

Mining Resources Rent Tax

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In June 2011 the Federal Government released the draft bill for the Mineral Resources Rent Tax ["MRRT"] as well as an explanatory memorandum on how the tax will be implemented. The MRRT is a proposed tax on profits generated from the exploitation of non-renewable resources in Australia and is a replacement for the Resource Super Profit Tax proposed in 2010.

The MRRT legislation is complex and may require mining companies to undertake a significant amount of valuation and transfer pricing analysis to calculate their MRRT liabilities. This article provides a brief overview of the requirements arising from the MRRT legislation and describes how Value Adviser Associates can assist mining companies adapt to this new tax regime.

How the MRRT works

The MRRT, which is forecast to apply from 1 July 2012, applies only to coal and iron ore and will be levied at the rate of 30%. The basic operation of the MRRT is illustrated as follows. The first step is to calculate the profit that is taxable under the MRRT:

$$\begin{aligned} & \text{Mining Revenue} - \text{Mining Expenditure} = \text{Mining Profit} \\ & - \text{Royalty Allowance} - \text{Mining Loss Allowance} - \\ & \text{Starting Base Allowance} \\ & = \text{MRRT Profit} \end{aligned}$$

The next step is to calculate the MRRT tax liability:

$$\begin{aligned} & \text{MRRT Profit} \times \text{MRRT Rate (30\%)} - 25\% \text{ Extraction Allowance} \\ & = \text{MRRT Tax Liability} \end{aligned}$$

The Mining Revenue is received from sale of the mineral resource. Since the purpose of the MRRT is to only tax profits on the mining of resources rather than the value added activities such as processing or transportation to market, it is necessary to determine the effective sale price of the resource at the taxing point – which is typically taken to be when the taxable resource leaves the 'run-of-mine' stockpile.

To calculate the Mining Profit, Mining Expenditure is deducted from revenue. Mining Expenditure includes all operating costs related to the mining operation up until the taxing point as well as capital expenditure which, under the MRRT, is immediately deductible. That is, unlike income tax, for MRRT purposes capital assets do not have to be depreciated over their effective lives.

To calculate the MRRT Profit, any royalties paid under State and Territory royalty regimes are deducted from the Mining Profit. Where the full royalty allowance for the year cannot be used, the unused portion is uplifted and carried forward to be used in the next year. The uplift rate is the Long Term Bond Rate ["LTBR"] + 7 per cent.

There is also a Mining Loss Allowance for any losses on the mining project from previous years. These can be carried forward, uplifted at LTBR + 7 per cent, to offset against the mining profit of the project in a later year.

Miners are also able to claim an allowance, called the Starting Base Allowance, for existing projects as at 1 May 2010. The Starting Base Allowance, which is designed to reflect the annual depreciation of the starting base assets, is calculated based on the value of the mining assets.

The MRRT Profit is multiplied by the MRRT Rate of 30% and a further 25% discount, called the Extraction Allowance, is applied to determine the MRRT Liability. The Extraction Allowance recognises the value of specialist skills employed by the miner to extract the resource and bring it to the taxing point. Taking into account the Extraction Allowance, the effective MRRT rate is 22.5 per cent.

Valuation requirements arising from the MRRT

The proposed MRRT requires existing mining companies to determine the value of their mining assets as at 1 May 2010 as part of determining the Starting Base Allowance. For this there are two options:

- Market Value; or
- Book Value.

There are key differences in how these two valuation approaches are applied and this will determine which valuation the mining company will adopt. For example, under the Market Value approach, the starting base asset is depreciated over the shorter of the asset's effective remaining life, the life of the mine and the period until 30 June 2037. Under the Book Value approach, the starting base asset is depreciated over five years and the undepreciated value of the starting base asset is uplifted each year by the LTBR plus 7 per cent.

The mining company must make its choice before it lodges its first MRRT return and once a particular method is adopted, it cannot be subsequently changed.



The explanatory memorandum prepared by the Federal Government to accompany the draft legislation provides details of how various assets are treated under the Market Value and Book Value approaches to calculate the starting base asset value.

All tangible assets used in the upstream mining project, such as equipment used in the extraction process, are included in the starting base asset. Land can be included in the starting base asset as well as improvements to land and fixtures. If the miner does not own the land, the improvements and fixtures owned by the mining company can still be included in the starting base asset.

If a miner chooses the book value approach, the rights and interests that make up the mining project interest itself are not included in the definition of a starting base asset. This exclusion reflects the policy to exclude the value of the taxable resources if a miner chooses the book value approach. For the same reason, the value of mining information is also excluded.

While goodwill is unlikely to be an asset that can be meaningfully identified in relation to the upstream operations of a mining project interest, it is excluded under the book value approach.

The market valuation approach requires the mining company to undertake a valuation of the mining assets up to the taxing point. This valuation will capture the value of rights, interests, mining information and goodwill (if any) in the starting base asset value.

Transfer pricing requirements arising from the MRRT

The Mining Revenue amount is determined through a process of reasonably attributing the consideration for supply (e.g. sale) to the resource in the form in which it existed at its taxing point and the place where it was located. The reason for the attribution to the resources as they were at the taxing point is that the MRRT does not seek to tax profits made downstream of the taxing point.



Where there is an arm's length sale of resource, the sale price is the Mining Revenue amount. However, where the sale is not at arm's length or where there is no actual transaction when the resource leaves the taxing point, the miner is required to determine the Mining Revenue for MRRT purposes. This involves using established transfer pricing principles to determine the amount that would be expected to be received by the miner as consideration if the miner made the supply under an agreement between the miner and another entity dealing at arm's length with each other in relation to the supply.

The MRRT legislation requires the miner to use the most reliable method to determine the arm's length consideration having regard to all of the relevant circumstances. The miners are encouraged to adopt one of the transfer pricing methodologies identified in the OECD Transfer Pricing Guidelines.


Value Adviser Associates is experienced in resources valuations and transfer pricing

Value Adviser Associates is well placed to assist mining companies adapt to the new MRRT regime. Value Adviser Associates has significant experience in valuation and transfer pricing in the resources sector including:

- advising both corporate and the ATO on valuations for tax purposes, including valuation of intangible assets such as mining information;
- identifying and valuing the assets of an integrated mining and processing operation for stamp duty purposes; and
- determining an appropriate transfer price to apply between a mining company and a related party marketing company to assist in calculating the mining royalties payable.

Value Adviser Associates also has access to the services of Victor Rudenno, a highly experienced resources valuation practitioner. Victor has advised Government and the ATO on resources valuations and is the principal author of a number of Independent Experts Reports including the \$500m takeover of Climax by Oceana and the \$1bn takeover of Resource Pacific by Xstrata. Victor has undertaken valuation reports for a number of major companies including Macarthur Coal, Rio Tinto and Vale. He is also the author of the international textbook "The Mining Valuation Handbook"



If you wish to discuss how Value Adviser Associates can help your company transition to the new MRRT regime, please call either Mark Gemmola or Michael Churchill on 03 9626 4300. 



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