MINERALS COUNCIL OF AUSTRALIA

SUBMISSION - MAKING VICTORIA'S TAX SYSTEM WORK

OCTOBER 2023

EXECUTIVE SUMMARY

A competitive tax regime is essential if Victoria is to realise its mineral sands, rare earths, gold and base metals potential.

Victoria needs a broader economic base and a more diverse economy. Developing the pipeline of critical minerals and gold projects would mean more mines, more jobs and generate royalties to fund state services.

Attracting investment to develop Victoria's critical minerals deposits will embed Victoria into renewable energy supply chains and reduce inequality in regional areas by providing a much-needed boost to regional Victoria.

Mining pays all the state taxes and charges other businesses pay, plus special mining fees, charges and royalties. Victorian mining is estimated to pay $140 million in royalties in 2022-23. This is in addition to various fees and charges imposed on mining. The sector paid $6.7 million in minerals specific license fees, land rents and royalties in 2021-22. Mining paid $46 million in new gold royalties in 2021-22.[1] Including increases in coal royalties and the new gold royalty, approximately $200 million in new costs have been imposed on the industry since 2017.

Reform to Victoria's flawed gold royalty, and fees and charges regime is required if Victoria is to attract mining investment and secure its share of the growth in demand for minerals to the benefit of regional host communities. A competitive tax regime for mining requires:

- The introduction of an exploration offset in the gold royalty to remove distortions against investing in exploration and to reduce impacts on small and growing mines with zero or thin profits
- Alignment of user pay fees to Earth Resources Regulation (ERR) with ERR performance
- No new taxes, rates or charges on mining or exploration.

Victoria's gold royalty, applied from 1 January 2020, was introduced without industry consultation. MCA Victoria does not oppose a gold royalty, however, the current royalty, imposed with no industry consultation, does not reflect Victoria's unique and complex geology, is uncompetitive with other states and imposes regressively high tax rates on thinly profitable mines.

A portion of royalties should be dedicated to regional Victoria.

Competitive user pays fees to fund Earth Resources Regulation (ERR) are required to ensure Victorian minerals explorers and mines have efficient and transparent regulation. ERR fees should follow user pays principles and not be used for revenue raising.

The additional payroll tax announced in the 2023 Budget is a tax increase on mining companies located in Melbourne and comes at a time when increasing confidence in mining investment is needed.

There should be no new taxes, rates or charges on mining or exploration. Including increases in coal royalties and the new gold royalty, approximately $200 million in new costs have been imposed on the industry since 2017.

The respected Fraser Institute Annual Survey of Mining Companies which ranks jurisdictions for exploration and mining investment competitiveness ranked Victoria last in Australia in 2022, coming in at 39th out of 84 global jurisdictions.[2] The Victoria government's gold royalty changes were cited as a reason for Victoria's poor performance on investment perceptions.

A competitive tax system with reforms informed by industry is urgently required if Victoria is to develop a strong pipeline of new mining projects which benefits all Victorians.

[1] Earth Resources Regulation Annual Statistical Report 2021–22, December 2022.
[2] Fraser Institute, Annual Survey of Mining Companies 2022, May 2022.

MINING – CRITICAL TO REGIONAL DEVELOPMENT

Mining and exploration play an important role in regional development in Victoria. Mining creates high paying jobs and supports a supply chain of innovative small and medium sized businesses.

Victorian has significant potential in mining and related manufacturing and services.

Demand for critical minerals including copper, rare earths and lithium is forecast to increase exponentially as essential inputs to modern technology. This creates economic opportunities for regional Victoria.

In the 12 months to June 2023, exploration spend in Victoria was close to a record high of $180 million – the fourth highest of all Australian states[3]. Exploration projects across the state for gold and base metals have the potential to develop into future mining projects.

The Geological Survey of Victoria estimates that there is as much gold left unmined in Victoria as has ever been extracted since the gold rush, demonstrating Victoria's high potential in gold. Victoria has known mineral sands deposits containing zircon and titanium minerals, and monazite and xenotime which contain rare earth elements - important inputs to wind turbines and batteries.

Victorian mining supports regional Victorian jobs.

Regional communities with a mine enjoy a large positive economic impact.

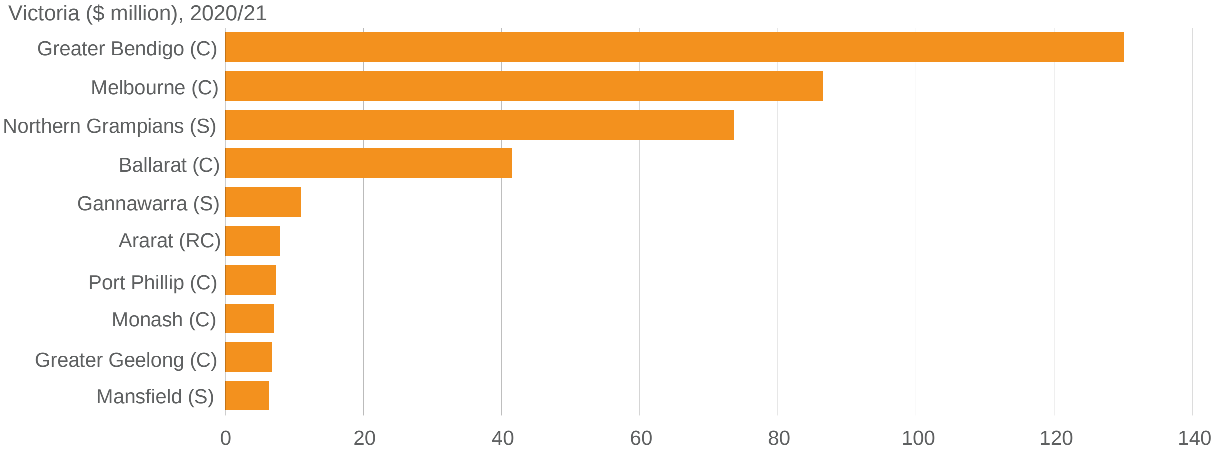
Victorian mines spent more than $500 million dollars in Victoria in 2020-21 comprising:

- $151.9 million in wages and salaries
- $307.3 million in purchases of goods and services from over 1,700 local businesses
- $48.1 million in state government payments.[4]

More than half (54 per cent) of Victorian mine supplier spend is in regional Victoria. Greater Bendigo LGA recorded the largest share of direct local businesses expenditure in 2020/21 ($130.2 million), with Northern Grampians ($73.7 million) and Ballarat ($41.5 million) also benefiting from mining spending.[5]

Minerals Sector Direct Spend by Local Government Area

Victoria ($ million), 2020/21



Source: Lawrence Consulting

Victorian mines buy local. Around three quarters of their spending stays in Victoria. The industry spent more than $300 million in wages, goods & services and taxes in Victoria last year.

Mining pays all the state taxes and charges other businesses pay plus special mining charges. The gold royalty constitutes a tax on the regions that comes in addition to state user pays charges, other

[3] *Mineral and Petroleum Exploration, Australia*: Australian Bureau of Statistics, July 2023.
[4] Lawrence Consulting, Victorian Minerals Sector Economic Contribution Study 2020/21. Report prepared for the Minerals Council of Australia, 2022.
[5] ibid

royalties, payroll tax and stamp duties already flowing to the state government. Mining paid $105.4 million in 2021-22 in minerals license fees, land rentals and royalties.[6]

Victoria's gold mining sector employs over one thousand workers directly in the Bendigo region at the Fosterville and Costerfield mines. Agnico Eagle's Fosterville Gold Mine is the fourth largest employer in Bendigo. Hundreds of workers are employed in the Ballarat and Stawell Gold Mines.

Mining jobs are predominantly full time and high wage.[7] In Victoria, $151.9 million in wages and salaries is calculated as an average salary level across the sector of $115,090 per annum.

Including the Mining Engineering, Technology and Services (METS) sector 88,000 jobs are supported by the industry in Victoria.[8] These include a range of jobs including equipment manufacturing in Melbourne, Bendigo, and Ballarat.

Regional development is critical to addressing socio economic challenges.

All Victorians benefit from gold mining through the high paying jobs and the tens of millions of dollars of goods and services purchased from supplying businesses across the state every year.

As a regional industry, mining is particularly critical to jobs and investment to support diverse regional economies. Mining projects provide economic stimulus, population growth, new infrastructure and services to regional centres.

Rural Victoria lacks economic diversity. Many areas of regional Victoria prospective for mining experience higher levels of economic disadvantage in terms of household income, disengagement with school and employment, gross regional product and population growth compared to state averages.

Mineral sands and rare earths projects are primarily in the Wimmera, Mallee and Loddon Murray regions, areas with declining populations and ageing demographics. These regions have experienced a lower Gross Regional Product (GRP), lower population growth rates over the 10 years to 2021 and have a lower percentage of people aged 15-44 than the state average.

Wimmera Southern Mallee has experienced negative GRP and population growth rates over the last 10 years.[9] Buloke, Northern Grampians, Southern Grampians, West Wimmera, Hindmarsh, and Yarriambiack recorded declines in population between 2011-2021.[10] The percentage of people aged 20 and over who did not complete year 12, and 15-19 year olds not engaged in school or employment, is significantly higher than the Victorian average in the Wimmera and Mallee.

On the industry diversity (the Herfindahl index), the Wimmera, Mallee, Great South Coast and Gippsland have a much poorer diversification score with higher industry concentration (205) than Melbourne (6).[11] The development of Victoria's resources is an important way to create economic opportunities and help reduce the increasing economic gap between regional Victoria and metropolitan Melbourne. This requires a competitive tax regime that attracts investment in this global industry.

[6] Earth Resources Regulation, 2023 Statistical Report.
[7] *Labour Force, Australia, Detailed;* Australian Bureau of Statistics, *Average Weekly Earnings, Australia, Nov 2022*, ABS cat. no. 6302.0, released on 22 December 2022.
[8] Deloitte Access Economics *Mining and METS: engines of economic growth and prosperity for Australians*, Report prepared for the Minerals Council of Australia, 2017.
[9] ibid
[10] ABS, Regional Population 2011-21: Population Change, July, 2022.
[11] RDV Regional Snapshot, viewed January 2022.

TAX AGENDA FOR REGIONAL GROWTH

Reform of Victoria's gold royalty

Recommendation: Victoria should review the gold royalty to reduce impacts on small and new mines with zero or thin profits.

Victoria's gold royalty, applied from 1 January 2020 is flawed. It was introduced without any meaningful consultation with industry or understanding of Victoria's geology and the impacts on Victoria's mines. It constituted a large new tax on a regional industry without consultation and came without warning.

The gold royalty will not meet the government's own objective of securing a sustainable revenue source to benefit the community. All states have different gold royalty regimes tailored to their gold industries. Most states tax gold at a lower rate than other commodities. This reflects the fact that gold involves higher mining and processing costs and gold is often a more marginal business compared with other minerals.

Critically, it is uncompetitive with other states and imposes regressively high tax rates on thinly profitable mines. Victoria's current gold royalty of 2.75 per cent with no deductions does not reflect the varied risk profiles and underground operations of Victoria's mines, or the need for ongoing exploration to sustain gold mines. The current structure imposes a significant tax burden on mines. The royalty creates a large tax rate of over 50 per cent on mines with thin margins.

The royalty discourages a marginally profitable mine from continuing to operate and invest and ultimately results in earlier closure. Furthermore, the royalty does not incentivise investment in smaller scale, shorter life mining projects because it applies from day one to the sales revenue. Many mining jurisdictions provide for a reduced royalty rate for new investment.

The recent large increase in payroll tax on companies makes Victoria and Melbourne less attractive for large companies to locate highly skilled and highly paid technical and professional experts such as accountants, lawyers, technology and geological experts.

The effective tax rate is higher than Western Australia (the largest gold mining state), New South Wales (which has various deductions) and other states with various offsets and royalty holidays for new mines. The 2.75 per cent royalty as applied to all commodities with no deductions (other than limited marketing costs):

- Is not tailored to Victorian gold's unique underground, exploration and processing costs or to Victoria's industry which is characterised by smaller mines
- Does not account for the ongoing major exploration costs required to sustain gold mining operations
- Takes no account for start-up mines or small mines in lean years of low gold prices.

These flaws work against smaller and start up mines and undermines ongoing exploration and reinvestment by all gold mines regardless of size. The royalty will potentially close mines earlier that they otherwise would by reducing ongoing sustaining exploration expenditure and future reinvestment in mines thereby curtailing mine life.

Victorian gold deposits are typically narrow-vein underground deposits with irregularly distributed gold. Narrow vein deposits are typically deep, difficult for mine planning and higher cost. These unique characteristics make it more difficult to 'prove' sufficient gold reserves to support a reasonable mine life and secure the necessary finance to develop a mine.

Larger, shallower and more predictable ore bodies, not typical of Victorian gold deposits, can be mined more cheaply and provide the advantage of greater grade predictability and easier extraction techniques. Victorian gold mines have short reserve lives making exploration the lifeblood of sustaining gold operations in our state.

A tax regime that is fair, does not bias against emerging mines developing into profitable, royalty paying mines and that can be reliably re-invested in, in regional Victoria is crucial.

MCA Victoria does not oppose a carefully considered gold royalty that is fit for purpose for Victoria. Modest reform to the gold royalty is required to make it more competitive with other jurisdictions and reduce impacts on small mines through:

- A built-in exploration offset to remove distortions against investing in exploration
- A royalty phase-in for start-up mines should be considered to reduce cash flow impacts in the early years of a new mine.

These changes would reduce the risk of closing mines earlier that they otherwise would, by reducing the impact of ongoing sustaining exploration expenditure and encouraging future reinvestment in mines in Victoria.

The Government's 2019 Regulatory Impact Statement (RIS) contained flawed modelling which cast doubt on the credibility and findings of the analysis and the RIS process. Analysis of the RIS by Castalia found that the 'quantitative assessment contain errors of both fact and logic', and that the 'royalty is more likely than not to have an effect on the level of activity in the sector, the total economic costs are likely to exceed benefits.' Further, the 'Imposition of a royalty in the proposed form poses a significant risk of forcing gold producers with higher production costs out of business. Exit of these companies would create adverse effects for the local economy, likely offsetting the net benefit of transfer of profits to government revenues.'[12]

The royalty as currently designed increases the risk of mines closing earlier than they otherwise could through a negative effect on investment in ongoing sustaining exploration and discouraging future reinvestment in mines in Victoria.

Regional Victorian workers, small businesses supplying goods and services, and local communities benefit from Victoria's gold mines. Without reform of the gold royalty structure, this is put at risk. A fair and genuine consultation process is critical.

To realise the benefits of mining, Victoria should look at how it can be more competitive, not impose new charges – especially on smaller mines with potential to increase production. Imposing new taxes which cruel a mine's chances of growing into a larger and more profitable operation generating greater benefits to the community, works against sharing the benefits.

In addition to risking wages and local procurement, without reform the current gold royalty will:

- Result in economically unviable projects that don't then proceed
- Cut into exploration spending which will curtail existing mine lives and impact future discoveries
- Close mines earlier than they otherwise would because as grades decline and costs increase with depth, an unsuitable royalty cuts into the cash flow needed to invest in future reserve definition and mine development.

These impacts will be significant and undermine a sustainable royalty flow over the longer term and disproportionally fall on regional Victorian communities.

ERR fees and charges

Victoria's 2014 fees and charges regime imposes high taxes on explorers. Every dollar in government fees, charges and taxes is a dollar less put into the ground in exploration.

Reform of fees and charges on exploration and resources projects must go hand in hand with proper consideration of the new royalty.

[12] Castalia Advisors. Analysis of Regulatory Impact Statement: Proposed Amendment to Mineral Resources (Sustainable Development) (Mineral Resources) Regulations 2019. Report to Minerals Council of Victoria. October 2019.

The 2014 fees and charges regime imposed fees and ‘rents’ on exploration, retention and mining licences and increased costs for exploration. A ‘rent’ charge on exploration licences was imposed setting a minimum cost of $5,000 scaling up to around $90,000 over five years depending on the area. Various new fees and charges were also imposed in 2014 on applications, variations and transfers under the cost recovery model for ERR on all industry participants.

In 2021-22 mining paid $1.2 million in regulatory charges, and $4 million in rents alone - more than double that of 5 years ago.[13] Royalties on gold are a new impost introduced on top of these charges in 2020.

Any review of the fees and charges regime that applies to Victoria’s minerals sector will require the introduction of mechanisms to ensure the cost recovery model translates into improved efficiency in regulation by ERR under the user pays system.

‘Rent’ charges on exploration licences should be reformed and reduced as a regressive tax on explorers with no income to increase incentives to invest in exploration in Victoria.

[13] Earth Resources Regulation, 2021-22 Statistical Report.

ATTACHMENT A: DETAILED PROPOSALS TO REFORM THE ROYALTY

The following proposals constitute genuine reform, are tailored to Victoria's circumstances to reduce distortions against investment and meet the basic royalty policy principles. They would help encourage exploration and development of gold deposits and improve the chance discovering and developing the 'next Fosterville' in Victoria.

A redesigned gold royalty structure that will work for Victoria

The royalty should be reformed with the following features to tailor it to Victoria's circumstances and avoid the unintended impacts of the current design in the RIS:

- *An exploration offset* to remove distortions against smaller and start up mines
- *A progressive royalty rate* structure with a gold price floor to reduce impacts on Victoria's competitiveness for global gold investment.

This royalty structure would deliver a gold royalty regime that is 'fit for purpose' for Victoria by tailoring the regime to take into account Victoria's gold deposit profile, costs and challenges. It builds in incentives to encourage exploration and maximise mine life which is critical to gold mining.

It also meets the policy aim of securing a sustainable revenue flow to the Victorian community while minimising the impacts on local investment from gold operations.

Other states have similar features in various forms to deal with the inefficiencies of royalties.

Importantly, it provides an enduring royalty system fit for Victoria's unique characteristics and avoids the need for ad-hoc special treatment for individual mines in years of low gold prices to which the current royalty structure designed for a high gold price cannot respond.

These modest changes would create a royalty regime that can weather the ups and downs of the gold price and allow smaller mines to develop into larger more profitable mines. This will help ensure Victoria benefits without risking jobs and spending in regional Victoria.

1. An exploration offset

An exploration offset would allow exploration expenditure to be deducible against a royalty liability.

An offset is the most effective way to remove distortions against ongoing exploration costs unique to gold mining and required to extend mine life.

An exploration deduction would:

- Recognise that ongoing sustaining exploration expenditure is the lifeblood of gold mines to maintain and extend mine life
- Limit the impacts of cutting back on exploration spending by start-up and smaller mines in expansion stages
- Reduce the uncompetitive nature of the royalty on all mines
- Help encourage exploration spending across the state.

Eligibility for the deduction against royalty would operate as a non-refundable offset equal to the amount of 'sustaining exploration expenditure' up to a cap to reduce revenue impacts if mines have particularly large exploration spending in any one year.

2. A progressive royalty rate structure

A tiered progressive rate structure (combined with an exploration offset) would deliver a fairer and more competitive royalty regime. It would account for Victoria's industry comprised of smaller mines as well as help limit cash flow impacts in the critical early development years of new mines.

A gold price floor below which no royalty is payable should be introduced as part of the tiered rate structure. A progressive tiered rate structure and a gold price floor would reduce the punitive impact of a royalty in lower gold price years. Other states have forms of a tiered rate structure and price floors.

3. *Maximise community benefit with funds directed locally in host communities*

Funds raised through royalties should be spent locally in host communities on social and community infrastructure to address disadvantage and improve the business environment for all industries. Expenditure should be locally driven involving councils, industry and the community.

The royalty structure proposed by the MCA Victoria would deliver a gold royalty regime that is fit for purpose for gold and for Victoria. The reforms would meet the Government's aim of securing a sustainable royalty revenue flow. Importantly, the MCA's proposed reforms create incentives to encourage exploration and maximise mine life.

The MCA reforms are carefully considered and would address the flaws with the current royalty framework.