Beijing bureaucrats cast eyes over tax plan

Opinion: 17-June-10 by Tim Treadgold

CITIC Pacific Minerals, a very Chinese company, is spending $5.2 billion building an iron ore processing facility on Western Australia's north-west coast – and might be perfectly happy to never make a profit from that enormous investment.

In fact, if the accountants at CITIC are smart, they might even run the 6 million tonne-a-year magnetite project at a loss, and claim a tax refund sometime in the future from the Australian government.

The reason for this bizarre situation, where a loss makes more sense than a profit, is courtesy of Australia's proposed new super tax on mining profits.

The CITIC example is purely hypothetical, but it is the most graphic illustration of what can happen when the potential for 'tax arbitrage' is created – precisely the situation emerging in Australia.

The game goes like this.

A foreign steel mill, or commodity trading company, owns a mine in Australia and a processing facility overseas.

The tax rate on mining profits in Australia is 58 per cent. The tax rate where the final mineral processing takes place is 20 per cent.

For management, this represents an incentive to minimise profits in high-taxing Australia, and maximise profits in the low-tax country.

The Australian Tax Office is fully aware of this game, known as transfer pricing, and views it very dimly.

But the challenge for the chaps from the ATO is to get deep inside the internal accounting processes of a wholly foreign-owned business, especially one that disappears inside a company ultimately answerable to the Chinese government.

It's actually even worse than that because since the infamous Rio Tinto case of a few months ago, which led to the jailing for four executives for alleged bribery, it is virtually impossible to know what might be deemed a state secret in China.

If demand for iron ore fell into the 'secrets' category then surely tax matters are an even more closely guarded secret.

Whatever the final outcome in Australia's great mining tax debate, and that seems to be very fluid today, there is absolutely no doubt in Bystander's mind that every foreign company working in Australia today is running the numbers to see how it can cut its tax obligations here – while every Australian mining company looks at ways of doing business in a lower-tax country.

In time the game of tax arbitrage, especially if Australia remains the high-tax shag on a rock, will have a severely distorting effect on business, with companies going to great lengths to dodge Australia. They'll do business here, but they'll seek to pay tax elsewhere.

Relocating the head office is an easy move for a company with factories around the world. It's harder with a mine, but there are techniques, especially if the foreign company involved is both the miner and the consumer of a particular mineral, such as iron ore.

Given that the ultimate owner of every Chinese company is the Chinese government, that means the people most closely studying Australia's new mining super tax are probably not in Perth, Sydney or Melbourne. They're in **Beijing**.

If there is a simple way of understanding Australia's mining tax mess it is to consider it an example of what happens when you try to force a large industry into an academic tax package – rather than wrap the tax package around the industry.

Overstimulated

ANOTHER example of disconnection is the way global financial markets appear to have disconnected from the underlying economy.

This separation was first noted early last week when rapid economic growth was reported in Germany and Brazil, followed by Australia's lower-than-expected unemployment rate, optimistic forecasts for Europe despite the near-bankruptcy of the Club Med countries, and confirmation that China's growth is not slowing, yet.

For a few days, as the good news flowed from the 'high street' retailing and factory production, there was continued gloom on 'main street' where stock market and commodity prices continued to fall.

As any good scientists might ask: why is this so?

How can financial markets, which are almost totally dependent on the underlying economy, be falling when the economy is said to be rising.

The answer, unfortunately, is government. Or, to be more precise, too much government with an alarming amount of the good economic news attributed to government spending and government job creation schemes.

True believers in a socialist approach to running a country will say that government jobs and government spending is not a bad thing. Others, including Bystander, will dismiss that as utter rubbish because more government jobs mean higher taxes and a continued stifling of the private sector.

Lasting recovery will only come when artificial government stimulus ends and business gets back to business. Stimulus played a role in saving the world from disaster. It is now a reason to worry about a double-dip downturn because the only way it can continue is by levying ever-higher taxes – such as what's happening to mining in Australia.

Language barrier

STICKING with this week’s theme of disconnection, it has been truly remarkable to follow the mining tax debate and wonder whether either side understands what the other is saying. It has almost been a case of listening to people speaking difficult languages; the prime minister in Mandarin and Andrew Forrest in English.

There is a reason for this. Mr Rudd is actually speaking politics. Mr Forrest is speaking money.

Traditionally, a mix of money and politics is a deadly combination. Just as WA’s disgraced former premier, Brian Burke, or his one-time business colleague, Alan Bond, discovered in the 1980s.

The danger for WA is that the more our super-rich miners, such as Mr Forrest and Gina Rinehart, rear their heads in the political debate, the greater the chance that they will become political cannon fodder in the tax debate.

Love them dearly, but there is something unsightly about Mr Forrest and Ms Rinehart trying to run a political rally. They have nothing in common with the average voter and their recent publicity stunts are likely to do more harm than good to the anti-tax campaign.

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