

THE MRRT CHALLENGE AND IMPLICATIONS FOR FEDERALISM IN AUSTRALIA

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I INTRODUCTION

On 22 June 2012 iron ore mining company Fortescue Metals Group Limited ('FMG') and related companies filed a Writ of Summons and Statement of Claim in the High Court challenging the Commonwealth Government's newly introduced *Minerals Resource Rent Tax Act 2012* (Cth) ('MRRT Act') and various Acts imposing the MRRT Act ('Imposition Acts') on constitutional grounds.¹ The MRRT Act came into effect on 1 July 2012 and imposes a Minerals Resource Rent Tax ('MRRT') on 'super profits' made in the mining and sale of the 'taxable resource' – namely coal and iron ore.² FMG allege the MRRT Act and Imposition Acts (collectively 'the Acts'); discriminate between the States contrary to the *Constitution* s 51(ii), curtail State sovereignty, give preference to one State over another contrary to the *Constitution* s 99 and restrict a State's ability to encourage mining contrary to the *Constitution* s 91.³ Accordingly they consider the Acts are not valid laws of the

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¹ Corrs Chambers Westgarth Lawyers, *Writ of Summons* (22 June 2012) <<http://resources.news.com.au/files/2012/06/22/1226405/873033-aus-file-writ.pdf>>.

² *Minerals Resource Rent Tax Act 2012* (Cth) ('MRRT Act').

³ Corrs Chambers Westgarth Lawyers, *Statement of Claim* (22 June 2012) <<http://resources.news.com.au/files/2012/06/22/1226405/873033-aus-file-writ.pdf>>; Fortescue Metals Group Limited, *Minerals Resource Rent Tax: Fortescue Launches*

Commonwealth and seek declarations that sections which impose the tax are not valid laws or alternatively that the Acts have no valid application on iron ore mining in Australia.⁴ The Commonwealth believes the Acts are constitutionally valid and they are simply exercising their taxation powers as per the *Constitution*.⁵ This essay will outline and elaborate on the four grounds of challenge stated above, argue the challenge has low prospects of succeeding, and discuss the predominant implications of concern for federalism in Australia.

II POTENTIAL GROUNDS OF CHALLENGE AND PROSPECTS OF SUCCESS

FMG are challenging the Acts on four constitutional grounds which will be discussed below. They also considered a fifth ground; the Acts conflict with the *Constitution* s 114 which prescribes that the Commonwealth cannot 'impose any tax on property of any kind belonging to a State'.⁶ This ground was not pursued as they considered they would be unsuccessful given the careful drafting of the Acts by the Commonwealth to contort the legislation so that it avoids contravening s 114.⁷

Constitutional Challenge to MRRT (22 June 2012) <http://www.fmgl.com.au/investors_and_media/Minerals_Resource_Rent_Tax>.

⁴ Ibid.

⁵ Email from Australian Government Treasury (Resource Taxation Unit) to Unknown, 7 November 2011, 1 <<http://treasury.gov.au/Access-to-Information/DisclosureLog/2012/Constitutional-legality-of-the-MRRT-tax-and-the-PRRT>>.

⁶ Peter Huston, Peter Meurs and Julian Tapp, 'Fortescue Press Conference' (Press Conference, 22 June 2012) <<http://www.abc.net.au/site-archive/rural/news/content/201206/s3531248.htm>>.

⁷ Ibid.

A *Discrimination Between States*

The first ground of challenge is that the Acts discriminate between the States in conflict with the *Constitution* s 51(ii).⁸ This section of the *Constitution* gives the Commonwealth power to legislate in relation to taxation provided it does not discriminate between the States.⁹ The *Constitution* gives States power to collect royalties in relation to their assets and property, in this case in relation to minerals located within their State.¹⁰ Various legislation has been enacted by the States to enable the levying and adjustment of such royalties.¹¹

The MRRT provides a mechanism whereby the Commonwealth credits a mining company ('miner') with any royalties paid to a State against any MRRT liability.¹² Given different royalty rates are payable in different States, the MRRT payable by a miner in one State will differ from that in another. Furthermore if a State decides to increase, decrease, graduate, exempt or defer royalty payments, a miner in that State will be liable to pay a higher or lower amount of MRRT than otherwise would be the case and relative to a similar company with the same production in another State, all other things being equal. For these reasons, FMG argue the Acts discriminate between the States.

Prospects of success under this ground are low. In refuting the assertion of discrimination the Commonwealth will likely argue the Acts simply

⁸ Corrs Chambers Westgarth Lawyers, *Statement of Claim*, above n 3; Fortescue Metals Group Limited, above n 3.

⁹ *Commonwealth of Australia Constitution Act* s 51(ii) ('*Constitution Act*').

¹⁰ *Constitution*; John Freebairn and John Quiggin, 'Special Taxation of the Mining Industry' (2010) 29 *Economic Papers* 384, 394.

¹¹ See, eg, *Mining Act 1978* (WA); *Mineral Resource Act 1989* (QLD).

¹² *MRRT Act* div 10-5; Lindsay Hogan, 'Non-renewable Resource Taxation: Policy Reform in Australia' (2012) 56 *Australian Journal of Agricultural and Resource Economics* 244, 247.

take the States royalties as they find them with varying rates and different methods of calculation.¹³ Any difference of MRRT payable between the States, for an equivalent circumstance, is a product of the different royalty regimes and not a product of the Acts.¹⁴

Taylor J stated in *Conroy v Carter*¹⁵ ‘...a law with respect to taxation cannot, in general, be said so to discriminate if its operation is general throughout the Commonwealth even though, by reason of circumstances existing in one or other States, it may not operate uniformly.’¹⁶ Whilst the MRRT payable may vary depending on the level of royalty this does not amount to discrimination. It is essentially no different to a tax deduction say the cost of labour inputs varying between the States for ordinary company tax.

B *State Sovereignty*

The second ground is the Acts curtail State sovereignty in conflict with the *Melbourne Corporation* principle.¹⁷ This constitutional law principle implies that the Commonwealth cannot introduce laws that discriminate against States or restrict control and/or function of the States.¹⁸

States can increase, decrease, graduate, exempt or defer royalty payments to encourage or discourage certain outcomes such as economic

¹³ Email from Australian Government Treasury (Resource Taxation Unit) to Unknown, 7 November 2011, 1 <<http://treasury.gov.au/Access-to-Information/DisclosureLog/2012/Constitutional-legality-of-the-MRRT-tax-and-the-PRRT>>.

¹⁴ Ibid.

¹⁵ (1968) 118 CLR 90.

¹⁶ *Conroy v Carter* (1968) 118 CLR 90, 101.

¹⁷ Corrs Chambers Westgarth Lawyers, *Statement of Claim*, above n 3; Fortescue Metals Group Limited, above n 3; Huston, Meurs and Tapp, above n 6.

¹⁸ *Melbourne Corporation v Commonwealth* (1947) 74 CLR 31; Anne Twomey, ‘Federal Limitations on the Legislative Power of the States and the Commonwealth to Bind One Another’ (2003) 31 *Federal Law Review* 507, 508–9.

development, mineral production, mineral sales, mining investment, stimulating one mineral over another and competitiveness with other States and even Countries.¹⁹ Given a miner is credited back royalties paid to the State by the MRRT (when in ‘super profit’), essentially they will remain in a similar position regardless of alteration of royalties by a State. As such the Acts curtail a State’s ability to use royalties to send the above listed economic signals and therefore their sovereignty.

This is the stronger ground but still difficult to sustain. To be found constitutionally invalid the Acts must destroy or impair the States existence or functioning.²⁰ This appears a high threshold. Whilst the MRRT potentially does curtail a State’s ability to use royalties as an economic signal, arguably in practice it would not be sufficiently significant. Given the ‘super profit’ threshold and the other adjustment mechanisms in the MRRT (treatment of capital, valuations and the like)²¹ other miners, even in the same State, may well not have to pay the MRRT during the same time frame and therefore will still pay the royalty. Early indications appear that few miners, if any, will have a MRRT liability even in the recent period of relatively high iron ore and coal prices.²² Accordingly the practical impact, if any, is not substantial enough to ‘destroy’ or ‘impair’ and therefore not sufficiently material to discriminate or undermine the State’s sovereignty.

¹⁹ Corrs Chambers Westgarth Lawyers, *Statement of Claim*, above n 3.

²⁰ *Queensland Electricity Commission v Commonwealth* (1985) 159 CLR 192, 217 (‘*Queensland Electricity Commission*’); *Re Australian Education Union; Ex parte Victoria* (1995) 184 CLR 188, 231 (‘*Australian Education Union*’).

²¹ *MRRT Act*.

²² BDO Corporate Tax Pty Ltd, Submission to Senate Standing Committee, Parliament of Australia, 21 December 2011; Huston, Meurs and Tapp, above n 6.

C *Preference to One State Over Another*

The third ground is the Acts give preference to one State over another conflicting with the *Constitution* s 99.²³ This section prohibits the Commonwealth introducing laws or regulations relating to trade, commerce or revenue that give preference to one State over another.²⁴

This is a very similar argument to the discrimination/sovereignty argument in Part II(B) above however the negative effect here is one State is preferenced over another. All other things being equal, a miner in a State that imposes a higher royalty rate will pay less MRRT so is preferenced over the equivalent circumstance in another State that pays a lower royalty. The cumulative effect of this preference may be a significant preference towards the higher royalty State.

As an example – the same company mining iron ore in two States deciding where to allocate resources. Prior to the MRRT the more likely option would be to allocate resources to the State that imposes a lower rate of royalty. Subsequent to the MRRT's introduction the mining company could consider the State that imposes a higher royalty rate the more favourable option given they will be paying less MRRT and will be credited royalties. Therefore the MRRT has a greater impact upon the State that imposes lower royalties and it could be said that the MRRT prefernces a State that imposes higher royalties.

This ground of challenge is unlikely to succeed for the same reasons outlined above in Part II(A). Any inequality between MRRT payable by miners in different States is a product of the differing royalty regimes in

²³ Corrs Chambers Westgarth Lawyers, *Statement of Claim*, above n 3; Fortescue Metals Group Limited, above n 3.

²⁴ *Constitution* s 99.

each State and not the Acts. The MRRT does have an equalising effect in some circumstances but this is unlikely to be accepted as so substantial as to amount to preferencing one State over another.

D *Aid and Bounty*

The fourth ground is the Acts restrict a State's ability to encourage mining conflicting with the *Constitution* s 91.²⁵ Section 91 establishes that States can grant aid to or a bounty on mining.²⁶ This argument is very similar to discrimination/sovereignty in Part II(B) above. The effect of decrease or exemption of royalties by a State to aid a miner is diluted because the MRRT payable by the miner increases so they pay a similar net amount. Therefore States ability to adjust royalties as an economic stimulus is diminished.

Prospects of success can be argued in the same way as in Part II(B) above. Using royalties to encourage mining is a subset of sovereignty. For a successful outcome it must be demonstrated that the MRRT will 'destroy' or 'impair' the States existence or functioning.²⁷ For reasons stated above, in practice the MRRT will unlikely be sufficiently material to meet this test.

III IMPLICATIONS FOR FEDERALISM IN AUSTRALIA

'Federalism' describes a system where governmental power is shared between a central or federal government having power over the whole country, and regional governments having power over their respective

²⁵ Corrs Chambers Westgarth Lawyers, *Statement of Claim*, above n 3; Fortescue Metals Group Limited, above n 3.

²⁶ *Constitution* s 91.

²⁷ *Queensland Electricity Commission* (1985) 159 CLR 192, 217; *Re Australian Education Union* (1995) 184 CLR 188, 231.

regions.²⁸ Australia implemented a federal system by creating the Commonwealth and various State Governments.²⁹ The drafters of the *Constitution* outlined the specific powers of the Commonwealth and left all other powers to the States.³⁰

The balance of power between the Commonwealth and States is critical, and in particular the decentralisation of power where the sovereign States are autonomous and hold all powers other than those that are necessary to be held by the central government.³¹ Benefits include; greater protection of citizens' rights,³² laws suited to local needs, which often results in greater citizen satisfaction,³³ and competition between the States which results in other States adopting models or parts of models that work well.³⁴ The more centralised power becomes, the less efficient our federal model operates.³⁵

It could be argued taxing miners' profits is merely a revenue raising exercise for the Commonwealth, they are not seeking to control how the profit is made or how the companies operate, and therefore there are no implications for federalism. However this is taken a step further given the MRRT will credit miners for any State royalties (assuming in super profits). Royalties influence on miners' production decisions will be diminished, as discussed above. In respect of government take they will also look to the Commonwealth. The Acts have the effect of at least

²⁸ *LexisNexis Concise Australian Legal Dictionary* (LexisNexis Butterworths, 4th ed, 2011).

²⁹ Robert Carling, 'First Principles' (2012) 28(2) *Policy* 8, 9.

³⁰ *Ibid.*

³¹ Kenneth Wiltshire, 'Australia's New Federalism: Recipes for Marble Cakes' (1992) 22 *Publius* 165, 166.

³² James Allan, 'The Case for Federalism' (2012) 28(2) *Policy* 14, 15.

³³ *Ibid* 14.

³⁴ *Ibid* 16.

³⁵ *Ibid.*

partially centralising decisions over iron ore and coal mining that used to solely be dealt with by the States. Those benefits of decentralisation listed above are now slightly diminished.

Another essential feature of federalism is the sovereignty of the Commonwealth and State Governments.³⁶ By imposing the Acts the Commonwealth is not directly collecting and taking away revenue (royalties) generated by the States as the States are free to charge and indeed change royalties. These are paid by the miners but credited by the Commonwealth through the MRRT mechanisms. As per the discussion in Part II(B) above there is a marginal undermining of State sovereignty.

However press reports indicate the Commonwealth has also threatened to offset any royalty increases against GST distributions and/or Commonwealth grants for capital spending on infrastructure and the like.³⁷ Evidence of this would amount to a greater undermining of State sovereignty. It would have been more consistent with Australia's federalism for the Commonwealth to have negotiated an agreement with the States for a MRRT to completely replace royalties with a guaranteed redistribution via grants and the like to each of the States prior to legislating. Over time the Commonwealth has incrementally assumed responsibility for functions previously controlled by States, sometimes by agreement and sometimes not.³⁸ For reasons outlined above the MRRT is another example without agreement. Perhaps no single example is fundamental to Australian federalism however cumulatively the arguments that the advantages are being lost become compelling.

³⁶ Robert Carling, above n 29, 9.

³⁷ 'Wayne Swan 'bullying' states over MRRT: Colin Barnett', *PerthNow* (online), 22 August 2012 <<http://www.news.com.au/national/wayne-swan-bullying-states-over-mrrt-colin-barnett/story-fndo4e3y-1226455705635>>.

³⁸ Robert Carling, above n 29, 10.

IV CONCLUSION

FMG's challenge of the Acts on four constitutional grounds is unlikely to succeed. The strongest ground of challenge appears to be the potential curtailment of State sovereignty as theoretically some impediment may be demonstrated. Whether this is material in practice is likely to be the question.

In the likely event the challenge does fail, FMG along with other miners will be liable to pay the MRRT.³⁹ However, early indications appear that few miners, if any, will have a practical liability due to the way the MRRT is calculated.⁴⁰ It seems improbable that a complex and inefficient tax that raises little revenue for the Commonwealth will not ultimately be resolved at a political level.

The Acts also impact upon essential features of federalism in Australia. By crediting back to miners any royalties paid (when in 'super profit') the effectiveness of royalties as being a tool for States to influence miners is diminished. Arguably it centralises power and affects State sovereignty, however only marginally.

V POSTSCRIPT

Since the time of writing, on 7 August 2013 the Full Court of the High Court of Australia unanimously dismissed FMG's (together with the States of Western Australia and Queensland intervening in support) proceedings therefore deciding the Acts are constitutionally valid.⁴¹ In lengthy reasoning several judges traversed the history of the relevant

³⁹ *MRRT Act*.

⁴⁰ BDO Corporate Tax Pty Ltd, above n 22; Huston, Meurs and Tapp, above n 6.

⁴¹ *Fortescue Metals Group Ltd v Commonwealth* [2013] HCA 34.

sections of the *Constitution* and similar Articles in the *United States Constitution* back to drafting stages and discussed the significant superior court decisions over time.⁴²

The grounds of challenge relating to the *Constitution* ss 51(ii) and 99 (discussed above in Parts II(A) and (C)) failed as the Court found the Acts did not discriminate between the States or give preference to one state over another.⁴³ The High Court held that the Acts, of themselves, are uniform in their prescription and different outcomes are appropriate and adapted to a proper objective or resulting from different circumstances in different States (that is, State royalty schemes).⁴⁴ Therefore they were found not to amount to ‘discrimination’ or ‘preference’ as defined in the *Constitution*.⁴⁵

The Full Court also rejected arguments relating to the *Constitution* s 91 and the *Melbourne Corporation* principle (discussed above in Parts II(B) and (D)) as the Acts are directed at the Mining Companies not the States, and do not impede on the functioning of the States.⁴⁶

As anticipated all arguments put forward by FMG found little favour as evidenced in the reasons and by the unanimous decision to reject.⁴⁷ It was considered above, whilst unlikely to succeed, the strongest argument may be the ground relating to the *Melbourne Corporation* principle (Part II(B) above). However the Court did not spend much time on this ground in rejecting it.⁴⁸ Rather they spent a lot of time considering the ground

42 Ibid.
43 Ibid.
44 Ibid.
45 Ibid.
46 Ibid.
47 Ibid.
48 Ibid.

relating to s 51(ii) (Part II(A) above).⁴⁹ It would appear the Court considered this was the stronger of the failed arguments.⁵⁰

⁴⁹ Ibid.

⁵⁰ Ibid.