Parliament of Australia
Parliamentary Budget Office

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Senator Christine Milne
Leader of the Australian Greens
Parliament House
CANBERRA ACT 2600

Dear Senator Milne

Please find attached a response to your costing request, *Abolishing fossil fuel subsidies* (letter of 14 August 2013).

The response to this request will be released on the PBO website (www.aph.gov.au/pbo).

If you have any queries about this costing, please do not hesitate to contact Colin Brown on (02) 6277 9530.

Yours sincerely

Phil Bowen
21 August 2013

COSTING – ELECTION CARETAKER PERIOD

Name of proposal:	**Abolishing fossil fuel subsidies**
Summary of proposal:	The proposal would abolish: • fuel tax credits (FTCs) for the mining industry (FTCs replaced the diesel fuel rebate from 1 July 2006), • accelerated depreciation tax concessions for aircraft, the oil and gas industry and vehicles (except those used for agricultural purposes), and • immediate deductions in the mining industry relating to exploration and prospecting. The intention of the proposal is to remove a distortion in the tax system favouring some industries over others and raise revenue to be invested in the industries of the future. The proposal would have effect from 1 January 2014.
Person/party requesting costing:	Senator Christine Milne, Australian Greens
Date costing request received:	14 August 2013
Date costing completed:	21 August 2013
Date of public release of policy:	14 July 2013
Agencies from which information was obtained:	Not applicable

Costing overview

This proposal is expected to increase the underlying cash balance by $10.50 billion and increase the fiscal balance by $10.85 billion over the 2013-14 forward estimates period. This impact reflects: an increase in revenue from abolishing accelerated depreciation and exploration tax concessions for the mining industry, a reduction in expenditure from abolishing fuel tax credits (FTCs) for mining companies and an offsetting decrease in company tax and minerals resource rent tax (MRRT) arising from increased fuel costs associated with abolishing FTCs.

This costing includes a number of components. A detailed breakdown of the components of this costing is included at Attachment A.

The underlying cash balance impact of this proposal differs from the fiscal balance impact because of the difference between the timing of accrual and cash expenses related to the FTC component of the costing.

This proposal will have an ongoing impact that extends beyond the forward estimates period.

Departmental expenses are not expected to be significant and have not been included in this costing.

This costing is considered to be of low reliability as it is based on a number of assumptions and projected aggregate data.

Table 1: Financial implications (outturn prices)[(a)]

Impact on:	2013-14	2014-15	2015-16	2016-17
Underlying cash balance ($m)	1,000	2,850	3,250	3,400
Fiscal balance ($m)	1,350	2,850	3,250	3,400

(a) A positive number for the fiscal balance indicates a decrease in expense and an increase in revenue in accrual terms. A positive number for the underlying cash balance indicates a decrease in expenditure and an increase in revenue receipts in cash terms.

Key assumptions

General assumptions

- The proposal would have effect from 1 January 2014.
- Estimates have been rounded to the nearest $50 million.

Assumptions relating to the abolition of fuel tax credits for the mining industry

- Currently entities in the mining industry are able to claim FTCs for fuel they use, as follows:
  - an FTC equal to the full excise paid on eligible fuel is available for fuel used in off road applications, and
  - a part FTC, equal to the excise paid less a road user charge (RUC) is payable in respect of fuel used on road in transport vehicles with greater than 4.5 tonnes gross vehicle mass (GVM).
- From 1 July 2012, FTCs for off road use of fuel used (inter alia) in the mining industry have been reduced by an amount equal to the charge imposed by the carbon pricing mechanism (CPM) on the fuel concerned. Companies are able to elect to receive a full fuel tax credit and to pay their CPM liabilities relating to eligible fuel use through the CPM. Similar arrangements will apply to the heavy on road transport sector from 1 July 2014, including heavy on road transport used in the mining sector.
  - The costing assumes that, if eligibility for FTCs is removed from the mining industry, mining companies will lose FTCs equal to the full excise of 38.143 cents per litre (cpl) (or 38.143cpl less the RUC for fuel used on road after 1 July 2014).
- FTCs currently reduce the expenses entities are able to claim for their fuel for both company tax and the minerals resource rent tax (MRRT). Abolishing FTCs for mining entities would increase the deductions claimed by mining companies for both these taxes. As the MRRT is a deductible expense for company tax purposes, this impact compounds over both taxes.
  - This costing uses the current company tax rate of 30 per cent and the current effective MRRT rate of 22.5 per cent.
  - The modelling takes account of the FTCs being deductible for both MRRT and company tax purposes.

- The costing assumes that there would be no behavioural change in response to the proposal, with the result that the level of mining activity and fuel consumption remains unchanged as a result of the proposal.

Assumptions relating to the abolition of accelerated asset depreciation and abolition of immediate deductions for exploration and prospecting

The costing assumes that there is no behavioural response to removing the accelerated depreciation provisions, for instance through reducing expenditure on the assets concerned.

The PBO has made the following assumptions in calculating the estimated impact of removing the accelerated depreciation tax concessions:

- Where there are varying safe harbour effective lives for the same category of asset, an average was taken to arrive at the safe harbour asset life.
- The average marginal tax rate for individual taxpayers is 33 per cent.
- Assets are assumed to be purchased throughout the year.
- Taxpayers are assumed to utilise deductions associated with aircraft, the oil and gas industry and vehicles according to the following profile:
  - 75 per cent are taxable in the year they purchase the depreciable assets
  - 15 per cent become taxable in the year after they purchased the asset, and
  - 5 per cent become taxable two years after they purchased the asset.
- Some of the increase in tax from companies arising from the proposal is clawed back through increased imputation credits being available in relation to dividends paid to shareholders.
- Estimates have been rounded to the nearest $50 million.
- Approximately 10 per cent of vehicles were considered to be used for agricultural purposes and were not included in the costing.
- Taxpayers are assumed to utilise deductions associated with exploration and prospecting according to their taxable/non-taxable status. In aggregate, 50 per cent of affected taxpayers are taxable each year.
- Exploration and prospecting assets are assumed to have a 15 year effective life under the proposal.

Methodology

Methodology for costing the abolition of fuel tax credits for the mining industry

The costing has been performed using an aggregate analysis, based on total FTCs paid to the mining industry. This is a “tops down” approach, using actual payment data and will include the effect of factors such as the take up rates for FTCs that were applicable in the period from which the data are drawn. The impact of the proposal was calculated as follows:

- Total FTCs payable in 2011-12 to the mining industry were obtained from the Australian Taxation Office (ATO) taxation statistics and projected out over the forward estimates using the growth rate in the budget data for diesel fuel excise.

- The FTC data was decomposed into 'on road' and 'off road' components using historical data from the Energy Grants Credit Scheme.

- The impact of FTCs on the MRRT and company tax payable by mining companies was estimated by calculating the combined change in the value of deductions for fuel for that part of the mining industry estimated to be subject to MRRT, and the change in the value of company tax deductions for the remainder of the mining industry.

- Timing assumptions on the frequency of FTC payments through the Business Activity Statement (BAS) system were made to determine the impact of the proposal on an underlying cash balance basis.

Growth rates in the model are based on the growth rates for diesel fuel excise reported in *2013 Pre-Election Economic and Fiscal Outlook* report. The road user charge (RUC) used to calculate 'on road' FTCs was grown in the projection period at the average of annual growth rates for the period 2008-09 to 2013-14.

Timing assumptions on the frequency of FTC payments through the BAS system were made to determine the impact of the proposal on an underlying cash balance basis.

Methodology for modelling the abolition of accelerated asset depreciation and the abolition of immediate deductions for exploration and prospecting

The abolition of immediate deductibility of exploration and prospecting has been modelled in the same manner as the removal of accelerated asset depreciation.

The impact of this proposal was estimated by calculating the impact of total depreciation deductions expected under the proposal over the forward estimates period less the impact of total depreciation deductions currently expected over the forward estimates period.

Company tax timing assumptions which allow for the impact of companies with substituted accounting periods were used in this costing.

Data sources

- ATO Taxation Statistics 2011-12, detailed tables from the ATO website www.ato.gov.au.

- Fuel excise data from the *2013 Pre-Election Economic and Fiscal Outlook* report.

- FTC estimates from the 2013-14 Budget Paper No. 1.

- ATO data on business depreciating asset expenditure was obtained from the Treasury.

ATTACHMENT A: DETAILED BREAKDOWN OF THE COSTING

This attachment provides a breakdown of the financial implications of the proposal.

Table A1: Financial implications – Fiscal balance ($ million)

	2013-14	2014-15	2015-16	2016-17
Revenue impact				
Remove accelerated depreciation for mining companies[a]	..	250	700	800
Remove immediate deduction for exploration and prospecting[a]	100	650	1050	900
Company tax and MRRT impact from abolishing FTCs for mining companies[a]	-	-550	-1050	-950
Total	***100***	***350***	***700***	***750***
Expense impact				
Abolish FTCs for mining companies[a]	1,250	2,500	2,550	2,650
Total	**1,350**	**2,850**	**3,250**	**3,400**

a) A positive number for the fiscal balance represents an increase in revenue or a decrease in expenses. A negative number for the fiscal balance represents a decrease in revenue or an increase in expenses.

“..” means not zero but rounded to zero.

Table A2: Financial implications – Underlying cash balance ($ million)

	2013-14	2014-15	2015-16	2016-17
Revenue impact				
Remove accelerated depreciation for mining companies[a]	..	250	700	800
Remove immediate deduction for exploration and prospecting[a]	100	650	1,050	900
Company tax and MRRT impacts from abolishing FTCs for mining companies[a]	-	-550	-1050	-950
Total	***100***	***350***	***700***	***750***
Expense impact				
Abolish FTCs for mining companies[a]	900	2,500	2,550	2,650
Total	**1,000**	**2,850**	**3,250**	**3,400**

a) A positive number for the fiscal balance represents an increase in receipts or a decrease in outlays. A negative number for the underlying cash balance represents a decrease in receipts or an increase in outlays.

“..” means not zero but rounded to zero.