

## Legal Alert



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## Australian Resource Super Profits Tax

The Australian Government has announced that it intends to introduce a Resource Super Profits Tax (RSPT). This is a key recommendation of a review of the taxation system of Australia completed under the auspices of Treasury at the end of 2009 (Henry Review).

### Overview

The RSPT will be payable at a rate of 40 per cent on the realised value of resource deposits, measured as the difference between the revenues generated from resource extraction and associated costs. The RSPT will be charged at that rate on assessable resource profits (assessable revenue less deductible expenses including an allowance for capital expenditure).

The RSPT will apply to all of Australia's non renewable resources on 1 July 2012, with the exception of projects currently subject to the Petroleum Resource Rent Tax (PRRT), for which opt in arrangements will be developed in consultation with industry.

Resource entities will receive a refundable credit for royalties paid under state laws, at least up to the amount of state royalties imposed at the time of announcement (including scheduled increases).

The RSPT will be a deductible expense for income tax purposes.

There will be a period of two years or more between announcement and commencement of the scheme. This is to allow for consultation on the details of the system.

### Assessment of RSPT

The RSPT will be charged at a rate of 40 per cent of assessable resource profits (assessable revenue less deductible expenses including an allowance for capital expenditure).

The RSPT will therefore be calculated through a capital account (i.e. a tax account) that records undepreciated tangible capital expenditure and unutilised losses. Essentially, it will keep a record of the tax credit carried forward.

The closing balance of the RSPT capital account from the previous tax year will be used to calculate an RSPT allowance, which is deducted from revenue to determine the RSPT liability. The RSPT allowance is intended to compensate investors for the deferred tax credit.

An RSPT (deemed interest) allowance rate will be used to uplift the RSPT capital account to ensure its real value is maintained over time. The RSPT allowance rate will be set annually at the 10 year government bond rate.

RSPT losses will be carried forward with interest. An RSPT loss occurs when project costs, including the RSPT allowance, are greater than the project's receipts in a given year.

While losses may not be immediately refunded, the Government says that it guarantees to provide a tax credit for unutilised losses even if the entity goes out of business.

Qualifying expenditure incurred within a year can be transferred from the loss making project to other profitable projects within the entity or company group. Where there are no other profitable projects, the loss will be carried forward.

Carry forward losses, included in the RSPT capital account, can be used to offset future assessable resource super profits within the entity or wholly owned company group. The amount that can be transferred out in a year is limited by the amount of assessable RSPT profit in other projects owned by the entity or within the company group. That is, transferred losses cannot drive the RSPT assessable profit below zero.

The RSPT value of losses will be refunded "on a reasonable basis". For example, losses would be refunded when a project is closed and the loss cannot be transferred to another project.

## Persons liable

The RSPT will apply to all legal entities (companies, partnerships and trusts) directly involved in the exploitation of Australia's non renewable resources with the exception of projects already covered by the Petroleum Resource Rent Tax (PRRT). The RSPT will not be levied on shareholders in a company or beneficiaries of a trust that are involved in exploitation of non renewable resources.

RSPT will apply to all mining and petroleum projects, with the exception of PRRT projects, for which opt in arrangements will be developed in consultation with industry.

## Taxing point

The taxing point is the point at which revenues and costs are determined for assessing RSPT.

The Henry Review suggests that, in principle, the taxing point be set close to the point of extraction of the resource (for example, the mine gate or well head) to be consistent with taxing the market value of the underlying non renewable resource. It notes, however, that the value of a resource at this stage in the production process is sometimes not observable and may need to be derived.

A practical approach, it is suggested, would be to set the taxing point where a saleable commodity exists (the earliest point that a world price or arms length sale occurs), similar to the case under the existing PRRT. For some commodities this may include processing and transportation.

## State Royalties

The Australian Government says it will provide a refundable credit to resource entities for state royalties paid to State governments following commencement of the RSPT. The objective of the credit is to reduce the impact of state royalties and negate concerns that the resource profits tax is a "double" tax.

The Commonwealth says it will discuss with the States what royalty rates to credit, given that some royalty rates are in nominal dollars and need to be increased from time to time, while others are applied on a mine by mine basis. The refundable credit will be available at least up to the amount of royalties imposed at the time of announcement, including scheduled increases and appropriate indexation factors.

## Deductibility for income tax

RSPT payments will be deductible for income tax purposes. This is expected to be consistent with the current income tax arrangements for state royalties, crude oil excise, resource rent royalty and PRRT. Conversely, RSPT refunds will be assessable for income tax purposes.

Resource entities will continue to be subject to income tax on their exploration and production activities.

Exploration expenditure will be immediately deductible under the RSPT. Exploration undertaken under an exploration licence is a precursor to the discovery of a deposit, determining its characteristics and establishing feasible and efficient methods of extraction. The immediate deduction will be available for the same range of exploration expenses that have access to the refundable exploration rebate under company income tax.

## Rebate

The Australian Government will introduce a new resource exploration rebate, within the company income tax system. Under the resource exploration rebate companies can receive a refundable tax offset at the prevailing company tax rate for their exploration expenditure. The rebate will apply to the same range of exploration expenses currently immediately deductible under the tax law, provided the exploration is undertaken in Australia.

Expenditure incurred in exploring for geothermal energy will be eligible for the new resource exploration rebate.

## Transitional

Existing resource projects will be brought into the RSPT, with the exception of projects already covered by the PRRT.

To provide certainty for projects already covered by the PRRT, the Government says it will consult with industry on arrangements that would allow an irrevocable election into the RSPT.

Projects within the scope of the PRRT will remain in the PRRT unless, and until, they elect to transfer into the RSPT.

The Government will recognise, in the RSPT starting base, the accounting book value of existing project assets as at the most recent audited accounts available at the time of announcement. The book value will be required to reflect a value consistent with Australian Accounting Standards. In principle, the RSPT starting base will exclude the value of the resource.

Market valuation could be used where audited accounting book values are not available.

For assets acquired after the accounts were audited, but before announcement of the RSPT, the asset's historical cost will be included in the RSPT starting base.

The RSPT starting base will be indexed at the RSPT allowance rate. Where an asset is disposed of, or taken out of the project during the interim period, the asset's indexed RSPT base value will be removed from the RSPT starting base.

The RSPT starting base from pre announcement investment will not be transferable or refundable.

The Government will allow the RSPT starting base to be written off over five years, at the rate of 36 per cent in the first year, 24 per cent in the

second year, 15 per cent in the third year and fourth years and 10 per cent in the final year. Where the project does not earn sufficient RSPT profit to fully utilise the deduction, the loss can be carried forward to offset future taxable profit. Losses from the RSPT starting base will not be transferable to other projects and will not be refundable if the project closes.

## Observations

An RSPT, if introduced, will represent a significant new tax in Australia amounting to what would arguably be the centrepiece of the current process of tax reform. The Government says it will use part of the revenue from the RSPT to fund a phased reduction in the company tax rate to 28 per cent. The company tax rate will be cut to 29 per cent for the 2013-14 income year and to 28 per cent from the 2014-15 income year. The RSPT is also to be used to fund state infrastructure needs.

Where a choice opting into the regime arises for an entity that is subject to the PRRT regime, weighing up the different outcomes will be required to make that choice. The use of the 10 year bond rate for example under the RSPT for calculating allowance may produce a different result to those under the uplift regime for the PRRT under which additional uplift may be available.

The Commonwealth refers to resource rich countries (such as Canada, Norway and the United States), which have moved towards tax systems based on resource rents or super profits. It notes that most provinces in Canada, as well as the state of Nevada in the United States, have adopted profit-based charging for extracting resources. The Commonwealth also refers to the prospect of sustained growth of China and India producing demand and the prospect of prices for Australia's non renewable resources remaining strong. Against this context, it is perhaps not surprising that the Commonwealth sees an opportunity for a new tax. Under the consultation process that is now commencing, it is expected that a proposal with the full details will be the outcome.

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