The impact of the Resource Super Profits Tax on super fund investors

An ISN briefing note

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About Industry Super Network

Industry Super Network (ISN) is an umbrella organisation for the industry super movement. ISN coordinates collective projects on behalf of a number of industry super funds with the objective of maximizing the retirement savings of five million industry super members.

Comments to Sacha Vidler at svidler@industrysuper.com or 02 9423 2134 or Matthew Linden at mlinden@industrysuper.com or 0407430613

Key points

The Henry Tax Review recommended a single Federal resources tax to replace the complex array of State mining royalties.

There has been some commentary suggesting the announcement has impacted negatively on resource company stocks and as a consequence has impacted negatively on superannuation member balances.

An estimate of the possible short-term direct cost of the Resource Super Profits Tax (RSPT) to super fund members is surprisingly low (12 basis points), and within normal volatility generated by equities.

Any direct cost is likely to be more than offset by substantial benefits, though some of these may take time to materialise and be difficult to value.

The RSPT will make it more cost-effective for mining companies to undertake risky or high-cost projects. This is because State mining royalties are levied on production, irrespective of profitability, while the RSPT is a profit-based tax. The Federal RSPT will compensate State royalties through a rebate.

Further, while taxpayers will enjoy 40 per cent of the supernormal mining profits, they will also be liable for 40 per cent of the mining company losses from failed projects. The Government has announced it will guarantee 40 per cent of project investment costs.

Additionally, many commentators have confused the issue by depicting the planned phased increase in the Super Guarantee (SG) from 9 to 12 per cent (beginning in July 2013) as an increase in the tax or regulatory burden on businesses.

It is important to keep in mind that a higher rate of SG means a higher rate of compulsory saving by workers. The chief cost falls not on business, but on workers, who must defer additional consumption.

Of course, increasing the SG rate also has a cost to government revenue, as superannuation contributions are generally taxed at a lower rate than income. But the long-term benefit of higher super balances is lesser reliance on the age pension, and therefore lower a tax burden on businesses and individuals.

The RSPT will offset the short-term revenue costs of a higher SG, and finance the much-needed tax refund for super contributions by low-income earners. (Low income-earners currently receive a negligible or 'negative' tax concession on super contributions.)

Finally, the RSPT is likely to dampen commodity price inflation leading to a more predicable inflationary environment for business investment and facilitate a less restrictive monetary policy.

1 Estimating the direct cost of the RSPT to super fund members

The announcement on the RSPT has been digested, provisionally, by the market.

Since the Government's announcement there have been sharp falls in resource and mining stocks (ASX materials index is down around 6.5 percent), however the announcement coincided with generalised falls in equity markets and resources stocks due to contagion fears arising from the Greek debt crisis and interest rate tightening in China.

Analysis from Citigroup suggests the fall in resource and mining stocks due to the RSPT have been overplayed:

> *"We see the volatility in the market continuing, but highlight that BHP, RIO and OZL may have been sold off too hard given the likely limited RSPT impact, we reiterate our BUYS on these stocks."*[1]

The sell off of resource and mining stocks has occurred against the backdrop of sharp commodity price falls globally. Base metal prices have recently fallen dramatically, owing to uncertainty caused by contagion in the EU from the Greek sovereign debt situation.[2] Oil is also reported to have fallen sharply on similar sentiment. Citigroup analysis suggests Australian mining companies have suffered a similar fate to other mining companies globally:

> *"Whilst the Australian miners have been hit hard, so too have their global peers. ..the FTSE 350 mining index has been the hardest hit since the start of April, underperforming the Australian mining sector by c5%. On a global basis, all the big diversified miners have generally suffered the same fate with prices being down 10-20% since April, with Xstrata getting harder hit than most. Clearly the sell off in Australia has been driven by more than just the potential implementation of the RSPT and factors such as European contagion fears, Chinese property prices and RRR tightening in China may all have played their parts in the market sell off. "*[3]

Clearly the fall in mining and resource stocks cannot be solely attributed to the Government's announcement on the RSPT.

Nevertheless a provisional impact on superannuation fund assets can be estimated.

Assuming super funds are not 'overweight' in resources, the direct impact on super fund members is the product of A, B, and C (as per Table 1, below), where A is the proportion of superannuation fund assets invested in domestic equities, B is the

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[1] Citigroup Global Markets – Metals & Mining Analysis 5 May 2010 *Metals & Mining RSPT: Where To From Here, A Working Example and FAQ's*

[2] http://www.reuters.com/article/idUSLDE64416H20100505?type=marketsNews

[3] Citigroup Global Markets – Metals & Mining Analysis 5 May 2010 *Metals & Mining RSPT: Where To From Here, A Working Example and FAQ's*

proportion of equities in the market directly affected by the RSPT, and C is the amount this group of stocks have fallen over and above the fall on the market excluding those stocks.

Table 1. Key values in impact assessment:

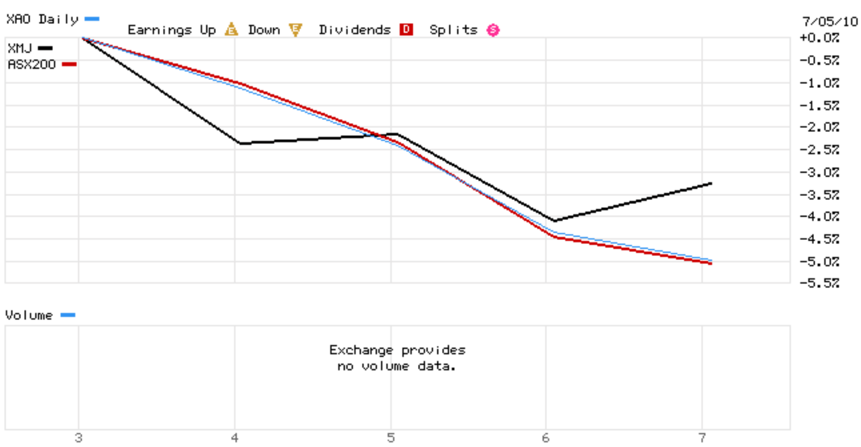
	A	B	C
	Proportion of Super fund assets in domestic equities	Proportion of ASX S&P 200 in materials	Since announcement, reduction in ASX 200 stocks attributable to the materials ASX S&P 200 stocks
Value	31%	24%	-1.55%
Date	6/2009	5/5/2010	6/5/2010
Source	Chant West	Standard & Poors	Australian Securities Exchange / Standard & Poors

Since May 1 2010 the ASX S&P 200 has fallen 4.75%. Over the same period the ASX S&P 200 materials index has fallen 6.5%. With the materials index comprising 24% of the broader ASX S&P 200 the weighted contribution of materials sector to the overall fall in the ASX S&P 200 is -1.55%

The product of A, B, and C is 0.12% of total superannuation assets as at 6 May 2010. Or for a member with a balance of $50,000 it amounts to a variation of $57 on their fund balance.

Such an impact is within normal volatility of equities. Indeed as at noon 7 May 2010, the ASX S&P 200 index had fallen to a greater extent than the ASX S&P materials index since the start of the trading week – suggesting the impact of the RSPT on the materials sector is negligible relative to other market factors (see chart below)

Chart 1 ASX All Ordinaries, ASX S&P 200 and ASX S&P 200 Materials Indices (XMJ) trading week to 7 May 2010[4]



[4] Source ASX

Finally, it is worth noting that takeover interest in Australian resource companies remains strong. For example, Peabody Energy have confirmed their bid for Macarthur Coal remains on the table[5] and JP Morgan have in the wake of the RSPT announcement taken a 10 per cent stake of Centennial Coal – sending shares up 20 per cent.[6]

2 Offsets to the direct cost

The direct costs to super fund members of the RSPT are offset by a number of benefits.

2.1 An additional lever to help manage the two-speed economy

The economy is in danger of overheating, mostly due to the developing resources boom. The pre-GFC resources boom resulted in policy interest rates being driven to 7.25 per cent per annum.

Hosing the current boom down with monetary policy, which the RBA will be forced to do unless other action is taken, will result in the rest of the economy – businesses and families – being soaked, if not washed away in the flood.

Financial risks on the global stage remain very high. A douple-dip financial crisis looms as a distinct possibility, which emphasises the importance of maintaining neutral monetary policy if demand and wages growth can be constrained.

In this context, a discretionary industry-specific brake on the resources sector is an attractive policy lever to smooth the income gains from the commodity boom. The mining industry might see the tax as a club rather than a scalpel, but monetary policy is the 'nuclear option' by comparison, impacting on all industries and all regions. Indeed, the impact of contractionary monetary policy on demand will be more profound on employers and workers in marginal industries, particularly agriculture and manufacturing.

The geographic impact of monetary policy is also unfortunate, impacting most heavily on mortgage belt urban fringes.

2.2 Other impacts of the RSPT

The direct cost to super fund members will also be offset by:

1. increased Government services that the resources tax fund; and/or
2. lower personal taxes;
3. lower cost goods due to lower corporate taxes; and
4. increased super returns due to increased after tax corporate profits due to reduced corporate taxes.

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5 http://www.theaustralian.com.au/business/news/peabody-vice-president-says-the-macarthur-bid-will-continue-despite-proposed-mining-tax/story-e6frg90x-1225862905901

6 http://www.theaustralian.com.au/business/city-beat/jp-morgan-snaps-up-10pc-of-centennial-coal/story-fn4xq4cj-1225862972285

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Chant West (2009) http://www.chantwest.com.au/PDFFiles/Chant%20West%20Media%20Release%20-%20June%202009%20Performance%2022Jul09.pdf

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Yahoo finance (6/5/2010) http://au.finance.yahoo.com/q/bc?s=^AXMJ&t=5d&l=on&z=l&q=l&c=^AORD