



RESEARCH NOTE

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Petroleum Resource Rent Tax (PRRT)

Over the past year or so, petrol prices have risen sharply with the price of unleaded petrol in Sydney, for example, about 23 per cent higher in September 2000 than a year before. While this is largely explained by the rapid increase in world oil prices and depreciation of the Australian dollar against the US dollar, public comment has focused on the tax component of fuel prices with calls to reduce taxes to offset international price pressures. Advocates of cuts point to the fact that taxes account for about 44 cents of the price of a litre of petrol.

To assist Parliamentarians improve their understanding of fuel tax mechanisms and policies, the IRS recently published a paper dealing with petrol and diesel excise, these being the most sizeable taxes. This Research Note complements this paper and deals with the second largest impost, the petroleum resource rent tax (PRRT).¹

Economic rent and the threshold rate

The PRRT is a Federal tax on 'economic rent'. Rent is a payment to a factor of production, such as labour, that exceeds the amount necessary to keep that factor in its current occupation. For example, if a person receives a salary of \$50 000 but would earn \$40 000

in the next best alternative employment, the person receives rent of \$10 000.

As applied to petroleum production, investors require a certain rate of return to undertake a project. A return above this threshold rate would result in the investors receiving rent. The PRRT applies to the return after all costs associated with exploration, development and production have been deducted. The PRRT is thus tied directly to the profitability of a project. In contrast, production-based taxes, such as the crude oil excise, are not tied directly to profitability.

The PRRT also provides the community—the ultimate owners of Australia's petroleum resources—with a fair proportion of the potentially high returns from the exploitation of scarce and non-renewable resources.

Under section 5 of the *Petroleum Resource Rent Tax Act 1987*, the rate of tax is 40 per cent. The PRRT is levied before income tax, and is deductible for income tax purposes. Projects incurring the PRRT are not subject to excise or royalties.

Effects on investment

Taxing rent should not lead to potentially profitable projects being deferred or cancelled. However, as with any tax, it can

change the relative ranking of differently structured projects.²

Where does PRRT apply and who pays?

The PRRT applies to offshore areas under Commonwealth jurisdiction except those located in the North West Shelf exploration permit areas.³ Producers of hydrocarbons (crude oil, condensate, LPG, natural gas and ethane) pay the PRRT. The Bass Strait project used to account for more than 90 per cent of PRRT revenue.⁴ But with production in Bass Strait declining and new projects maturing, this proportion is falling.

How does the PRRT work?

The *Petroleum Resource Rent Tax Assessment Act 1987* provides for the assessment and collection of the PRRT. The PRRT is generally assessed on a project basis. The tax base is net cash flows after recovery of eligible exploration expenditure, operating costs, and capital expenditure. Any excess of expenditure over receipts can be compounded forward (at the long-term bond rate plus 15 percentage points for exploration and the long-term bond rate plus five percentage points for other expenditures provided they are incurred less than five years before the

Table: Revenue from PRRT and excises on petroleum and petroleum products (\$million)

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
PRRT	876	1389	1072	865	791	1308	907	419	1205	1760
Excise	7157	7316	8561	9433	10237	10552	10911	11005	11419	12892

Sources: Budget paper No. 1 2000-01, p. 5-31, MYEFO 2000-01, and Final Budget Outcome 1999-2000. Figures for 2000-01 estimated.

production licence commenced) for deduction against future receipts from the project.

Effect on pump prices

The PRRT has no direct effect on pump prices of petrol as it is a tax on profits (i.e., it is absorbed by petroleum producers). In contrast, excise on petrol and the goods and services tax directly raise pump prices.

How much revenue does the PRRT raise?

The amount of revenue raised depends partly on international oil prices. The higher than expected prices and the depreciation of the Australian dollar against the US dollar largely account for the increase in the Treasury's estimate of revenue in 2000-01, from

\$1.28 billion at the time of the Budget to the revised estimate of \$1.76 billion. This compares with estimated revenue of \$12.892 billion from the excises on petroleum products and crude oil.⁵ Revenue from these excises and the PRRT taxes is shown in the table.

1. Other taxes applied to crude oil production are royalties and crude oil production excise. Petroleum production not subject to PRRT is generally subject to either Commonwealth or State/Territory royalties. Crude oil production excise applies to on-shore fields producing stabilised crude and off-shore fields in the North West Shelf. This excise should not be confused with the excise on refined products such as petrol and diesel. For a description of the latter, see <http://www.aph.gov.au/library/pubs/rp/2000-01/01RP06.htm>
2. To encourage exploration, the Government, in the 1990 Budget, announced that a company would be allowed to deduct all exploration expenses incurred in other PRRT licence areas. Previously, deductibility was limited to expenditure in individual permit areas.
3. North West Shelf production licence areas and associated exploration permit areas are subject to excise and royalties.
4. PRRT replaced the excise and royalty system that used to apply to the Bass Strait field before 1991.
5. Statement by the Treasurer and the Minister for Finance and Administration, 'Mid-Year Economic and Fiscal Outlook 2000-01', November 2000, p. 31.

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