

RESOURCE SUPER PROFITS TAX (RSPT)

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On 2 May 2010 the long anticipated “root and branch” review of the Australian taxation system as well as the Government’s initial response to the recommendations made in the Henry Review was finally released to the public.

In short, the Henry Review, provided to the Government on 23 December 2009, comprised approximately 1,300 pages and makes 138 recommendations. The stated brief was to deal with socio-economic challenges faced by Australians in the 21st century.

The backlash from the mining industry to the Resource Super Profits Tax (RSPT) and the reaction of markets has been well publicised.

We now cut through the rhetoric and pinpoint the essential elements of the RSPT and discuss what it will mean for business.

Key Facts of the RSPT

- RSPT will be introduced with effect from 1 July 2012 and apply at a rate of 40% on ‘profits’ made from the realised value of resource deposits.
- It will apply to all entities directly involved in exploitation of Australia’s non-renewal resources with the exception of projects already covered by the Petroleum Resource Rent Tax (PRRT).
- The RSPT profit is calculated by reference to revenue less the associated costs.
- In calculating RSPT profit, a deduction will be allowed for the grossing up of undeducted capital expenditure and project losses carried forward from the previous year.
- Carried forward undeducted capital expenditure and project losses are tracked through keeping an RSPT capital account.
- The allowance is calculated by multiplying the carried forward RSPT capital account balance by the 10-year Government bond rate (note that the rate to be used is the subject of substantial debate).
- The RSPT is calculated on a project-by-project basis.
- Losses from loss projects may be transferred and utilised against profitable projects.
- The RSPT is calculated as 40% of the RSPT profit.
- The RSPT ultimately payable is calculated after crediting state-based royalties paid by the taxpayer.
- As state-based royalties will be a refundable credit, taxpayers will receive an RSPT refund where the state-based royalties exceed the primary RSPT.
- The RSPT paid is deductible for income tax purposes.
- RSPT refunds will be assessable for income tax purposes.
- Loss projects that wind up without being able to transfer losses to profit-making projects will be subsidised by the Government through the refund of the 40% of the unrecouped project loss.

Key Aspects of the RSPT Mechanism

Taxing Point

The taxing point at which revenues and costs are taken into account for calculating the RSPT profit is still subject to consultation. The Henry Review suggests that the taxing point



should be close to the point of extraction e.g. the mine gate or well-head. This can be impractical as revenues and costs at this point will be difficult to determine. Instead, the Government has suggested the point at which a saleable commodity exists. The taxing point may be set at different points for different commodities.

Assessable and deductible items

Certain costs will not be deductible in calculating RSPT profit. These include interest and financing costs, cost of acquiring existing exploration permits and interests in projects subject to RSPT, share issue costs and hedging costs.

There will need to be significant further consultation to determine exactly what receipts and costs will be relevant in calculating RSPT profit.

Assets transferred out of a project will give rise to a balancing adjustment.

RSPT capital account

The RSPT capital account tracks the undepreciated tangible capital expenditure and unutilised losses of a project. In calculating RSPT profit, a deduction will be allowed for the grossing up of the capital account balance carried forward from the previous year.

The rationale behind the capital account and allowance calculation is the preservation of real value of project outlays. The allowance is designed to compensate the project of the time value diminution of project costs that are not deducted until future years of income.

Project losses

Losses from loss projects may be transferred to profit-making projects to reduce the taxpayer's overall RSPT profit.

Losses from projects being wound up that cannot be transferred to profit-making projects will be subsidised by the Government through the refund of 40% of the unrecouped project

loss. In the Government's reasoning, this subsidy is the corollary to charging an additional 40% tax on profits.

Transitional arrangements

All existing projects as at 1 July 2012 will transition into the RSPT regime with the exception of projects under the PRRT. Projects under the PRRT regime will be able to make an irrevocable election to enter the RSPT regime.

For projects transitioning into the RSPT regime, an opening RSPT capital account balance will have to be established. The Government has stated that in principle, it will allow 100% of the accounting book value of existing capital to be brought into the opening balance. The book value will be based on the most recent audited accounts at the time of the Henry Review announcement.

Post-announcement investment or asset disposals that occur prior to 1 July 2012 will add to or reduce the opening balance of the RSPT capital account.

To ease the transition into the RSPT regime, the Government will allow early access to the RSPT capital account starting base for projects transitioning into the regime. The starting base may be written off as a deduction over five years at a rate of 36% in the first year, 24% in the second year, 15% in the third year and 10% in each of the fourth and fifth years.

The transitional arrangements are intended to be addressed during the first phase of the consultation process.

Concessions for small business

It is expected that the Government will allow small business operators immediate write offs or an accelerated rate of write off for projects costs.

Expected Outcomes for Resource Companies and Investors

Tax Profile

Based on the Government's economic modelling, the overall cost of capital will be lower in the earlier phases of the project. This is because a refundable credit is given for state-based royalties. The Government argues that this coupled with the fact that RSPT is based on profits means that the tax burden of resources operations will be more in line with their profitability thereby smoothing the effects of an inefficient state-based royalty regime.

For a fully profitable project, the effective tax can be as high as 56.8% even after taking into account the reduction of the corporate tax rate to 28%.

Offshore operations

An interesting effect of the RSPT will be the levelling the playing field between offshore and domestic projects for investors. For domestic investors invested in fully profitable projects, there will be less disparity between investing in Australian companies operating offshore versus those operating in Australia.

The increased domestic effective tax rate (which is not compensated by increased franking credits) mirrors the effects of the double taxation suffered on a flow through of profits from foreign operations.

For profitable offshore projects, Australian investors can expect a better after-tax return where the

total effective tax rate in the country their company is operating in is less than 37%.

Foreign investors

For foreign investors, there will be uncertainty about whether the RSPT represents a permanent leakage or whether their own domestic regimes will allow a credit for the tax.

In theory, it is possible for a situation to occur where a company pays RSPT but no income tax. It is still uncertain at this stage how such profits will be treated for say dividend withholding tax purposes if paid out to foreign investors.

Where to from here?

The purpose of this bulletin was to assist in your understanding of the Government's proposal.

There is a long way to go before we will have legislative certainty regarding these announcements.

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