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Miners' taxes pay for PM's follies

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LAST Tuesday, Martin Parkinson, the Treasury Secretary, used the annual post-budget address to examine the uncertainties in the economic outlook. While his speech was wide-ranging, one component stuck out: the suggestion that the rapid growth of mining was "dampening tax receipts as a share of the economy", with "the accelerated write-offs provided for many mining assets" being "of particular importance".

Coming after repeated claims that mining fails to pay its fair share of tax, the implication seemed to be that mining taxes should be increased again so as to fund ever-rising public spending. Proposals canvassed by the government's Business Tax Working Group to pare back those accelerated write-offs made that inference all the stronger.

The next day, Jac Nasser, chairman of BHP Billiton, hit back. Australia, he warned, is "at the upper end of overall taxation levels", which "means we are not competitive". Stressing that mining investment involves the long term, where "that can be 50 years and longer", "what matters at this point in time is stability".

"I cannot overstate how the level of uncertainty about Australia's tax system is generating negative investor reaction," Nasser said. "People don't know where it's going". Without that predictability, investments that could have been made here were likely to go overseas.

Nasser's concerns are understandable, for the government and the Greens are engaged in a concerted campaign to portray mining as a free rider. At the heart of that campaign are misleading claims about mining's share of company tax payments compared with its share of gross operating surplus.

GOS is essentially a measure of cashflow -- that is, of the difference between companies' cash receipts from operations and their cash payments. Since the resources boom began, the advocates of higher taxes complain, mining's share of GOS has exceeded its share of company tax.

But that comparison is meaningless. To begin with, if a graph of resource prices looks like Everest's North face, it is because there was a prolonged period from the early 1980s to 2004 when prices were at rock bottom (so to speak). With investments lasting a half century or more, one needs to look at taxes relative to profits not just in the boom but in the lean years as well.

Moreover, as even the Treasury Roundup admitted in 2007, GOS is hardly the right measure of profits for that comparison. Since it merely reflects cash in from operations versus cash out, it takes no account of the need to remunerate investors for risk and for the opportunity cost of capital. And because some industries require much more capital for each unit of sales than others, and hence have higher capital costs, a dollar of GOS in a capital-intensive industry translates into far lower profits than the same dollar would elsewhere.

To make like-for-like comparisons, GOS must therefore be adjusted to take account of capital charges. To see how important that is, consider the construction industry. Viewed over the long term, it is far more profitable than mining: unpublished ABS data shows that $1 invested in construction in 1999 would have increased in value to $14 by June 2010, while the same $1 invested in mining would only have appreciated to $3.50.

And construction uses just one dollar of capital for each dollar of sales, while mining uses four. A larger share of mining's cash revenues consequently goes to remunerate investors for the opportunity cost of capital, making its properly measured profit rate much lower than the sheer scale of its GOS would suggest.

When those adjustments are made, mining pays a far higher share of its income in company tax than the all-industries average. Again, the comparison with construction is telling: since 2000-01, construction has paid some 8 per cent of its income net of capital charges in company tax; mining has paid more than 40 per cent. On top of that, mining pays state royalties, which account for 6 to 7 per cent of sales and hence for a much higher proportion than that of profits.

As for the claims that mining receives unusually generous accelerated depreciation provisions, they too are difficult to take seriously. The most important tax allowances for mining relate to the capital used in exploration. That capital can be written off more quickly than other mining investments, reducing immediate tax payments, albeit at the expense of higher payments down the road.

But those allowances are, if anything, less generous than the tax treatment of capital used in manufacturing R&D, which qualifies not only for accelerated depreciation but for a supplementary tax credit. It seems bizarre to argue mining exploration, whose wider benefits for Australia have been far greater than those from manufacturing R&D, should be treated less favourably.

What seems to especially irk the higher taxes chorus is that the cost of exploration permits can be included in the accelerated depreciation. But that too is no more favourable than the tax treatment of purchased patents in manufacturing R&D.

Moreover, exploration permits are sold by state governments, so some part of the value of the tax concession will be reflected in the price they receive. To that extent, removing the concession would simply shift income away from the states, who own the resource, back to the commonwealth. And if the concession were eliminated for permits that had already been acquired, as seems intended, the effect would be to retroactively remove a benefit miners had already paid for, increasing sovereign risk.

Ultimately, the claims of the anti-mining campaigners just don't stack up. In fact, far from not paying its way, the Henry Tax Review's modelling shows mining already bears the greatest costs of the company income tax, with the tax causing its output to shrink by 10 per cent below efficient levels.

Further increases in effective company taxes on mining would only cause those distortions to mount ever more rapidly.

But someone has to pay for follies such as the National Broadband Network and the Clean Energy Finance Corporation. Taxes on companies are especially attractive in that respect, as they are so much less transparent than those on people. And mining companies can hardly pack up their billions in sunk assets and move them elsewhere.

Little wonder expropriating resources companies has long been the profligate's drug of choice. How else could Gabon have paid for its Trans-Railway, Libya for the Gaddafi Great Man-Made River, or Turkmenistan for its Golden Statue of Saparmurat Niyazov, "leader of all the Turkmen"?

And with those examples to follow, how could Julia and Wayne go wrong?

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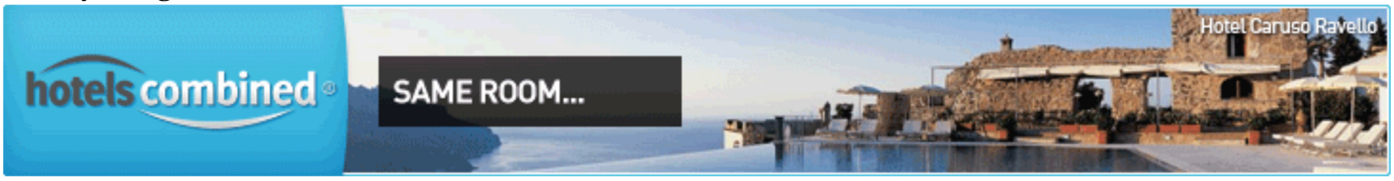

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