spillovers (mainly in the form of environmental quality, and public health and safety).[29]

The broad ranging 1995 inquiry by the IC into R&D concluded that there is often a significant divergence between the private and social benefits of R&D, which justifies public support of R&D activities. The IC was supportive of the 150 per cent tax concession, concluding that *"... the 150 per cent tax concession has brought net benefits to the Australian economy*".[30]

In addition, a recent study of business expenditure on R&D suggests that the tax incentive is an appropriate way of assisting R&D. In fact, this study found the R&D incentive to be "*... super efficient*", in the sense that R&D managers within firms do not appear to fully discount for the effects of the 'claw back' of the R&D incentive through the current dividend imputation system.

The Council's supplementary submission [31] to the Mortimer Review of Business Programs provided examples of spillover benefits within the minerals sector and between it and other sectors (eg manufacturing, environmental management, rehabilitation, waste management and construction).

Maintaining the international competitiveness of the Australian tax system for R&D is also important. The Review's *An International Perspective* paper noted[32] all 26 countries considered in that paper provided some form of 'tax preference' for R&D.

For example, Malaysia allows a deduction equal to 200 per cent of the R&D outlay (on a range of eligible expenditures that is more limited than those in Australia). Most countries provide for immediate deductibility or accelerated write-off of R&D capital expenditure.

C.4.4 What Would Be The General Implications For The Minerals Industry If The Provision Was Reduced Or Abolished?

While critical research projects will be carried out as necessary business support, reducing or abolishing the provision would remove a useful additional stimulant, reducing the net benefits of the provision to the Australian economy.

The ability to write-off capital expenditure on prototype, pilot plants and research facilities is a significant benefit in capital intensive minerals projects, reducing risk. Without this provision, such risk would be increased.

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[29] Bureau of Industry Economics (1995), *Beyond the Innovator: Spillovers from Australian Industrial R&D*, Occasional Paper 16, AGPS, Canberra.
[30] Industry Commission (1995), *Research and Development,* Report No. 44, AGPS, Canberra.
[31] Minerals Council of Australia (1997), Appendix D.
[32] Review of Business Taxation (1998), *An International Perspective,* AusInfo, Canberra, December, p. 87.

C.5 ALLOWABLE CAPITAL EXPENDITURE DEDUCTION

C.5.1 What Is The Objective / Rationale Of The Provision?

Subdivision 330-C of the ITAA97 provides for the deduction of certain allowable capital expenditures incurred in developing prescribed mining over ten years or the life of the mine, whichever is the lesser, for expenditure incurred after 19 July 1982. Deductions for mining capital expenditures were introduced as part of the first Commonwealth income tax, introduced in 1915. The deduction was provided because, as a mine was a 'wasting' asset, it was equitable to exempt from tax the profits of a mine owner that were necessary to provide for the replacement of investment capital.

The provisions allow for deductions for capital expenditure incurred in the minerals industry **that would not otherwise be deductible** (that is, the capital expenditure is not 'plant' and so would not qualify for a deduction under the general depreciation provisions). The provision recognises the distinctive circumstances applying to the mining and petroleum industries, which were discussed in detail in **Attachment B**.

C.5.2 What Are Some Of The Effects / Benefits Of The Provision?

In its 1991 inquiry report, *Mining and Minerals Processing in Australia,*[33] the then IC examined whether or not the existence of the ACE deduction implied 'preferential' treatment of the minerals industry. The IC noted the ACE deduction contains no concessional treatment when the estimated mine life is shorter than ten years (even if the actual mine life proves to be longer). However, the IC did conclude the ACE deduction was concessional (compared to the depreciation rates available for similar assets) when estimated mine life is greater than ten years. Significantly though, the IC did not formally find that the ACE deduction was inappropriate and did not recommend any fundamental changes to the provision.

The IC found[34]

> *"The list of capital expenditures deductible by mining activities is unarguably more extensive than most industries, but justifiably because many of the eligible expenditures are rarely incurred by other activities."*

In 1975, the Asprey Committee, in the *Taxation Review Committee - Full Report*,[35] focussed on the coverage and availability of the ACE provisions (that is, what is ACE as opposed to capital expenditure to be depreciated under the general depreciation provisions). The Committee did not recommend any fundamental changes to the provision.

C.5.3 What Are Some Of The Arguments For Retention Of The Provision?

The ACE deduction provides a deduction similar to the general depreciation deductions for expenditure that would not otherwise be deductible for tax purposes because it does not fit within the definition of plant. The expenditure is not of a type which would be incurred by

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[33] Industry Commission (1991), *Mining and Minerals Processing in Australia*, Report No. 7, Vol. 3, AGPS, Canberra, February, pp. 332-335.
[34] Industry Commission (1991), *Mining and Minerals Processing in Australia*, Report No. 7, Vol. 3, AGPS, Canberra, February, p. 96.
[35] Asprey, K. (Chairman) (1975), *Taxation Review Committee - Full Report*, AGPS, Canberra, January, pp. 294-296.

companies other than mining, quarrying and petroleum companies, and so the deduction provisions are limited in their application to companies operating in those industries.

C.5.4 What Would Be The General Implications For The Minerals Industry If The Provision Was Reduced Or Abolished?

Failure to allow the capital intensive minerals and petroleum industries to fully depreciate capital expenditure would be very severe, resulting in sub-optimal investment in those industries. It would also create other black hole expenditure problems for the minerals industry. The impact on new project feasibility studies would be very significant and it is likely many projects would not proceed.

Reductions in the application / availability of these provisions may reduce investment in these highly capital intensive industries and see minerals companies investing offshore to projects located in more 'tax competitive' destinations.

C.6 DEPRECIATION PROVISIONS

C.6.1 What Is The Objective / Rationale Of The Provision?

Depreciation allows the capital cost of plant to be deducted from assessable income over the item's effective life.

The current depreciation rates and effective life provisions for plant generally are found in Section 42-125 of the ITAA97, and were introduced following the February 1992 *One Nation* statement[36] (which added to the changes announced in the March 1991 *Building a Competitive Australia* statement). Statutory effective life and the broad banding of depreciation rates were introduced in 1991 to provide greater flexibility in the selection of an appropriate depreciation rate and simplify the operation of the depreciation provisions.[37] The 20 per cent 'loading' of depreciation rates, introduced in the May 1988 *Economic Statement* to provide a tax benefit to stimulate investment in plant,[38] was subsumed in the general rates (and in the case of assets with an effective life greater than five years, increased).

The overall aim of the changes was to substantially reduce the effective tax rate on domestic investment in plant and equipment, to:

- encourage domestic investment in plant and equipment (in preference to other forms of investment, including Australian investment abroad); and

- improve the international competitiveness of Australia's business tax system.

The depreciation rates are particularly focussed on assets with long effective lives. The depreciation provisions are generally available across all industry.

[36] Keating MP, the Hon P. (1992), *One Nation*, AGPS, Canberra, February, pp. 71-73.
[37] Hawke MP, the Hon R., Keating MP, the Hon P., and Button MP, the Hon J. (1991), *Building a Competitive Australia*, AGPS, Canberra, March, pp. 5.23-5.27.
[38] Keating MP, the Hon P. (1988), *Economic Statement*, AGPS, Canberra, May, pp. 75-77.

C.6.2 What Are Some Of The Effects / Benefits Of The Provision?

According to the Review, the benefit to the taxpayer of accelerated depreciation is 'tax deferral'. In after-tax terms, accelerated depreciation increases the net present value of an investment, or its rate of return, above what it would be in the absence of accelerated depreciation.[39] Therefore, the provisions are of most benefit to capital intensive industries (such as mining, manufacturing, infrastructure and parts of construction).

C.6.3 What Are Some Of The Arguments For Retention Of The Provision?

There are a number of features of the current Australian tax system that support the need for these depreciation provisions.

The lack of a 'real' income base for business taxation (that is, no indexation for inflation of any part of the business tax system (with the exception of the capital gains tax regime) may bias investment decisions towards the use of debt rather than equity financing. This is because, with a high proportion of equity funding, the 'real' Government tax take rises as capital costs increase - a regressive outcome that can be removed by using a higher proportion of debt funding. To some extent, the current depreciation provisions redress this bias, and represent a 'second best' outcome in the absence of full indexation of the business tax system.

It can be argued that there are externalities associated with capital expenditure by the minerals industry such as technology spin-offs and the importance of high quality infrastructure in attracting further industry activities. Accelerated depreciation encourages this investment and allows some of the benefits of these externalities to be captured by those making the investment.

In the absence of the current depreciation provisions, the tax system would be biased against long-term investment. A long-term minerals project cannot utilise tax deductions in the start-up years (because the project is generally not producing income). This cash flow disadvantage can be partly offset by providing 'accelerated' depreciation once the project is operational. Long-term investments require higher before-tax rates of return (and hence higher project discount rates) relative to short-term investments because their payback periods are longer and hence they are inherently more risky.[40]

National taxation regimes have an impact on international investment decisions. Other countries (including minerals competitor countries) offer incentives to attract particular projects, including through tax concessions. These concessions can play an important part in the location of certain investments.
The current depreciation provisions, by encouraging business to update its capital stock more frequently, improve productivity and competitiveness.[41]

[39] Review of Business Taxation (1999), *A Platform for Consultation*, AusInfo, Canberra, February, p. 117.
[40] Ibid, p. 120.
[41] Ibid, p. 121.

C.6.4 What Would Be The General Implications For The Minerals Industry If The Provision Was Reduced Or Abolished?

The abolition of the accelerated component of the depreciation provisions may have the following effects on the minerals industry:

- negative impacts on returns from major minerals projects as tax liabilities are brought forward - this may result in a number of projects being ‘marginal’ or ‘uneconomic’;
- increasing debt to equity ratios and making capital raising for new projects more difficult;
- potentially diverting mobile “mining” international investment capital away from Australia to other locations;
- encouraging a shift in the allocation of investment towards projects with shorter lives; and
- increase the trend towards repairing older capital equipment rather than investing in new, more efficient, capital equipment.