Submission to Ministry of Business, Innovation and Employment on

"REVIEW OF THE ROYALTY REGIME FOR MINERALS – DISCUSSION PAPER" (OCTOBER 2012)

INTRODUCTION

1 Straterra[1] welcomes the opportunity to submit on the Ministry's discussion paper on the review of the royalty regime for minerals. As stated previously, we do so in the interests of achieving benefits for the minerals sector, and for the New Zealand economy as a whole (including the Crown).

2 Straterra Inc represents more than 90% by value of New Zealand minerals production, exploration, scientific research, engineering and geo-technical services, and legal, consulting and other ancillary services to the industry. Current membership stands at 54[2]. In preparing this submission, Straterra has consulted widely within its membership, notably Greenwood Roche Chisnall, NZ Coal & Carbon, Newmont Waihi Gold, OceanaGold, and Solid Energy, as well as PwC.

RECOMMENDATIONS

3 Straterra recommends the Ministry of Business, Innovation and Employment to:

a) Note Straterra's support for the rationale for the royalty review;

b) Note Straterra's view that further work is required to ensure that a new royalty regime is internationally competitive;

c) Agree to revisit the proposed royalty regime in consultation with industry, and a number of other matters, via further engagement between industry and officials; and

d) Agree to repeal the Energy Resources Levy Act 1976, via an amendment to *either* the Crown Minerals Act 1991, *or* the Income Tax Act 1995 (in connection with the tax review for specified minerals), in the course of Bills to amend these Acts being enacted by Parliament, noting that the ERL Act is an anachronism, and is obsolete (Appendix 1).

[1] Straterra represents more than 90 % by value of NZ minerals production, exploration, research, services, and support http://www.straterra.co.nz/About+Straterra

[2] http://www.straterra.co.nz/uploads/files/straterra_members_list_1_december_2012.pdf

EXECUTIVE SUMMARY/DISCUSSION

4 Straterra generally supports the Ministry's rationale and proposals for reviewing the royalty regime, as it applies to coal, gold+silver, platinum group elements, ironsands, phosphate, seabed massive sulphides, and underground coal gasification (UCG). A question remains as to the degree of international competitiveness of the Ministry's proposals.

5 Specifically, we find that the Ministry's international comparisons are at odds in many instances with an analysis carried out by PwC, published in June 2012[3]. The Ministry believes the tax rate in Russia is 28%, while PwC finds it to be 15.5% - 20%. In Ontario, the royalty rate is not 17%, as claimed by the Ministry, but 10%, according to PwC. In Indonesia, the tax rate is not 28% but 25%, and the royalty is not 13.5% but 3% - 7%, according to PwC. In South Africa the tax rate is not 28% but 25%, according to PwC. These are major discrepancies that warrant investigation.

6 As well, there has been a failure to take into account various types of concession available in some overseas jurisdictions, but not in New Zealand, or to a lesser degree.

7 For instance, even though Australia has set a Minerals Resource Rent Tax of 22.5% (noting a number of provisos), State royalties of 7-10%, based on volume, and corporate tax of 30%, Australia enjoys immediate write-offs for some classes of capital expenditure, or accelerated depreciation. There is also no guarantee the MRT will survive the next general election.

8 It is also noted that no international comparison has been made for other regulatory costs, e.g., local government rates; other fees, levies and other charges; compensation under access arrangements; development contributions under the Resource Management Act 1991; and support of communities. It is accepted that such a comparison would be difficult to undertake.

9 The Ministry's belief that commodity prices have increased is correct to a greater or lesser extent, depending on the mineral, however, the costs of mining, e.g., physical inputs and labour, have also gone up. We note that a number of New Zealand minerals producers, and contracting firms to industry, have been forced to lay off staff in recent months.

10 On the other hand, it is noted that New Zealand ranks relatively highly internationally in areas such as political risk, and policy and regulatory stability.

11 In conclusion, it is difficult for Straterra to determine whether or not the Ministry's proposed changes to the royalties are reasonable, for each mineral under consideration, on the material provided. That argues strongly for further engagement between industry and officials on the

[3] PwC white paper (June 2012). "Corporate income taxes, mining royalties and other mining taxes"

royalty review: to improve our understanding of the discussion paper; to properly evaluate the Ministry's proposals; and to determine what a reasonable royalty regime would look like, for each mineral. By "reasonable", we mean a royalty regime that provides a fair return for the Crown, while ensuring that investment in the mineral sector is encouraged in comparison to typical overseas regimes.

12 As a starter for discussion, Straterra contends that a 10% royalty on profits would be most off-putting to potential new investors in New Zealand, at least for some minerals. While the treatment of phosphate looks reasonable on the surface, the proposed regimes for coal and gold may be otherwise.

13 In the specific case of coal/lignite mined from opencast or open pit operations, an Energy Resources Levy of $2 or $1.50/tonne of coal produced is applied (para. 11). This levy is anachronistic, is obsolete, and should be repealed (refer to Appendix 1 for a discussion).

14 Turning to specific sections of the royalties review discussion paper:

15 We accept the Crown is entitled to review the royalty regime, on the basis stated in para. 5 of the discussion paper[4], namely, that the Crown is entitled to a fair, financial return on minerals it owns (para. 12 (a)), while ensuring the regime is internationally competitive.

16 The proposal to grandparent existing arrangements is supported, as a basic principle of contract law (para. 6).

17 While royalty regime attempts to take into account the tax regime applying to minerals (para. 7), we refer again to the discussion in paras. 5 – 11 of this submission.

18 We agree with the discussion paper that most if not all marginal projects should not be rendered uneconomic as a result of a change in the royalty regime (para. 12 (b)). That would also be consistent with the Government's economic policies.

19 We agree with the approach being taken towards appropriate risk sharing between the Crown and the private sector when setting royalty rates, i.e., to apply more favourable consideration to marginal projects, than highly-profitable projects (para. 12 (c)).

[4] http://www.med.govt.nz/sectors-industries/natural-resources/oil-and-gas/review-of-the-crown-minerals-act-regime/consultation-on-proposed-changes/consultation-royalty-regime-minerals/review-of-the-royalty-regime-for-minerals-discussion-paper.pdf

20 We accept the Crown's preference for applying a revenue-based, profits-based, or hybrid of the foregoing, royalty regime, as opposed to other approaches (para. 24). Further discussion may be desirable here to fine-tune the Crown's approach.

21 In testing the various scenarios for a royalty regime (para. 30), we accept the materiality thresholds chosen for coal and gold (para. 31) as distinguishing between the small number of highly-profitable operations, and the long tail of more marginal operations.

22 We note the rationale for the hybrid option proposed (paras. 34-36), noting once more that further discussion is warranted. While the proposed hybrid regime would be more difficult to administer than a purely revenue-based, or profit-based regime, that should not be onerous on permit holders or the Crown.

Appendix 1: Energy Resources Levy

The Energy Resources Levy Act 1976 is described as: "An Act to make provision for the imposition, assessment, and collection of a levy on certain energy resources produced in New Zealand".

The ERL is payable by the owner of the coal mine at the time the coal was produced (or, for natural gas, the licence-holder when it was produced). Originally it applied to all natural gas, coal and South Island lignite at rates of: 45c/GJ, $2/T and $1.50/T, respectively. Subsequently its application to natural gas was confined to discoveries pre-1 Jan 1986. However, for coal and South Island lignite it still applies, regardless of whether the coal/lignite is Crown or privately owned.

The original reasons for imposing the levy are unclear. Institutional memory within industry suggests it was introduced to help fund Think Big projects, e.g., the Huntly power station.

The Government – Cabinet - has twice decided to remove the ERL on coal, in 2005 and 2009, however, these decisions have never been actioned.

In 2009, Cabinet Minute CAB Min (09) 6/5B had as its purpose to "confirm the decision to repeal the Energy Resource Levy on coal". It said, further: "The [ERL] on coal is intended to maintain price relativities to oil and gas and to achieve **climate change objectives**. It provides the Crown with approximately $8m p.a. in revenue. Cabinet agreed in 2005 [EDC Min (05) 15/8 refers] that the ERL on coal is superfluous and that it should be removed as its original purposes are now being properly addressed." (Straterra's bold.)

Certainly, the ERL is now an anachronism, particularly with subsequent amendments to the royalty regime applying to coal, and with the introduction of climate change legislation in 2002, and subsequent amendment of the Climate Change Response Act in 2012.

Despite the Government twice considering the removal of the ERL, it has failed to do so. One reason may be - to quote the 2009 Cabinet Minute – "a legislative vehicle for the reform will need to be found".

Straterra proposes that the royalty review, or the tax review for specified minerals, provides that legislative vehicle. Amendment Bills to either the Crown Minerals Act 1991, or the Income Tax Act 1995, would furnish a prime opportunity for a clause to repeal the Energy Resources Levy Act.