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[12] Not in scope

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Office of the Minister of Finance
Office of the Minister of Revenue

Chair
Cabinet Economic Growth and Infrastructure Committee

Specified Mineral Mining – Tax Review

Proposal

1. We seek the agreement of the Cabinet Economic Growth and Infrastructure Committee to amendments to the Income Tax Act 2007 to be included in the first omnibus tax bill for 2013, currently scheduled for introduction in April.

2. We recommend for inclusion in that bill provisions that will replace the existing tax rules for "specified mineral miners" with rules that are more consistent with those that apply to taxpayers more generally, while still catering for some unique aspects of the industry.

Executive summary

3. There is a separate set of tax rules that apply to "specified mineral miners". There are 50 specified minerals, of which gold, silver and iron sands are the most commonly mined. The current tax rules that apply to this group effectively allow a tax deduction for capital expenditure in the year the expenditure is incurred, and, in certain circumstances, allow expenditure to be deducted in anticipation of it being incurred. This is very concessional compared to the tax treatment of most other forms of investment.

4. Tax concessions for specific industries are inconsistent with the Government's broad-base, low-rate tax policy framework. Concessions reduce the Government's tax base and the productivity of capital.

5. In October 2012 an officials' issues paper entitled *Taxation of specified mineral mining* was released for public consultation. That paper suggested amending the tax rules applicable to specified mineral miners to more closely align them with the rules that apply to other industries. Following consultation, we recommend that a revised set of tax rules for specified mineral miners be introduced. These rules will more closely align the treatment of mineral miners with that of taxpayers more generally, but still aim to cater for some of the more unique aspects of the mineral mining industry.

6. This issues paper was released alongside one entitled *Reviewing the Royalty Regime for Minerals*. This work, led by the Ministry of Business Innovation and Employment, proposed an increase in the royalty rates applying to larger, more profitable mines. The policy decisions surrounding the royalty regime for minerals were considered by this committee on 27 February 2013 (EGI Min (13) 3/7 refers). The review of specified mineral mining taxation also complements this work.

7. We accept that the proposals, by raising the tax impost on specified mineral miners, may result in lower production levels – at least in the short term. However, we consider that:

- Production levels are more contingent on other factors, such as the price of minerals than on tax settings (provided those settings do not discriminate against the industry). To the extent that tax settings are important, it is necessary to consider not only any specific concessions but also the headline rate of corporate income tax and any special mineral taxes imposed. This makes direct international comparison difficult. However, we note that a PricewaterhouseCoopers report on mining taxes has noted that since the 2008 global financial crisis "..the global trend is an increase in the overall tax burden on mining companies because governments view mining companies as quite profitable in light of increased mineral prices."[1]
- The removal of most of the tax concessions will create a more stable, coherent set of tax rules for the industry to grow on in the future.

8. These changes, along with those made in other areas, seek a fair return on the Government's mineral resources consistent with the Government's Business Growth Agenda, by better ensuring that scarce capital and labour is allocated to the most productive areas of the economy.

Background

9. The Income Tax Act 2007 differentiates between specified minerals (including gold, silver and iron sands) and other minerals (including oil, gas and coal). The current tax rules that apply to a specified mineral miner allow an immediate tax deduction for:

- prospecting, exploration and development expenditure, including expenditure on capital items such as plant, machinery and production facilities, and
- an amount set aside (appropriated) for mining exploration or mining development, if it will be applied for these purposes within the next two years. The amount that can be appropriated is limited to the company's net income for the year.

10. These immediate deductions for capital expenditure and expenditure yet to be incurred make the tax rules for specified mining very concessionary compared to most sectors, including petroleum mining, which also has a concessionary regime. Under general tax principles, deductions for such expenditure should be deferred and allowed over the economic life of the asset that is being created (in this case, a productive mine).

11. The objective of the current review is to create a set of tax rules that are appropriate for the specified mineral mining sector. In determining what is appropriate it is necessary to consider not only the effected industry but also more general economic efficiency, the wider tax framework and the rest of the taxpaying community.

12. The suggested rules would make the tax treatment of specified minerals broadly consistent with the rules that apply to other business activities. From a tax perspective, this would make domestic and foreign inbound investment decisions more efficient, promote fairness and coherence of the tax system and broaden the tax base.

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[1] *Corporate income taxes, mining royalties and other mining taxes: A summary of rates and rules in selected countries*, June 2012: http://www.pwc.com/en_GX/gx/energy-utilities-mining/publications/pdf/pwc-gx-miining-taxes-and-royalties.pdf

Issues paper and public consultation

13. In Budget 2012, the Government announced its intention to review the tax treatment of specified mineral mining as part of its on-going commitment to ensuring fairness across the tax system. Cabinet agreed to the release of officials' issues paper, *Taxation of specified mineral mining,* in October 2012 (EGI Min (12) 24/1 refers).

14. A total of 39 submissions were received from a mix of accounting firms representing clients, mining firms, and mining industry representatives. Twenty-six of the submissions received were standard form submissions from West Coast alluvial gold miners, with the assistance of Minerals West Coast.

15. Although submissions were opposed to the repeal of the current rules, we do not consider that the existing concessions are justified.

Recommended rules

16. As a result of consultation, we now recommend a set of rules for specified mineral miners with the following features:

Prospecting, exploration and development expenditure

17. We recommend that "prospecting expenditure" and "exploration expenditure" should be immediately deductible, and that "development expenditure" should be capitalised and deducted over the life of the mine. However in terms of "exploration expenditure", our view is that any expenditure on items that are later used for the extraction of minerals should be added back as income in the year the mine becomes operational and deducted over the life of the mine as if it were development expenditure. This is to ensure that there is no risk of non-deductible development expenditure being reclassified as deductible exploration expenditure. This is consistent with officials' proposals in the issues paper.

Life of a mine

18. The "life of a mine" is a key concept for spreading development costs that are in existence for the operational period of the mine. To minimise compliance costs, we recommend that the "life of the mine" should be self-assessed by taxpayers based on their expected activities in a particular permit area, but should not be less than the expected life of the mine used for accounting purposes. For simplicity and to minimise compliance costs, however, we propose that for tax purposes a mine would have a maximum life of 25 years. This cap was not a proposal in the issues paper but we feel it is necessary to provide a level of certainty to mine operators while still adhering to more orthodox tax principles.

Other expenditure

19. We propose that "mining expenditure" which relates to the general operation of the mine should be subject to the ordinary capital/revenue distinction that applies to other businesses. However specific "rehabilitation expenditure" should be deductible in the year it

is spent, but a refundable credit up to the level of past tax paid should be generated if a loss is incurred in that year. This is to provide for the fact that the expenditure may be after income-earning activity has ceased. The proposal in the issue paper was to allow a deduction for money placed on account with Inland Revenue. This proposal was disliked by submitters as it effectively required mining companies to prefund their rehabilitation expenditure. We sympathise with this concern and so are comfortable with proposing this alternative.

20. Consistent with the issues paper, we propose that land should be treated as revenue account property of a mining company, meaning income or a deduction is accounted for in the year of disposal. As with rehabilitation expenditure, if a loss is incurred in the year of a land sale, a refundable credit should be generated to the extent tax has been paid previously. Again, this is to recognise the fact that selling the land might be the final act of a mining operation and no income may be available to offset any loss.

Losses and grouping

21. The issues paper proposed that specified mineral miners be brought into the general loss rules. Under general rules, a company has the ability to offset losses against group company profits, but these losses are lost with majority shareholder changes. Submitters argued that, as they are part of a high risk industry, they find it very difficult to obtain debt financing. If they wish to expand they fully exploit any mineral deposits they therefore require additional equity, and often additional owners. This makes them more susceptible than most businesses to major shareholder changes. As a result they were very concerned with this proposal, which would result in them losing the value of their losses on a shareholding change. The ability to offset losses with non- mining group companies was not considered to give much benefit to them.

22. We are sympathetic to these concerns and now consider that it is preferable that the existing mining loss rules continue. That is, while the shareholder continuity rules will not apply, mining losses would not be able to be offset against non- mining income.

Other issues

23. The rules that allow mineral miners to appropriate income for future expenditure should be repealed. This is consistent with the issues paper. However, to account for the fact that the repeal of this rule may result in unexpected tax liabilities for miners, we recommend that they be allowed to spread any income tax liability over the two years following effective date.

24. When a “farm-out” of mining rights takes place, the consideration received should be treated as income in the year the rights pass and the consideration paid should be deducted over the expected life of the mine (or be immediately deductible if the mine is still in the prospecting or explorations phases).

25. The normal tax rules should apply in respect of insurance receipts and bad debt/bad debt recovery. Our recommendations regarding the “farm out rules”, insurance receipts and bad debts are consistent with the issues paper.

Consultation

26. In addition to the public consultation mentioned above, the Ministry of Business, Innovation and Employment (MBIE) were consulted on the recommendations proposed in this paper.

27. MBIE is conducting a separate review of the royalty rates for new high-value mineral developments. This committee recently agreed to direct Parliamentary Council Office to draft regulations that incorporate revised royalty rates on new permits issued for high-value mineral developments (EGI Min [(13)3/7] refers).

28. We consider the tax changes recommended in this paper are consistent with the previous decision regarding royalty rates, although note that those impacted may consider the combined effect of both of these changes to be detrimental to their operations.

Financial implications

29. The recommendations in this report are expected to be revenue-positive by around $30 million per annum.

30. This estimate is based on the current production volume and price of gold, and is highly sensitive to changes in future gold production and price. For example, if gold production remains the same as the 2010 level, a 50% fall in gold prices from its 2011 level would mean that the estimated annual revenue gain would decrease to $10 million.

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17 & out-years**
Tax Revenue	-	3.000	27.000	30.000	30.000

31. We recommend this $30 million per year be included as a savings item in Budget 2013.

32. The new rules proposed in this report should not have significant systems implications for Inland Revenue, as most of the changes will impact on the self-assessed tax returns provided by taxpayers. To the extent that systems changes are required, they are able to be funded through existing baselines.

Human rights

33. The proposals are not inconsistent with the Human Rights Act 1993 or the New Zealand Bill of Rights Act 1990.

Legislative implications

34. The proposals will require changes to the Income Tax Act 2007 and the Tax Administration Act 1994. These changes would be included in the first omnibus tax bill of 2013, currently set down for introduction in April 2013. An effective date for the changes of the income year 2014/15 is recommended.

Regulatory impact analysis

35. The Regulatory Impact Analysis requirements apply to the proposal. A Regulatory Impact Statement (RIS) is attached.

36. The Work Programme Manager, Policy Advice Division has reviewed the Regulatory Impact Statement (RIS) prepared by Inland Revenue and considers that the information and analysis summarised in the RIS meets the quality assurance criteria of the Regulatory Impact Analysis framework.

37. We have considered the analysis and advice of officials, as summarised in the attached RIS, and are satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:

- are required in the public interest;
- will deliver the highest net benefits of the practical options available; and
- are consistent with our commitments in the Government statement *Better Regulation, Less Regulation*.

Publicity

38. Amendments to the tax rules for specified mineral mining have been widely consulted on, as has the potential introduction of new rules in the first omnibus tax bill of 2013. On the assumption that the Committee agree with the policy recommendations in this paper and their inclusion in the April tax bill, we have agreed that officials can discuss the proposed legislation with key industry representatives and their advisors immediately prior to the introduction the bill. No additional publicity other than that associated with the relevant tax bill is planned.

Recommendations

We recommend that the Cabinet Economic Growth and Infrastructure Committee:

1. **Note** that the existing tax rules that apply to specified mineral mining is highly concessionary.

2. **Agree** to legislative amendments that will introduce new rules that apply to specified mineral miners that are more consistent with those that apply to taxpayers generally with the features set out in recommendations 2.1 to 2.11

2.1. "Prospecting expenditure" and "exploration expenditure" should be immediately deductible, subject to the claw-back rule discussed in recommendation 2.3, below.

2.2. "Development expenditure" should be capitalised and deducted over the life of the mine.

2.3. Exploration expenditure" on items later used for the extraction of minerals should be added back as income in the year the mine becomes operational and deducted over the life of the mine as if it were development expenditure.

2.4. The "life of the mine" should be self-assessed by taxpayers based on their expected activities in a particular permit area, but should not be less than the expected life of the mine used for accounting purposes. A mine would have a maximum life for tax purposes of 25 years.

2.5. "Mining expenditure" should be subject to the ordinary capital/revenue distinction that applies to other businesses.

2.6. "Rehabilitation expenditure" should be deductible in the year it is spent, but a refundable credit should be generated if a loss is incurred in that year to provide for the fact that the expenditure may be after income-earning activity has ceased.

2.7. Land should be treated as revenue account property of a mining company, meaning income or a deduction is accounted for in the year of disposal. As with rehabilitation expenditure, if a loss is incurred in the year of a land sale, a refundable credit should be generated.

2.8. That the existing loss rules for mining companies remain so that losses can only be grouped against other mining income and can survive a continuity breach but only be offset against income from the same permit area.

2.9. The rules that allow mineral miners to appropriate income for future expenditure should be repealed. To account for the fact that the repeal of this rule may result in unexpected tax liabilities for miners, they should be able to spread any income tax liability over the two years following effective date.

2.10. When a "farm-out" of mining rights takes place, the consideration received should be treated as income in the year the rights pass and the consideration paid should be deducted over the expected life of the mine (or be immediately deductible if the mine is still in the prospecting or explorations phases).

2.11. The normal tax rules should apply in respect of insurance receipts and bad debt/bad debt recovery.

3. **Agree** that the changes in recommendation 2 be included in the next omnibus tax bill, currently set to be introduced to Parliament in April 2013.

4. **Agree** that the changes in recommendation 2 be effective from the 2014/15 income year.

5. **Delegate** authority to the Minister of Revenue to make any minor or consequential amendments to the rules necessary to ensure their effective implementation.

6. **Note** that the estimated tax revenue costs associated with the change in recommendation 2 are:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17 & out-years**
Tax Revenue	-	3.000	27.000	30.000	30.000

7. **Agree** that the positive revenue impact of an estimated $30 million per annum should be included as a savings item in Budget 2013.

Hon Bill English
Minister of Finance

____ / ____/ ____
Date

Hon Peter Dunne
Minister of Revenue

____/ ____/ ____
Date