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The MRRT should not be abolished

Submission to the Senate Inquiry into Minerals Resource Rent Tax Repeal and Other Measures Bill 2013

Submission
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Summary

The Senate has invited submissions on the draft amendments to the *Minerals Resource Rent Tax Repeal and Other Measures Bill* 2013. This submission comments on the repeal of the tax and the 'other measures'.

The direction of the present set of changes greatly advantages a small number of large companies including some foreign-owned corporations worth hundreds of billions of dollars. To fund the repeal of the MRRT with the consequential measures mentioned below will hurt millions of households, up to 10 million workers and hundreds of thousands of small businesses.

Three of the beneficiaries of the MRRT repeal are BHP Billiton, Rio Tinto and Glencore (owns Xstrata) together worth more than $200 billion. These are all members of the Business Council of Australia and are majority, majority and completely foreign-owned respectively.

By contrast the losers from the package are all workers with compulsory superannuation contributions, millions of households with children and hundreds of thousands of small businesses. The overall numbers include around 8.2 million people who have super contributions made by their employers and around 1.5 million people of workforce age who rely on income support payments.

The Labor Government may well have associated the mining tax with various other measures such as the superannuation initiatives when the mining tax was introduced. The government wants to continue to keep treating them as a package. In principle it makes no difference how or when an initiative comes about, such initiatives should stand or fall on their own merits. No matter how worthy the measures up for repeal in the present context, there remain less worthwhile items in the federal budget.

Nevertheless, the 2012-13 budget referred to 'spreading the benefits of the boom' and included some of the measures that are proposed to be repealed. We have argued elsewhere that with limited exceptions the boom did not spread much further than those immediately involved[1] and so it was important to spread the benefits to others in the community. When events as disruptive as the mining boom come along there is indeed a challenge for governments to ameliorate the negative impacts and to spread the positives.

1 Richardson D and Denniss R (2011) *Mining the truth: The rhetoric and reality of the commodities boom*, The Australia Institute Paper No 7, September.

The Minerals Resource Rent Tax

The most important thing to say up front is that the MRRT should not be abolished.

The mining industry is one of the most profitable in Australia with total profits (gross operating surplus in 2011–12) of $84 billion out of a total value added of $133.0 billion.[2] That is, 63 per cent of the value produced in the mining sector is profit (using the broad Australian Bureau of Statistics measure).

Just a few years ago, in 2003–04, total profits were a more modest $26 billion. Most of the increase since then has been a result of the commodity boom. If not for that, profits might have gone backwards given the decline in mining productivity. Nevertheless, the increase in profit due to high commodity prices is considerable, perhaps around $55 billion in annual profits.

The mining companies knew that there were strong arguments to the effect that their profits depended on access to resources that are owned by all Australians. Consequently, much more of the additional profits should have gone to the community as a whole—more than the extra to be paid as company tax. And, in principle, the mining industry favoured a profit-related tax as it did not want to be lumbered with higher state royalties that it would still have to pay when commodity prices slump again.

The Henry Report

The Henry Report recommended a ‘resource rent tax’ to cover most minerals in Australia. The Rudd government agreed and decided to implement the ‘Resource Super Profits Tax’ (RSPT).

The RSPT was to address the decline in the share of mining profits being collected by governments in Australia. The combined share of the two types of mining-specific taxes, state royalties and collections under the Petroleum Resource Rent Tax, has fallen substantially from around 40 per cent of profits on the eve of the mining boom to about 13 per cent currently.[3]

The essential idea of the RSPT was simple; if a mining project is only earning ordinary returns then it would only attract the ordinary company tax. However, where a mine is sitting on a superior resource, super profits are generated just because of the attributes of the mineral deposit and not the attributes of the miners. The super profits arise because a company has access to a resource that is really the property of the people of Australia. In any other industry a super profit would be the signal that would encourage competitors to enter the industry, expand the market and so eliminate the super profits. Competition is expected to work to eliminate super profits unless they are due to something that the competitors do not have access to; in this case superior Australian resources.

As the report put it:

Through the Australian and State governments, the community owns rights to non-renewable resources in Australia and should seek an appropriate return from these resources.

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2 ABS, *Australian System of National Accounts, 2008-09*, cat no 5204.0, 8 December 2009.

3 Australian Government, *Australia’s Future Tax System: Report to the Treasurer*, December 2009.

Another attraction of the RSPT for the Henry Review was the fact that the tax base was immobile; it could not be shifted offshore for example. It would be wrong to interpret the Henry Report as saying there would be no reduction in mining activity but instead that any behavioural changes are small and are less than the changes in behaviour of the equivalent collection of some other taxes.

In principle, the tax on super profits arising from access to superior resources should not deter investment or induce other changes in behaviour. However, in practice we are talking not about a large number of competing anonymous companies but about specific companies with their own management styles, their own ideas about playing bluff and so on. This should not be pushed too far but it always needs to be borne in mind that when talking about the reaction of companies, it is specific individuals who may not always react as if economic incentives were all that matter.

An important question then is how much of the rent should be taxed. If all super profits were taxed at 100 per cent, there would be no incentive for the mining company to operate the mine efficiently. As the Henry Report acknowledges, Norway imposes a 78 per cent tax on rents in the petroleum sector which may well be about the rough upper limit for resource rent taxes. The government had instead accepted the Report's recommendation that rents be taxed by way of a separate resources super profits tax of 40 per cent. The RSPT was to be a deduction against company tax so that in the first year of operation, 2012–13, the total tax on rents or super profits would have been 58 per cent. However, as the company tax was to be reduced to 28 per cent by 2014–15, the RSPT would have been reduced to 56.8 per cent that year. The Henry Report's agenda is a company tax of 25 per cent, which implied a total tax on super profits of 55 per cent.

While the rates could have been higher, in other ways the RSPT was rather tight. To tax super profits, or profits above a normal rate, the government has to define that normal rate of return on investments. The rate for the Petroleum Resource Rent Tax (PRRT) is the bond rate plus five percent for most expenditure and the bond rate plus 15 per cent for some exploration expenditures. However, for the proposed RSPT the normal rate was just the long bond rate. Given that the long-term bond rate has been around 3.5 to 4.0 per cent recently in Australia, the RSPT would have been triggered once the project had repaid its original capital outlay and, in addition, had generated a five per cent return.

Prior to Henry there was speculation that the Australian Government would have to negotiate with the states to abolish their royalty regimes. However, the RSPT scheme intended state royalties and any already announced changes to be deducted against RSPT obligations.

Pre-election (2010) changes

The original RSPT was too much for the big mining companies and they threw everything behind their effort to get rid of it. Not only is the mining industry a powerful lobby but it is largely dominated by three powerful companies; BHP Billiton (BHP), Rio Tinto (RIO) and Xstrata.[4]

Incidentally, the miners were also instrumental in sinking the Carbon Pollution Reduction Scheme (CPRS). Mining uses an incredible amount of energy; it is estimated that energy

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4 There has recently been a debate about whether regulators should allow banks to grow so big that they cannot be allowed to fail. Maybe there is an argument against letting mining companies to grow so big that they wield enormous political and economic power. In that context it is interesting to observe that the international regulators objected to BHPB and Rio combining their iron ore operations.

costs account for up to 16 per cent of the value of mining output in Australia.[5] So any price on carbon represents another threat to the mining companies' profits. The Minerals Council of Australia complained about 'massive new costs to mining activity in Australia' and published estimates of job losses. Its claims were ludicrous; it claimed that 66,000 jobs would be lost when total employment in mining is 198,100 people.[6]

On 2 July 2010, the Prime Minister, Julia Gillard, and Treasurer, Wayne Swan, announced the Minerals Resource Rent Tax (MRRT) to replace the RSPT. There were a number of differences but the two main changes were to the structure of the tax. First, the definition of super profits (or rents) was changed to be the bond rate plus seven per cent rather than just the bond rate under the RSPT.

In addition, the actual rate of tax was reduced from 40 per cent to a nominal 30 per cent but, with the addition of a 25 per cent extraction allowance, the 30 per cent becomes an effective 22.5 per cent.

The MRRT also dropped the arrangements for carrying forward losses under the RSPT. Those were complicated arrangements that meant the government would share in loss-making projects but those arrangements were not valued by the mining industry.

The MRRT is now essentially similar to the tax on petroleum under the PRRT but with different rates. Given that Australia already had the PRRT operating as a long-term and well-understood example of a resource rent tax, it may have been inevitable that the final outcome would be similar arrangements for all other minerals. However, an important change is that the MRRT only applies to iron ore and coal. Also announced at the time was an extension of the PRRT to all other oil and gas projects. Apart from iron, coal, oil and gas, most minerals remain free from resource rent tax.

State royalties are also deductible against the MRRT; however, the miners wanted Commonwealth protection against any other increases in royalties that the states may impose.[7] The original Commonwealth position was that it would only allow deductions against the mining taxes for royalty increases already in the pipeline or otherwise expected. For example pre-existing indexation arrangements were to be honoured. The ideal Henry model would have the states vacate the field so that the resource rent tax would replace royalties altogether. That seems to have been dropped from the negotiations and now the states can increase royalties on coal and iron ore and simply reduce the MRRT retained by the Commonwealth. Hence there is no discipline on the states not to increase royalty rates.

The Commonwealth should act to limit the amount of royalties mining companies can credit against the MRRT. That way any increase in royalties would be a net new impost on the mining companies which may well make good sense for the state concerned but need not be at the expense of the Commonwealth.

Arguments for the mining tax

Over the past five years BHP Billiton (BHPB) announced a pre-tax profit ranging between US$12,160 million in 2009 to a high of $31,816 million in 2011. From the high to the low that is an increase of Net after-tax profit increased by an incredible 162 per cent. And that is

[5] See C Eren, R Denniss and D Richardson, *Green jobs: what are they and do we need them?* The Australia institute, 7 July 2010.

[6] ABS, *Labour force, Australia, Detailed Quarterly*, Cat no 6291.0.55.003, 16 September 2010.

[7] J Freed and J Kehoe, 'Miners cry foul over rate refunds', *The Australian Financial Review*, 20 October 2010.

basically the case for taxing the super profits of the miners. BHPB did not suddenly become a great deal cleverer or more skillful at its business; it increased profit dramatically because the rest of the world, and especially China, wants Australian commodities so badly. BHPB was more profitable because of Australia's resources—nothing to do with BHPB.

BHPB earned a very high return on equity at 48 per cent.[8] In a competitive market, high returns are competed away unless the company has some underlying advantage. BHPB's advantage is its access to high value Australian (and overseas) resources. In this sense, BHPB can be fairly said to enjoy 'monopoly' profits. Of course, this submission is not singling out BHPB for special treatment; other corporations could equally be chosen. The point here is that BHPB's profits and those of other mining companies reflect the international demand for scarce Australian resources.

There are other considerations. The mining boom gave very little by way of benefit to ordinary Australians. Indeed, prior to the global financial crisis most people would have been affected only by the higher interest rates on their mortgages as the Reserve Bank of Australia (RBA) fought the inflation threat it perceived arising from the commodities boom. Others would have been affected by the appreciation of the Australian dollar that reduced the competitiveness of all other trade-exposed industry in Australia. Outside mining there is little evidence of real incomes being higher than what they would otherwise have been.

A mining tax is a vital mechanism for capturing some of the national gains and distributing them more widely. The initial plan was to use the MRRT revenues to fund a reduction in company tax rates and a gradual increase in the superannuation guarantee from 9 to 12 per cent of wages. However, by the time of the 2012-13 budget[9] new measures were announced including increases in family payments, a new supplementary allowance for those on income support, the school-kids bonus. In addition to that additional assistance was announced to assist families meet higher living costs as a result of the carbon tax. As it happened the company tax rate was not reduced from 30 per cent.

A more imaginative approach could have addressed some of the other problems associated with the mining boom, in particular its tendency to squeeze out other sectors such as agriculture, manufacturing, tourism and other trade-exposed sectors. That squeeze follows the large cash flows from mining exports that flowed into Australia and pushed up the exchange rate. A fund that is used to invest offshore can offset the cash inflow and so remove the pressure on the exchange rate as the Petroleum Fund of Norway has done over the years. In addition, by keeping some of the revenue offshore, governments will not be tempted to spend it in a way that could exaggerate the boom.

The important point here is not the details of how a mining-boom fund might be set up but recognition of the principle that if a mining boom is associated with a massive increase in the flow of cash into Australia, this should be offset by the government managing a simultaneous outflow of cash. The build-up of a portfolio of overseas assets is prudent as a means of hedging against a possible future when the mining boom might end, either through a crash in commodity prices or a depletion of the resources.

Indeed, it is not even necessary for the government to undertake all the offshore investment; super funds and other financial institutions could be encouraged to invest in offshore assets. The mining companies themselves might be urged to keep their profits surge offshore. The important thing is that we understand how the Norwegian fund worked and debate the need in Australia to set up a mechanism that would do a similar job.

[8] BHP Billiton, *Annual Report 2010*. Return on equity is calculated by dividing profit before tax by equity at the beginning of the financial year.

[9] *2012-13 Budget Paper No 1*.

Arguments against the mining tax

Obviously, no one likes to be subject to a higher tax and the mining industry is no exception. The miners were always going to cite employment and anything else they could think of to use against the tax. So their first predictable point is that the tax is too heavy and will deter investment and activity in the industry.

A sense of history is needed to inform about these claims. The tax on super profits will still be less than the tax on ordinary profit in the previous resources boom of the late 1970s and early 1980s. Back then the company tax rate was 46 per cent. Royalties, which tended to be at least five per cent of the value of production, were imposed on mining companies as well. A five per cent state royalty would have meant that profit was taxed at a total of 51.4 per cent (if profits are 50 per cent of revenue). Private companies were also subject to an undistributed profits tax.

There were no franking credits then, so by the time the company income was received in the hands of the shareholder, the company income in this example was taxed at 81 per cent for someone on the top personal tax rate of 60 per cent at the time.

By contrast, under the formerly proposed RSPT, a company's super profit was to be taxed at a maximum of 67.9 per cent from the perspective of a shareholder on the top personal tax rate.[10] For a company with ordinary profits and super profits in the ratio 50:50, the company income would be taxed at 57.2 per cent in the hands of the individual on the top rate. Under the MRRT, the maximum tax rate from the perspective of the shareholder is reduced to 58.5 per cent of super profits. Of course, super profits are more narrowly defined and limited to iron, coal, and through the PRRT, oil and gas. Neither the MRRT nor the earlier RSPT approached the tax levels of the 1970s and 1980s yet some of the same companies were the enthusiastic participants then as they have been recently.

One of the arguments the miners have used against the mining tax is that it will drive miners away from Australia. Figures published by the Australian Bureau of Statistics (ABS) show that in 2009 Australia possessed:

- 35 per cent of the world nickel resources
- 47 per cent of uranium resources
- 36 per cent of the lead
- 25 per cent of the zinc
- 25 per cent of the recoverable brown coal
- 16 per cent of the silver
- 17 per cent of the iron ore and
- 16 per cent of the gold.[11]

If Australia had insignificant supplies of those commodities, the mining companies might have a case. But if they really want to be world players in the major commodities, there are few countries other than Australia of any significance.

Looking at those figures and bearing in mind that Australia produces much smaller shares of the world's oil and gas, it appears that the wrong minerals have been exempted from the

[10] For each $100 of super profit, the RSPT was to be $40, company tax initially at 30 per cent of the remainder ($60), and then, assuming all the rest is paid as dividends, 46.5 per cent is payable with a franking credit for company tax paid.

[11] ABS (2012) *Year Book Australia, 2011-12*, Cat no 1301.0, 24 May 2010.

MRRT and PRRT. With a third or more of all nickel, uranium and lead, perhaps Australia should be thinking of even bolder taxation initiatives for those particular minerals.

'Sovereign risk' is a concept that the miners have re-introduced into the debate. It used to refer to the risk of nationalisation or expropriation in some third-world countries in the past. Nowadays, it seems to refer to just any tax increase that affects a mining company. For example, it was used in the context of the proposed emissions trading scheme. There is, of course, the 'risk' that any democratic country will change tax rates, environmental laws, industrial relations legislation, land rights and a host of other circumstances. But in a democracy, questions about spending and taxing are always subject to debate and change.

While the proposed MRRT is much more generous than the previous RSPT, it should be noted that neither applies until all capital investment has been recovered together with the 'uplift factor'—either the bond rate under the RSPT or the bond rate plus seven per cent under the MRRT. Company tax now applies irrespective of any notion of risk and well before a company has clawed back its initial outlay. By contrast, the MRRT does not kick in until capital has been repaid, and repaid more than in full with the 'uplift factor' equal to the bond rate.

The question of risks is interesting. Even salaried workers take a risk that their employer will be solvent on pay day and when leave and super etc. are due. Risk has never been a reason for being light on tax. And it is easy to overstate the risk. A typical mining project does not go ahead until a full assessment of the deposit, the engineering studies, and full costings are undertaken and even then the sponsor will try to line up long-term sales contracts and hedging operations. When returns were lower, iron ore producers for example used to try to get buyers to invest in projects as a means of tying up the customer's long-term support.

Earlier it was mentioned that in order to define super profits or 'rents', the question of normal returns had to be defined. The Henry approach was to assume that normal rates of return are given in the market by the 10-year bond rate. The idea here is that a government bond is risk-free and so its value in the market should reflect the returns investors will accept on a risk-free investment. In theory, investors should want a similar return plus the appropriate risk premium on any other investment, suggesting that, for the investor, there should be no real difference between investing in a government bond and investing in a risk-free mining project.

This sounds reasonable, but in a global economy we need to ask which country exhibits the appropriate 10-year government bond rate. According to *The Economist,* the 10-year bond rate is 3.91 per cent in Australia, 2.49 per cent in the US, 1.77 per cent in the euro area, 2.63 per cent in the UK, and 0.61 per cent in Japan.[12]

Given the wide variability in world 10-year government bond rates, the miners would appear to have a legitimate complaint against using the long bond rate. Treasury's theoretically pure argument may not necessarily fit the dirty world of real markets. It is not possible to provide an exact definition of the normal rate of return or an exact means of calculating that rate.

It must be said that these types of criticism are telling. We cannot know exactly where the boundary between normal and super profits lies but, in a global economy, it cannot reflect each of the different 10-year government bond rates. Strangely, the miners have not examined those sorts of issues.

On the other hand, no matter how the MRRT and PRRT are constructed, it is clear that the mining industry at the moment has more than enough capacity to pay. Perhaps that is

12 *The Economist*, 18 October 2010.

another way of saying that as long as the tax is profit-related, it probably does not matter much how it is constructed. When the miners are profitable they should pay.

The mining industry has recently put the view that it should not have to pay the MRRT because it already makes a large contribution to the communities in which it operates. For example the Chief Executive of the Minerals Council of Australia, Mitch Hooke, recently issued a press release referring to the mining industry's 'community spending' in which he claimed:

> *A survey of 25 Australian mining companies, explorers and resources contractors by Corporate Social Responsibility consultants Banarra found that $34.7 billion was spent on community infrastructure, Indigenous contractors, local suppliers and other activities in 2011-12.*[13]

While only 25 companies were surveyed those companies included the big ones such as BHP Billiton, Rio Tinto, Glencore Newcrest and Newman to name a few. It also included some smaller exploration companies and mining service companies.[14] Given these companies it is likely the survey included half or more of the value added in Australian mining. The biggest single category is payments to local and indigenous suppliers and contractors worth $34.4 billion or 98.8 per cent of the total. What that means is the mining industry is including inputs into their business as a 'community benefit'. The definition of local was left up to the person filling out the survey. One respondent defined local as 'those who are directly associated with the operations and located within Australia, providing means for the company to continue with our business operations'.[15] If every Australian industry did that then according to the input output tables, Australian industry could claim they generate community benefits of just under twice Australia's GDP.[16] For example, while the mining industry might claim its purchases are 'community benefits' the electricity generating sector could likewise claim that its spending on coal supplies is a 'community benefit'.

The remaining 'community benefits' include 'land access related payments' which are problematic. The item education and training for non-employees includes items such as engineering scholarships. Community infrastructure included items such as airport operations and maintenance and accommodation. These are items many people would see as necessary cost of business.

The claim of 'community benefits' has been so exaggerated as to make the genuine discretionary spending look trivial. The genuine component was probably of the order of up to $100 million. That is well below the MRRT which is expected to ramp up to $2.2 billion in 2016-17.[17]

Other issues

Revenue

The revenue arguments have been curious to say the least. In railing against the tax its critics have referred to the vast damage it is supposed to have wrought. Yet the tax was expected to only raise only $200 million in 2012-13 and another $5.3 billion over the forward

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13 Hooke M (2013) 'Minerals industry's community spending exceeds $34 billion' *Minerals Council of Australia, Press release*, 18 November.

14 Banara (2013) *The value of community contributions in the Australian minerals industry; A report for the Minerals Council of Australia*, September.

15 Banara (2013), p. 15.

16 The latest input output tables show that Australian industry purchased $2,470 billion as inputs into their production while total GDP was a much smaller $1,292 billion. See ABS (2013) Australian National Accounts: Input-Output Tables - 2009-10, Cat no 5209.0.55.001, 20 September.

17 2013-14 Budget Paper No 1,

estimates. That compares with an annual $90 billion in the mining industry's earnings before interest, tax, depreciation and amortization according to the ABS[18] Given the value of profits involved in mining the MRRT is barely a nuisance for the mining companies.

Some design features

An issue with the MRRT is its failure to collect much revenue in its early years. The 2013-14 budget papers report that only $0.2 billion was expected to have been collected in 2012-13.

One of the reasons apparently is that the even old mines with costs that have long been fully written off were allowed to set a new and generous notional investment cost that would be deducted against revenue in the calculation of the MRRT. Miners had the choice of adopting not the book value but the market value of particular mines. Mine values were inevitably very high when based on capitalising the potential future cash flow projected at the peak of the commodity price boom. Moreover any 'loss' brought forward would be subject to the uplift factor (the bond rate plus seven per cent).

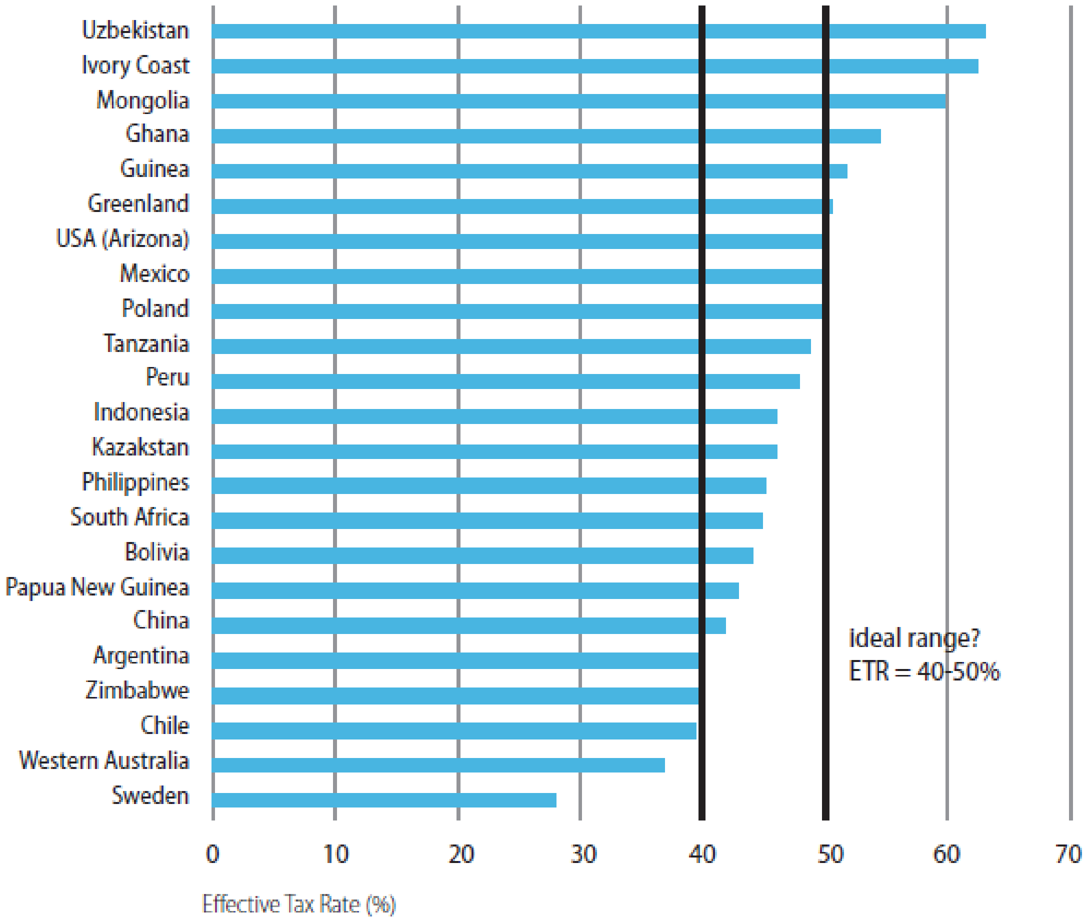
This should not be treated as a criticism of the mining tax itself but instead reflects the generous way the mining companies were allowed to influence their own tax liabilities.

International comparisons

International comparisons are rarely published. The reason is most likely the difficulty of making comparisons between countries when there is a vast difference in the way mining is taxed. Indeed, some other measures are used that can have tax-like effects but act completely differently. For example, some countries operate production-sharing agreements or compulsory sharing of equity in mining projects. In addition, the attributes of the mine itself can influence the tax treatment. However, a recent study done for the OECD compares a hypothetical copper mine in various countries. The relevant graph showing the results is reproduced in the figure below.

18 ABS (2013) *Australian Industry, 2011-12*, Cat no 8155.0, 28 May

Figure 1: Effective tax rates on a model copper mine in various countries



Source: P Mitchell, 'Taxation and investment issues in mining', in The Extractive Industries Transparency Initiative, *Advancing the EITI in the mining sector: a consultation with stakeholders*, EITI, 2009.

These results are very interesting. They show that if the model copper mine happened to be in Western Australia, the effective tax rate would be around 37 per cent, the second to bottom on the list of countries included in the study. Moreover, the study finds the ideal range is 40 to 50 per cent, the range in which most countries fall.

Of course, not only is the effective tax rate important, so is the design of the tax system. As the Henry Report argues, resource rent taxes are better than royalties because the latter is a cost to miners whether or not the operation is profitable. Hence a royalty is more likely to deter investors than resource rent taxes, which are more of a profit-sharing arrangement, or indeed, a super-profit-sharing arrangement.

Conclusion

The need for a tax on mining activities in Australia and it should be broadened to include all minerals. The miners can easily bear it and their super profits are due the Australian resources they exploit—not their own abilities. If, as suggested in the Henry Report, a rent tax on mining is compared with other income taxes, there would seem to be no contest. The Henry Report outlines a strong case for a resource rent tax.

If implemented, the Henry Report's proposal for an RSPT would have meant that super profits would be taxed at a maximum of 67.9 per cent from the perspective of individual investors. By comparison, in the last resources boom of the late 1970s early 1980s the tax on all profits in all companies was taxed at 81 per cent for those at the top of the personal income tax scale.

The politics of the RSPT meant that the government watered it down with the MRRT, which operates in a similar manner to the PRRT but with a lower effective rate. From the perspective of individuals, that brings the maximum tax on super profits down to 58.5 per cent but super profits are more narrowly defined and exempted for most minerals.

There is a strong case for taxing mining super profits and it seems the miners have got off fairly lightly. At the very least, we might suggest that the MRRT should be increased to 40 per cent, the PRRT rate, and that it should apply universally.

The Henry Report proposed a theoretically pure resource rent tax. The political negotiations that followed resulted in some important compromises and perhaps too many concessions to the mining industry. The biggest anomaly is that the resource rent tax, in practice, has three rates: 40 per cent for oil and gas, 22.5 per cent for iron and coal and zero for all other minerals. It would seem there is an important unfinished agenda here.

If this measure succeeds and the MRRT is passed back to the miners their income will increase by that amount. Most of it will go overseas to foreign shareholders and we can be confident that very little else will happen to the benefit of ordinary Australians. The miners have not promised to employ more, train more, explore more, invest more or produce more. This will be a simple gift with nothing in return.

Small Business Measures

The present package involves three measures;

- repeal of loss carry back;
- reduction in the small business instant asset write off threshold;
- repeal of accelerated depreciation for motor vehicles;

It is not the intention here to discuss these arrangements in any depth. However it should be noted that these measures assist small business and to repeal them in the interests of assisting big business in the mining sector seems curious. Most small business operates outside the mining industry and has been disadvantaged by the mining boom which has made much of the Australian economy uncompetitive.

The issue of accelerated depreciation for motor vehicles is also likely to affect motor vehicle manufacturing in Australia so that the government would repeal this particular measure while in Opposition it said it would reverse the decision to tighten up on the FBT for motor vehicles.

Geothermal energy

The Abbott government plans to eliminate the geothermal energy exploration deduction only just introduced under the Labor government and which for geothermal energy levels the playing field with other mining.

Geothermal energy is relatively new in Australia and there is no commercial production as yet. However geothermal energy has massive potential with Geoscience Australia reporting that just one per cent of the shallow geothermal energy could supply all of Australia's energy needs for 26,000 years. Moreover, geothermal energy can be used to provide base load power since it does not fluctuate with the wind, sunlight or rainfall in the case of hydro power.

Expenditure on exploration or prospecting for the purpose of mining and quarrying is immediately deductible against assessable income in Australia. However, that did not extend to geothermal energy until amendments made in 2012 and which applied from July 2012. Now the Abbott government is set to repeal the immediate deductibility for geothermal exploration from July 2014. That will save $5 million per annum after that compared with the $400 million in tax concessions expected to be given to other mining companies in 2014-15.

To repeal this measure seems to contract the intention behind Direct Action. If this measure is repealed geothermal exploration will not have the same incentives as any ordinary explorer looking for fossil fuels will get. If anything the playing field should be tilted in favour of geothermal energy exploration.

We have argued earlier that new investment in renewables should receive assistance through the tax system to reflect their unique attributes. There are important arguments in favour of assistance.[19] Renewable projects tend to be relatively new technologies that are still evolving rapidly. In the case of geothermal energy of the type being developed in Australia the technology is truly at the cutting edge. The important point about new technologies is that improvements tend to be very rapid. Unfortunately that means that any investment is soon over taken as later investments tend to be much more efficient. Hence there is a rapid technological obsolescence in this type of project. Our tax system does not recognise the fact of technological obsolescence. While the earlier arguments suggested accelerated depreciation for those investments the exact mechanism is not so important. Geothermal needs to be favoured relative to other investments and repealing the exploration provisions goes in the wrong direction. This decision should not go ahead or, if it does, it should be replaced with measures to boost the attraction of investment in geothermal.

[19] Richardson D (2008) *Tax treatment of capital investments in renewable energy*, October

Re-phasing of the change in rate of the superannuation guarantee charge percentage

This measure literally takes money out of the retirement accounts of millions of working Australians. On the latest figures 90 per cent of Australian employees have super paid on their behalf[20] and there are 9.17 million employees[21] so this measure will affect some 8.2 million people at any one time.

The super guarantee is presently 9.25 per cent. It was due to increase every year on 1 July by 0.25 per cent until it reaches 12 per cent which was due to occur on 1 July 2019. The present proposal is to defer the increase planned for 2014 and not increase it to 9.50 per cent until July 2016.

For someone on average weekly ordinary time earnings at age 30 and who retires at 65 the cost of the delay in the super increases could cost around $6,500 in today's prices. It is the retirement income of the current workforce that is being hit here in order to contribute to increasing the income for the miners.

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[20] ABS (2013) *Employee earnings, benefits and trade union membership, Australia, August 2012*, Cat no 6310.0, 17 May.
[21] ABS (2013) Forms of employment, Australia, November 2012, Cat no 6359.0, 19 April.

Low income superannuation contribution

The low income superannuation contribution is not a concession to low income earners but is a measure designed to offset the penalty of having income super taxed at 15 per cent when the taxpayer concerned has insufficient income to trigger any personal income tax liability.

The Low Income Super Contribution is calculated as 15 per cent of the super contribution to a maximum of $500 so long as the income itself is less than $37,000. The government pays that amount to the super fund as a co-contribution alongside other payments into super. The philosophy behind the measure is that high income earners receive a large tax concession for money they put through the super system but low income earners are often disadvantaged, especially those that would not have paid any tax if the money were received as part of their wage.[22] Hence in order to extend the tax advantage to low income earners the Labor government introduced the low income super contribution. The low income super bonus extends to most full-time workers in retail, restaurants, cafes, accommodation and similar industries.

At the time it was introduced the then minister, Bill Shorten, said ‘the Low Income Superannuation Contribution benefits 3.6 million Australians on low and modest incomes, including 2.1 million women’.[23]

It has to be said that a maximum of $500 does not sound like all that much but it can add substantially to the final super balance available at the time of retirement. For example, a low income earner who gets the full $500 and expects to keep getting it, at age 25 now and who expects to retire at 65, would have an additional super of $37,700 on retirement due to the low income super contribution. So if this contribution is repealed the eventual super payout would be $37,700 less. (This assumes a very modest 3 per cent per annum rate of return in the super fund.)

It is worth noting that people hit by the repeal of the low income superannuation contribution are also going to be affected by the delay in the increase in the superannuation guarantee rates over coming years.

The cuts facing low income earners contrast dramatically with the last decisions of the Howard government and the dramatic tax cuts it delivered to the rich through both cuts in personal income tax and increases in tax concessions for superannuation that went mainly to the very high income earners.

If tackling superannuation arrangements to improve the budget balance is the issue then there are other matters that could be addressed. The then Minister for Financial Services and Superannuation used to host a superannuation roundtable to discuss issues and policies related to superannuation. That discussion included the circumstances whereby some individuals had self-managed super funds worth $100 million or more. Clearly for many people superannuation is not just a retirement savings vehicle but a tax-avoidance vehicle. Running businesses or receiving other income through a super fund is attractive when the

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[22] Taxpayers who attract the low income tax offset pay no income tax until their income reaches just over $20,500. However, before the low income super contribution they paid 15 per cent tax on their own super contributions. By contrast the many taxpayers in the 32.5 per cent marginal tax range get a ‘discount’ when they put money into superannuation where the contribution is taxed at 15 per cent. The ‘discount’ is even higher for those on the 37 and 45 per cent marginal tax rates.

[23] Shorten W (2013) ‘Reforms to make the superannuation system fairer’, Press Release no 20, 5 April.

tax rate on super is 15 compared with the top personal tax rate of 45 per cent plus a Medicare levy of 1.5 per cent.[24]

The latest estimates we have indicated that tax concession for super that go mainly to the rich will reach $50.7 billion in 2016-17. Even that figure will be dwarfed in the future when super balances are expected to quadruple. In the meantime the head of Treasury, Martin Parkinson, has voiced concern about the fiscal sustainability of super tax concessions, especially when all other areas of the budget are under scrutiny.[25]

[24] The Australia Institute has written extensively on this topic in the past. See for example Denniss R and Richardson D (2012) *Can the taxpayer afford 'self-funded retirement'?* The Australia Institute Policy Brief No 42, August.

[25] Parkinson M (2012) 'Future challenges: Australia's superannuation system', Speech to the ASFA 2012 conference – New directions, Sydney, 28 November.

Income support bonus

The income support bonus is a twice yearly payment to people on some income support payments and is designed to assist with unexpected living costs. It is paid on 20 September and 20 March at $105.80 for singles and $88.20 each for couples. The payments are adjusted each year in line with the Consumer Price Index. The payments that attract the bonus are:

- ABSTUDY Living Allowance
- Austudy
- Exceptional Circumstances Payment
- Newstart Allowance
- Parenting Payment
- Sickness Allowance
- Special Benefit
- Transitional Farm Family Payment
- Youth Allowance

The people on these payments include some of the poorest in Australia. All in all there are some 1.5 million people at any time who rely on these payments and all will be affected.

Schoolkids Bonus

The Schoolkids Bonus is paid to eligible families each January and July. To be eligible for the Schoolkids Bonus the child must be in primary or secondary school and in receipt of the Family Tax Benefit Part A or government income support.

The Schoolkids Bonus is paid twice a year in January and July with each payment at $205 twice a year for a primary school child and $410 twice a year for a secondary school child.

The Schoolkids Bonus can be quite helpful for a large family even on a relatively high income. A family with one primary school child and two high school children would receive $2,050 per annum. If that family relies on one income earner on average weekly wages, currently $1,420.90 a week, the household's after-tax income is boosted by 3.5 per cent per annum which they receive at strategic times during the year. That is a significant item even for families quite a way up the income scale.