



HENRY REVIEW

RESOURCES SUPER PROFITS TAX AND EXPLORATION REBATE

► TAXING THE RESOURCE SECTOR

Assuming the Government's Resource Super Profits Tax (RSPT) is introduced as proposed it will alter the economics of the resource sector in Australia – it has already altered some resource sector investment decisions. The quantum and timing of taxation on the industry will alter significantly. The immediate result is a substantial increase in resource industry taxation with 'super profits' projects the clear losers. As the prop for other tax reform, the rest of the economy must hope the mining cycle is on a long up curve. The introduction of an exploration rebate will greatly assist in the funding of exploration projects and presumably make more projects economically feasible. This is a win for explorers but tarnished by the RSPT. So what has been proposed and what should you be doing now?

RSPT – THE FACTS

Taxable activities:

RSPT will apply to all existing and future mining and petroleum projects of non-renewable resources, with the exception of projects under the PRRT. PRRT projects will be allowed to irrevocably opt in to RSPT. RSPT will be payable on resource extraction activities. The RSPT will apply from 1 July 2012.

BDO Comment: The concepts of 'resource extraction' and 'non-renewable resources' will be critical to the operation of the RSPT. What minerals will be subject to the RSPT and is there potential for the RSPT to have broader application than the existing State-based royalties?

Taxable Entities:

It will apply to all legal entities directly involved in the exploitation of non-renewable resources. RSPT will apply on a project interest basis thus allowing calculations at the individual joint venturer level.

BDO Comment: Assessing RSPT at the owner level will remove possible distortions that complex joint venture structures could have created. However, the level of information required to be provided by operators to joint venturers will significantly increase due to the more complex nature of the RSPT compared to existing royalties.

The taxing point:

Tax will be levied on assessable receipts minus allowable deductions. A point needs to be determined where receipts and deductions are measured and taxable RSPT profit determined. As RSPT is levied on resource extraction activities the taxing point should be set close to the point of extraction of the resource - the point where a saleable commodity exists has been suggested by the Government. This point may vary for different commodities as some are saleable immediately upon extraction while others require some processing between extraction and sale. Consultation with industry will be undertaken to determine how best to achieve this in practice.

BDO Comment: Creating a taxing point requiring income to be deemed will inevitably lead to disputes between revenue authorities and taxpayers and possibly lead to inequities across different resources. If the Government wishes to create a 'more efficient' mechanism for taxing resources this issue will be critical.

SECTOR

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Tax Profit/Loss and Rate:

The RSPT net profit (assessable income minus allowable deductions, including an uplift allowance for capital expenditure) will be subject to tax at a rate of 40%.

Current year or carried forward RSPT losses for a project will be available for offset against other profitable projects within the same entity or wholly owned company group. Unused losses can be carried forward for use in future years. The Government has guaranteed that RSPT losses will be refunded under reasonable circumstances such as when a project is closed and the loss cannot be transferred to another project. Losses will also be indexed (see below).

BDO comment: Whether the 40% rate is a benefit or detriment to a project will depend on the project's expected future profit margins and current royalty rates. Consistently low margin projects will benefit and super profit projects will be worse off. The concept of loss carry forwards and refunds is a benefit to taxpayers, but concerns exist as to whether the Government guarantee can be relied upon.

Assessable receipts:

Assessable receipts will include income from the sale of resources but exclude receipts from the transfer of mining interests. The taxing point will determine the value of receipts to be assessed. Value added post taxing point would be outside the scope of the RSPT as will be non-extraction activities such as derivation of interest income. The Government has indicated that it will consult industry on what income falls within the RSPT.

BDO comment: Defining the taxing point and assessable receipts are critical to the overall impact of the RSPT. The inclusion of foreign exchange gains and losses in the calculation of RSPT will significantly alter the tax position of those who deal in foreign denomination markets.

Allowable deductions:

The costs of extracting resources (including exploration) and getting them to the taxing point are allowable deductions. The concept of immediately deductible operating expenditure and deductions for capital expenditure over time has been taken from income tax with some notable modifications outlined below.

BDO comment: Treasury has indicated that deduction will be determined in accordance with existing income tax concepts.

Capital Allowances:

The Government states that the income tax capital allowance arrangements could be adopted where possible, however the concept of accelerated depreciation rates will not be inherited. The RSPT capital base of a project (i.e. the tax depreciable base) will not change with ownership. A new owner will simply inherit the previous owner's undeducted or residual capital amount. If an asset leaves a RSPT project (but possibly not the legal entity) then a profit/loss on sale calculation would be required and the result included in the calculation of RSPT profit.

BDO comment: The creation of a once only deduction concept seems at odds with the concept of profit. As projects increase in value over time and new owners pay more than the residual capital value for assets, pools of non-deductible purchase price will be created, increasing taxation collections. In the case of an acquisition, this will make valuing projects difficult as RSPT will need to be estimated. How assets with mixed uses

are treated will create possible apportionment issues between taxable and non-taxable. On an administrative level this will create another depreciation schedule purely for RSPT purposes which would seem inefficient.

Non-deductible expenses:

Some expenses have been specifically tagged for exclusion from deduction: interest and dividends, financial hedges, payments to acquire a tenement or interest in a project, payments of income tax or GST. Government will consult industry on what expenditure falls within the RSPT and how to apportion expenditure that may relate to RSPT and non-RSPT activities.

Undeducted Capital and Losses:

The RSPT capital account records the balance of unutilised losses and undepreciated assets. Annually, the opening balance of the RSPT capital account will be used to determine an RSPT capital allowance which would be deductible against assessable income. The RSPT allowance uplift rate will be set annually at the 10 year government bond rate.

BDO comment: The move away from nominal values will generate value for taxpayers. However the 10 year government bond rate isn't an appropriate inflator; a project's weighted average cost of capital is more logical. The government argues that the long-term bond rate is appropriate given that the government guarantees to give resource entities a refund of any unused losses at the RSPT rate. The RSPT allowance rate is designed to compensate investors for the delay in the government's guaranteed recognition of the tax credit when a project winds up. Thus the required rate of return to compensate investors for the delay is independent of the riskiness of the project. The government bond rate is a proxy for the risk free rate.

Transitional Measures:

As RSPT applies to existing projects, a mechanism will be required to transfer these projects into the RSPT system. The 'RSPT starting base' for existing projects will include the accounting carrying value as at the most recent audited accounts available at the time of announcement. This expenditure will not be transferrable between projects or refundable if a project ceases but will be indexed.

Expenditure between announcement and start date of the RSPT will be included in the RSPT starting base, indexed and available for transfer and refund. Any capital items subsequently disposed of pre-commencement will be excluded from the RSPT starting base calculations.

As a concession to ease initial cash flow, the RSPT starting base will be written off over five years, at the rate of 36% in year one, 24%, 15%, 15% and 10% in year five.

BDO comment: The transitional measures will provide fruitful ground for debate in the consultation process. For instance, what will happen to inventories that are partially extracted at the proposed start date e.g. minerals that are exposed but not severed from the earth? Would all assessable income from such minerals be captured by the RSPT but pre-RSPT operating costs excluded? Many resource companies have impaired assets on their books as a result of the GFC. What will be the RSPT starting base for these assets, the impaired or unimpaired value?

Interaction with Income Tax:

The RSPT is deductible (refunds will be assessable) for income tax purposes. Once the proposed company income tax reduction to 28% is fully implemented in 2014/15, the effective rate of tax on resource profits will be 56.80%.

State Royalties:

State Government royalties (not private royalties) will be refunded by the Federal Government. The level of refund will be set at least up to the amount of royalties imposed at the time of announcement, including scheduled increases and appropriate indexation factors.

BDO comment: The obvious risk for resource companies is that the Federal government may not refund all future State Government royalty increases and the effective rate of tax will increase above the headline rate. If this occurs the Constitutional sidestep by the Federal Government may take a stumble.

EXPLORATION REBATE

The Government proposes to introduce a Resource Exploration Rebate providing a refundable income tax offset for exploration expenditure incurred in Australia on or after 1 July 2011. This refundable tax offset is to be set at the company tax rate.

BDO comment: The tax offset will allow tax loss making entities to immediately access the value trapped in carried forward tax losses and remove the risks associated with their carry forward with ownership changes. This measure will put loss making explorers on a more level playing field with their taxable peers and in theory alter investment decisions. Given the application date of the rebate we question if some exploration expenditure will be deferred until 1 July 2011. Perhaps the Government could also consider the carry forward of past exploration costs (or at least costs from the date of announcement) in relation to ongoing projects which may be rebated over a transitional period.

CONSULTATION

The Government will consult extensively on the design of the RSPT. The importance of the consultation phase of the RSPT should not be underestimated. The RSPT design will be directly influenced by this process. As can be seen from the recent employee share scheme changes, the Government will listen to stakeholders when drafting legislation. The consultation timeline and deliverables are as follows:

Now	Initial Government response
May - July 2010	Treasury consultation and issues paper, stakeholder submissions
Late 2010	Final design paper
Mid 2011	Exposure draft legislation
Late 2011	Legislation introduced into Parliament

WHAT SHOULD YOU BE DOING?

The RSPT will alter the value of many resource projects in Australia. Management and owners will require information on the impact of the changes in order to make informed decisions when allocating scarce resources. In-house finance teams should endeavour to understand the changes and assess the impact on their projects. There will be uncertainties surrounding the scope and application of the RSPT but high level calculations can be performed based on the information currently at hand.

The Government will immediately start an extensive consultation process on the proposed changes. It is incumbent upon the resources industry to be actively involved in this process to obtain a design for the RSPT that is best suited to their needs.

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