



Minerals Council of Australia

Potential financial impacts of
the Resource Super Profits Tax
on new mining projects in
Australia – Supplementary
Report

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1 Supplementary findings

1.1 Purpose of this report

This report has been commissioned by the Minerals Council of Australia (MCA) as a supplement to our report dated 1 June 2010 (the **RSPT Report**) and should be read in conjunction with the RSPT Report.

This report summarises KPMG's assessment of the potential financial impacts for participants in the Australian mining sector from a variation to the Resource Super Profits Tax (**RSPT**), being the adoption of a resource rent tax (**RRT**) in a form equivalent to the Petroleum Resource Rent Tax (**PRRT**).

1.2 Overview

Mining companies evaluate projects according to post tax risk adjusted returns. The impact of higher tax costs will generally be to reduce net present value (**NPV**) returns of domestic mining projects under evaluation. Reduced NPV returns are likely to result in mining companies deferring or cancelling Australian mining projects in the short to medium term.

NPV represents the value of future cash inflows less the cost of investing in the project, discounted for timing and risk, in order to derive a present value for the project. As NPV determines a value today for projects it is a central tool used by investors in appraising long term projects. Importantly, it is an indicator of how much value an investment or project adds to a company. Where there is a choice between two mutually exclusive alternative projects, the project yielding the higher NPV will generally be selected.

1.3 Modelling findings

KPMG has worked with the MCA to develop whole-of-life financial models for Australian mines across six commodities (iron ore, coal, copper, nickel, bauxite and gold). The models are for "typical" greenfield tier two (second quartile on the industry cost curve) mines, and can be used to calculate the NPV of the mines under different taxation scenarios. Details of the mine models are contained in the RSPT Report.

KPMG originally modelled two scenarios at the request of the MCA:

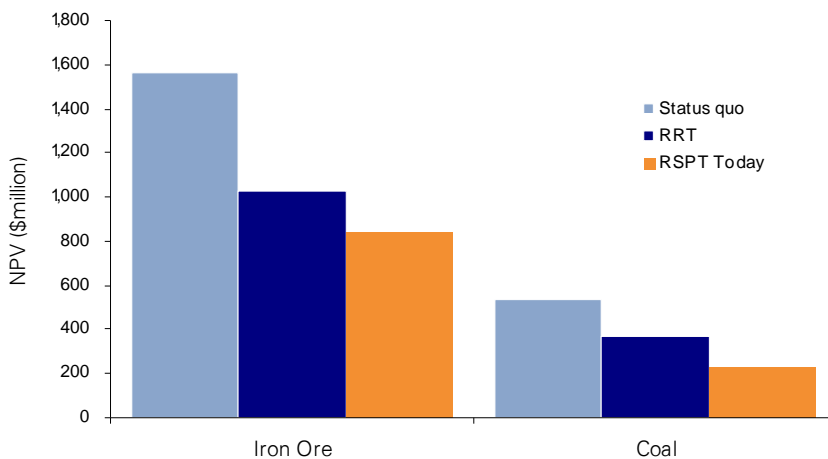
- "Status quo" – This scenario assumes that the corporate tax rate and the royalty rates remain unchanged, and that the current equity funding and gearing levels remain unchanged (i.e. pre introduction of the proposed Government tax changes). All mines are assumed to be 100% equity financed with the exception of iron ore which assumes 10% debt, and all mines debt finance working capital; and
- "RSPT today" – This scenario assumes a 40% RSPT, a 28% corporate tax rate and no change in capital structure. This assumes that the tax credit does not affect the cost of equity, the cost of debt or the gearing, so they are all the same as under the status quo scenario, but operate under the new tax arrangements.

We have now modelled a third scenario at the request of the MCA¹:

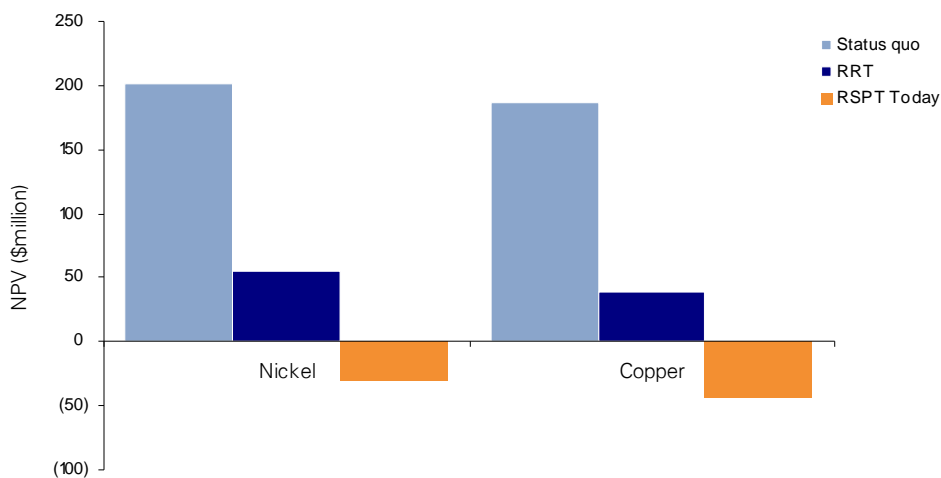
- “RRT” – This scenario assumes a 40% RRT, a 28% corporate tax rate and no change in capital structure. In adopting the PRRT rules² in this scenario, we have included an allowance rate of the long term bond rate plus 5% (plus 15% for exploration), and have prepared the models so that no RRT is payable until capital development costs and carried forward losses are fully recovered.

Using parameters under the “RSPT today” and “RRT” scenarios, the project financial modelling shows a reduction in NPVs as compared to the “status quo” scenario. The results of the modelling are illustrated in the following charts.

Bulk commodities

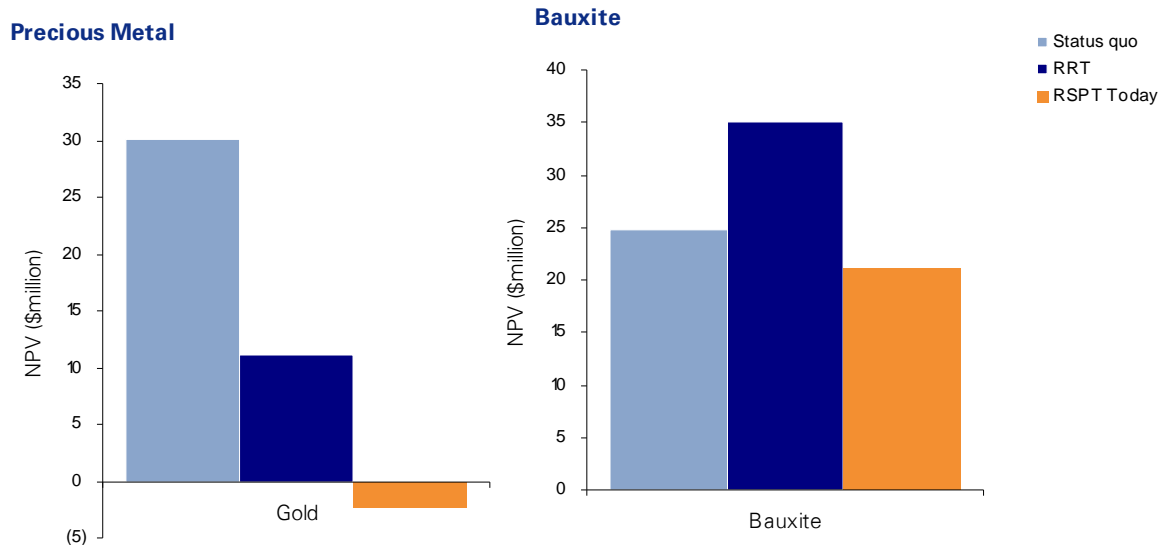


Base Metals



¹ We also modelled a scenario for the RSPT Report, which illustrated the variance in the value of mining projects between the proposed RSPT and a theoretically neutral tax. Details of this modelling are included in the RSPT Report. Our modelling for this report is limited to NPVs and does not consider internal rates of return.

² The provisions in the *Petroleum Resource Rent Tax Assessment Act 1987*.



The extent of the reductions in NPVs under the “RSPT today” and “RRT” scenarios as compared to the “status quo” scenario are summarised in the following table:

Relative NPV decline	Iron Ore	Coal	Nickel	Copper	Gold
RSPT today	46%	57%	115%	124%	107%
RRT	34%	31%	73%	79%	63%

The NPV of the Bauxite mine reduces by 15% under the “RSPT today” scenario, and increases by 41% under the “RRT” scenario.

The application of an RRT as modelled in the “RRT” scenario reduces NPVs relative to the status quo across iron ore, coal, nickel, copper and gold. Though the reductions are less than under the “RSPT today” scenario, these are reductions which would be expected to affect the evaluation of investment opportunities. The reduction in risk adjusted returns of Australian mining projects would likely result in Australian mining projects moving ‘down the list’ for large multinational mining companies. Importantly, a project moving from negative to positive NPV does not mean the project will necessarily proceed in the short to medium term.

Impact on effective tax rates

KPMG has used the financial models to calculate indicative effective tax rates for greenfield tier two mines on a project basis under the “RSPT today” and “RRT” scenarios.

We have calculated the effective tax rates for the mining projects using the following formula:

$$\frac{\text{Total taxes paid in relation to a project}}{\text{Total project profit before any taxes}}$$

Total taxes paid in relation to a project only include company tax, RSPT and royalties not subject to Australian Government rebate. Total project profits before any taxes are calculated before deductions for unrebated royalties.



The effective tax rates over the lives of the projects are summarised below.

Effective Tax Rate	Iron Ore	Coal	Nickel	Copper	Bauxite	Gold
Status quo	43.6%	41.1%	34.3%	34.4%	50.1%	34.6%
RSPT today	54.7%	55.0%	55.1%	55.0%	54.0%	54.1%
RRT	54.9%	54.7%	55.4%	54.5%	54.6%	47.8%

The effective tax rates under the “RRT” scenario are higher than under the “RSPT today” scenario for iron ore, nickel and bauxite. This indicates that the “RRT” scenario will result in more tax being payable over the life of the mines. However, the NPVs are higher under the “RRT” scenario because taxes are paid later in the life of the project, and so have a lower impact on NPV returns.

The modelling undertaken for the RSPT Report and this report is for typical greenfield second quartile mines, and the effect of tax changes on first, third and fourth quartile mines and other second quartile mines is likely to be different again.

Taxation of oil and minerals

Internationally, the tax treatment of oil and gas typically differs from the tax treatment of mineral resources, and the tax treatment often differs between oil production and gas production. International practice is that oil production is generally taxed at higher rates than mineral resources.

The international differences in the taxation treatment of oil production and for minerals is a relevant consideration for the competitiveness of the taxation regime for the Australian minerals sector, including assessing whether different tax rates should apply to different commodities.

1.4 Limitations & reliance

This report is a supplement to and should be read in conjunction with the RSPT Report.

The conclusions presented in this report are based on KPMG’s understanding of the proposed tax changes as at 1 June 2010. The conclusions in this report may change where design elements of the RSPT change from those currently proposed.

The financial modelling results are based on parameter instructions provided by the MCA and have been verified by the MCA. The MCA has advised that the financial model outputs are consistent with current modelling practices within the mining sector for assessing project viability, in particular the use of NPVs for assessing project viability. Our report does not consider existing projects. Details of the mine models are included in the RSPT Report and the modelling outcomes in this report should be considered by reference to the details in the RSPT Report.

The financial modelling conducted as part of this engagement is focussed at a project level with start dates in the short to medium term. Financial modelling approaches at the project level may vary between companies and, importantly, may vary significantly from approaches adopted for broader macroeconomic modelling, such as the modelling undertaken by KPMG Econtech for Treasury. The modelling undertaken for Treasury seeks to assess the long-term impacts of tax reform on the broader Australian economy and applies taxation economics principles not necessarily applied to project level modelling. It is important for readers of this report to understand the assumptions and approaches adopted under different modelling scenarios. The assumptions and approaches used in this report are disclosed in section 3 of the RSPT Report.