Senate Standing Committees on Economics
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30 March 2017

Dear Committee Secretary,

Senate inquiry into corporate tax avoidance – inquiry into Australia's offshore oil and gas industry

Please find attached a submission from the Tax Justice Network – Australia in relation to the expansion of the scope of the inquiry into corporate tax avoidance to include Australia's offshore oil and gas industry.

Tax Justice Network – Australia welcomes the opportunity to discuss further any matters contained in the attached submission. I can be contacted on

Yours sincerely,

Jason Ward
Tax Justice Network – Australia

Submission to the Senate inquiry into Australia's offshore oil and gas industry

March 2017

Executive summary

Australia is set to be the world's largest exporter of liquefied natural gas (LNG) – but the industry is projected to generate little direct government revenue for decades.

By 2021, Australia's LNG exports are expected to exceed those of Qatar. Yet the Petroleum Resource Rent Tax (PRRT) will not generate any revenues from LNG for decades, while each year the Government of Qatar collects $26.6 billion in LNG royalties.

Responding to concerns that the PRRT is failing to secure any return to the community on Australia's finite oil and gas resources, the Government is currently undertaking a review of Australia's resource tax and royalty regimes.

There is a simple, practical solution: extend the existing 10% Commonwealth royalty to all current and future offshore oil and gas projects that are otherwise only subject to the PRRT.

Five large LNG offshore projects (existing or planned) in Commonwealth waters off the coast of West Australia are only subject to the PRRT unlike all other gas projects in Australia.

All other oil and gas projects in Australia, including the long-standing North West Shelf Project and new CSG to LNG projects in Queensland, are subject to State or Commonwealth royalties of 10% or higher plus the PRRT. Extending the existing Commonwealth royalty regime to the five new offshore LNG projects would generate up $30-45 billion in new revenue over 30 years.

The PRRT was designed for a very different petroleum industry, and suffers from design flaws that are excessively generous to industry while creating perverse incentives. Critical reforms would ensure the PRRT is fit for purpose in an industry dominated by integrated gas-to-LNG production. By stamping out opportunities for profit-shifting and incentives for inefficient allocation of capital, reforms to the PRRT would increase future PRRT revenues and improve public confidence in Australia's resource royalty and tax regime. However, the industry has already accumulated $238 billion in PRRT credits. This means that even a reformed PRRT is unlikely to generate revenue for years or even decades.

Extending the existing Commonwealth royalty regime to the five new offshore LNG projects would ensure that there is a minimum price for extracting and selling Australia's finite natural resources. Equalising royalty rates would level the playing field for all Australian oil and gas projects, onshore or offshore. As with the existing royalty regimes, it would be fully deductible from the PRRT.

No other industry is able to obtain its basic inputs for free. This is a vital step that can secure government revenues and ensure that Australians receive a fair return for the nation's oil and gas. Eighty-seven percent of production from these new projects will be foreign owned. Without an extension of existing royalty regimes to these five offshore LNG projects, Australia will continue to

give away its natural gas resources to Chevron, Shell and ExxonMobil and other multinational oil companies for free.

Summary of recommendations

RECOMMENDATION 1: Extend a ten per cent royalty, similar to that paid by the North West Shelf project, to the five new LNG projects in Commonwealth waters

RECOMMENDATION 2: For integrated gas-to-LNG projects, treat LNG sales – not minimally processed gas – as the point of resource taxation

RECOMMENDATION 3: Limit the uplift factor across all categories of both carry forward and new deductible expenditure to no more than LTBR + 5%

RECOMMENDATION 4: Eliminate refunds for decommissioning costs

RECOMMENDATION 5: Ring fence all exploration expenditure by project

RECOMMENDATION 6: Provide public, detailed guidance regarding the types of spending that are included in each class of deductible expenditure

RECOMMENDATION 7: End self-audit system and increase transparency requirements for PRRT taxpayers, including reporting of carry forward expenditure in each category on a project-by-project basis

RECOMMENDATION 8: Remove transfer pricing for the allocation of profits between upstream and downstream operations in integrated gas-to-LNG projects. Require public reporting of pricing arrangements agreed between taxpayers and the ATO

RECOMMENDATION 9: Maintain the PRRT definitions of exploration spending, instead of adopting those used for income tax, to promote community trust in Australia's resource tax system.

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The Tax Justice Network – Australia commends the Committee for its interest in Australia's offshore oil and gas industry. There is an urgent need to reform the resource tax and royalty regime to ensure that Australians receive a fair share from the coming natural gas boom. Moreover, strong public oversight is critical to prevent multinational corporations' use of aggressive accounting practices to minimise payments to governments.

The Committee has requested submissions address the treatment and payment of royalties; the Petroleum Resource Rent Tax; deductions; and other taxes by corporations involved in Australia's offshore oil and gas industry. This submission will focus on the operation of the PRRT and royalties for the five new offshore LNG projects, including the deduction of a wide range of expenditure from assessable receipts under the PRRT. It will also provide an overview of the record of tax payments by corporations involved in offshore oil and gas.

Australia is poised to be the world's largest exporter of liquefied natural gas (LNG). Recent years have seen massive investment in gas extraction and liquefaction in Commonwealth waters off the coast of Western Australia and onshore in Queensland, primarily for export to consumers in Japan,

South Korea and elsewhere. Yet Australia's Petroleum Resource Rent Tax (PRRT) is not expected to collect any revenue from these new projects for decades to come – if at all.

The failure of the existing resource tax and royalty regime to secure a fair share for Australians is particularly acute in the case of the offshore LNG projects such as Chevron's Gorgon and Wheatstone projects. In contrast to the long-running North West Shelf project and all onshore oil and gas production, including LNG in Queensland,[1] new offshore LNG projects are not subject to any royalty.

Australia has wasted the benefits of previous resources booms. It is critical that the same mistakes aren't repeated this time. The PRRT must be amended to better suit a petroleum industry that is very different from that of the 1970s. An extension of the Commonwealth royalty scheme to cover new offshore gas projects is needed to ensure a minimum share of the benefits from commonly-owned resources flow to the Australian people. These reforms will support more efficient capital allocation by removing distortionary incentives and establishing a level playing field for all Australian oil and gas projects.

Australians need to have confidence in our resource tax and royalty regime. Large multinationals - like Chevron - that own 87% of new offshore LNG production are renowned for their use of aggressive tax avoidance strategies. The current system of self-regulation and voluntary compliance under the PRRT must be replaced by one that has greater transparency and strong public oversight at its core.

This submission will focus on the existing or planned offshore gas projects which are only subject to the PRRT: Gorgon, Wheatstone, Ichthys, Pluto and Prelude. The first part will review the evidence that these projects contribute no revenues to government from the Petroleum Resource Rent Tax or from royalties; in stark contrast to government revenues in other LNG producing countries. The second part will propose a way forward that will address the root causes of this lack of revenue, including the design of the PRRT, the absence of a Commonwealth royalty on new projects, and the failure of corporate self-regulation.

Part I: scale of the problem

LNG boom will not bring any new revenues from the Petroleum Resource Rent Tax

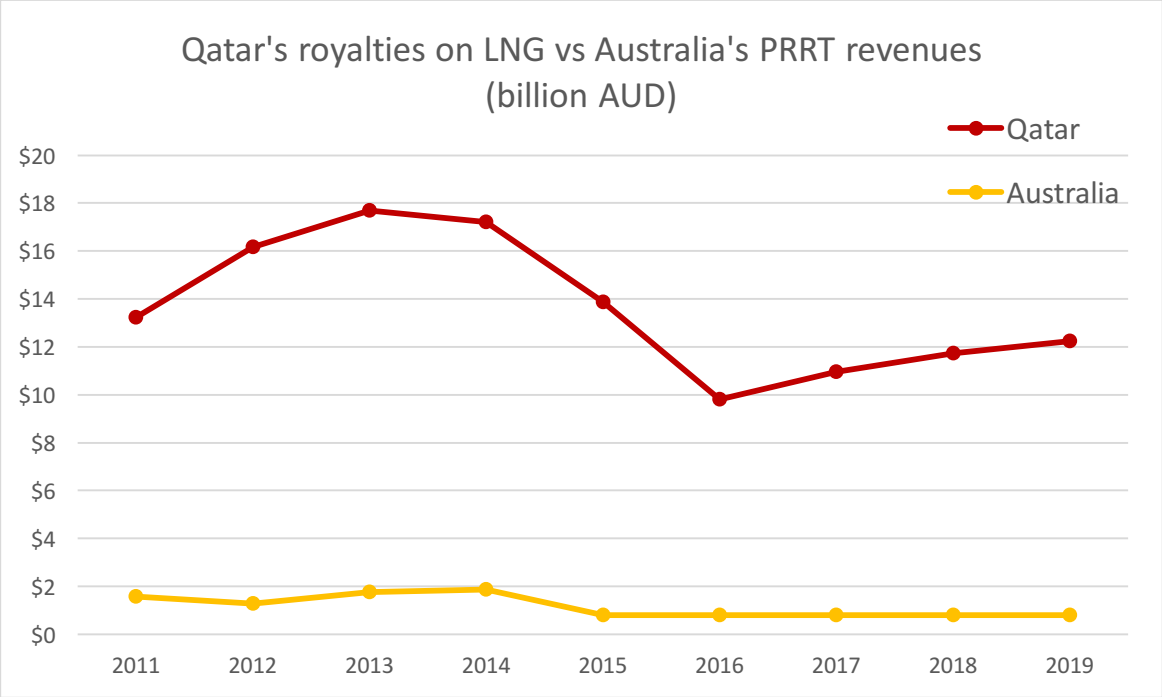
The primary mechanism for compensating Australians for the exploitation of our oil and gas resources is the Petroleum Resource Rent Tax. The Commonwealth Government is currently conducting a review of the PRRT in response to increasing community concern that this objective is not being met. A major concern is the operation of the PRRT on new offshore LNG projects.

Analysis by the Western Australian Treasury suggests that the Gorgon project will not pay any PRRT revenue for two decades or longer.[2] This analysis is confirmed by academics and other observers and has not been publicly contested by the companies involved or their lobby group.

Modelling of government revenue commissioned by the industry body, APPEA, shows that at current oil prices, Chevron's Gorgon project will never pay PRRT. The modelling by Wood

Mackenzie shows that there is no "spike" from PRRT payments with oil at $40 or $60 a barrel. It is only if oil reaches $80 a barrel that the PRRT is expected to produce revenue to government. With current oil prices around $50 per barrel, the modelling suggests that the largest new LNG project may never pay any PRRT.[3]

This stands in stark contrast with the experience of Qatar. Australia will shortly overtake Qatar as the world's biggest LNG producer. The Government of Qatar collects $26.6 billion in royalties from LNG exports annually – while Australia will see no new PRRT payments for decades.[4] This does not include additional – and substantial – revenue that Qatar's Government will collect from LNG in the form of dividends from state-owned companies or corporate income tax from these companies and from the multinational companies that are also invested in Qatar's LNG sector.



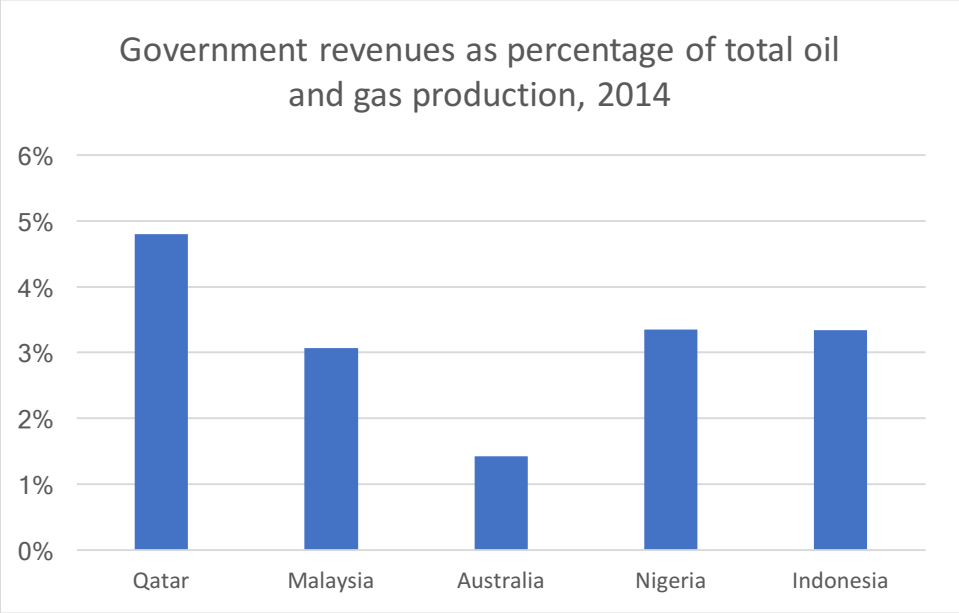
New offshore LNG projects pay nothing in royalties

The North West Shelf Project, operated by Woodside Petroleum, is the only offshore LNG project to be subject to royalty payments. The North West Shelf royalty has been in place for many years. It is administered by the Commonwealth at a rate of 10 to 12.5 per cent of well-head value. As a result of an historical agreement with WA, proceeds are shared approximately 67 per cent to WA and 33 per cent to the Commonwealth.[5]

The Commonwealth has elected not to levy a royalty on new LNG projects that extract gas from Commonwealth waters. These are Gorgon, Wheatstone, Ichthys, Pluto and Prelude.[6] This gives these offshore projects an advantage that is not available to any other project. For example, three Queensland CSG-to-LNG projects must pay the State Government royalties at a rate of 10 per cent of well-head value.[7] All Australian states and the Northern Territory levy a royalty on petroleum production within their jurisdiction, at an average rate of 10 per cent.[8]

Australia outstripped by international competitors

A comparison of Australia's top competitors in the growing LNG export industry shows that Australia is falling far behind in its ability to capture sufficient public benefit from private exploitation of oil and gas resources. Australian government revenues from oil and gas in 2014 were significantly less than those of the other leading LNG producers, even after accounting for varying levels of production.



According to industry data, Australian governments collected US $7.3bn in revenues related to oil and gas production in 2014. This includes PRRT payments, state royalties, corporate taxes and all other taxes paid by companies operating in the sector. At the same time, IMF documents show the Malaysian government received US $20.2bn in oil and gas-related revenues. This represents nearly three times the Australian revenues - but Malaysian production was less than 30% above Australian levels.

In fact, data from IMF country reports and BP's statistical review of world energy shows that all other top LNG exporters secure more than double the share of government revenues as a percentage of oil and gas production, compared with Australia.

Adjusted for production volume, Indonesia's government revenues from oil and gas production were more than double Australia's. Total government revenues were US $25.8bn - more than three times Australian government revenues - from production levels that were approximately 50% above Australia.

Similarly, Nigeria's government revenues as a percentage of the country's oil and gas production were more than double Australia's. Total government revenues in Nigeria were US $37.0bn - more than five times Australian government revenues - from production levels that were just over double those of Australia.[9]

Combined impact of fiscal policy and resource tax and royalty regime on investment in oil and gas

A 2015 article from the Boston Consulting Group ranked Australia fourth from the bottom of a list of nineteen oil and gas producing countries in terms of government revenue as a percentage of oil

and gas production for the period 2009 to 2014.[10] While Australia's percentage of revenue from oil and gas production appears to have declined over that period, the article notes that most governments have increased their take by an average of US$20.50 per barrel of oil equivalent over the period. However, as Australia is on the verge of a major expansion of LNG exports and revenues are forecast to fall, Australia may succeed in becoming the country that gets the lowest share of government revenue from its oil and gas production.

Research by renowned Canadian economist and tax expert Dr Jack Mintz confirms that Australia's approach to oil and gas taxation is radically out of step with comparable governments'. The research reveals that Australia has far lower marginal effective tax and royalty rates (METRR) for oil and gas than the US, Canada, Norway and the UK.

The METRR is a measure of the effect of all taxes and royalties on the marginal oil and gas investment. Therefore, it measures the impact of the entire fiscal regime on potential new investment.

Australia's METRR is so low that it is negative. For example, the average METRR across the states of the USA is 36.1%, while the METRR for Australia is minus 35.5%, far below the rate for any other jurisdiction. The nearest jurisdiction in the study has an METRR of -3.5% (Nova Scotia), while the average for Canada as a whole is 27.7%. The METRR for Norway is 31.9%; and the METRR for the UK is -2.5%.

When exploration only is considered, the Australian rate falls even further to minus 146.3%. Again, this is far below the rate that applies in any other jurisdiction in the study.[11]

TABLE 1 MARGINAL EFFECTIVE TAX AND ROYALTY RATE BY JURISDICTION (IN PER CENT), 2016

	Exploration	Development	Depreciable	Inventory	Aggregate
	(A)	(B)	(C)	(D)	(E)
Canada*	**13.8**	**18.8**	**31.7**	**30.8**	**27.7**
British Columbia*	24.3	28.1	32.9	25.7	**28.7**
Alberta					
Conventional** (2016)	38.5	41.7	25.3	26.6	**35.0**
Conventional** (2017)	25.2	29.1	25.3	26.6	**26.7**
Oilsands	-1.0	5.5	34.5	34.6	**29.3**
Saskatchewan**	28.4	32.2	36.7	27.9	**32.6**
Newfoundland & Labrador	-2.9	3.8	50.1	N/A	**11.8**
Nova Scotia	-6.1	-18.8	36.4	N/A	**-3.5**
U.S.	**36.3**	**37.1**	**35.5**	**24.6**	**36.1**
Arkansas	23.8	24.9	39.3	27.1	**29.5**
Colorado	28.4	29.4	36.5	26.1	**31.5**
North Dakota	35.7	36.6	35.4	25.9	**35.7**
Pennsylvania	18.8	20.0	38.0	29.1	**25.9**
Texas	37.4	38.2	35.4	23.9	**36.7**
Australia	-146.3	3.2	17.6	N/A	**-35.5**
Norway	-3.7	30.1	82.9	N/A	**31.9**
United Kingdom	-2.5	-1.5	-4.8	N/A	**-2.5**

Source: Authors' calculations.

* Canada average METRR reflects the new royalty regime in Alberta (2017). With the existing Alberta royalty regime, the Canada-wide METRR would be 30.9 per cent.

** The royalty rates, and hence the marginal effective tax rates, for British Columbia, Alberta conventional oil and Saskatchewan are contingent on well productivity. In this table, we assume a well producing 50 barrels of oil per day for all three provinces. For a lower-productivity well with an output of 30 barrels per day, the aggregate METRR would be 23.3 per cent in British Columbia, 28.2 per cent in Alberta under the current regime and 21.3 per cent under the modernized regime, and 27.1 per cent in Saskatchewan. For a higher-productivity well with an output of 80 barrels per day, the METRRs would increase to 31.7 per cent in British Columbia, 40.6 per cent in Alberta under the current regime and 26.7 per cent under the modernized regime, and 35.7 per cent in Saskatchewan. One of the recommendations of Alberta's royalty review panel was indeed to flatten the royalty rate schedule across different-sized wells.

Source: Daria Crisan and Jack Mintz, 2016, "Alberta's New Royalty Regime Is a Step towards Competitiveness: A 2016 Update." SPP Research Papers 9 (35), available at http://www.policyschool.ca/wp-content/uploads/2016/10/AB-New-Royalty-Regime-Crisan-Mintz-final.pdf p9

Alternative approaches internationally

A number of governments around the world take a much more active interest in securing benefits for their citizens from the petroleum industry. This is vividly illustrated in the case of Japan, the world's biggest importer of LNG, which is set to collect more tax revenue from Australian gas than Australia will collect in PRRT from all LNG production.

Case study: Japan's gas reservation policy and energy security

Japan has long been the primary buyer of Australian LNG. The Reserve Bank of Australia estimates that despite diversification of Australia's LNG trading partners, Japanese demand will continue to account for 45% of all Australian LNG exports under contract by 2020.[12] Despite being a net importer, the Japanese Government has a comprehensive policy to protect its domestic gas supply

– a policy that secures more revenues from Australian LNG production than the Australian Government will receive through the PRRT.

Shipments of LNG from Australia are taxed in Japan under the national government's Petroleum and Coal Tax. At current exchange rates, the import tax rate levied by the Japanese Government on gaseous hydrocarbons – including LNG shipped from Australia – is AU $22.32 per tonne.

The Japanese Government will collect $2.93 billion in import taxes on the 45% of Australian LNG exports that are destined for Japan over the four years to 2020-21, based on estimated production data from the Australian Government Office of the Chief Economist.

	Total Australian LNG exports (t) [13]	LNG imports to Japan from Australia (t)[14]	Value of tax on LNG imports from Australia (AUD)[15]
2017-18	68,146,000	30,665,700	$684,458,424
2018-19	73,974,000	33,288,300	$742,994,856
2019-20	74,327,000	33,447,150	$746,540,388
2020-21	75,158,000	33,821,100	$754,886,952
TOTAL	**291,605,000**	**131,222,250**	**$2,928,880,620**

In turn these revenues are dedicated to investment in policies for stable fuel supply. These policies include the development of oil and natural gas, and establishment of reserves, to ensure the stable and low-cost supply of fossil fuels.[16]

Equity shares in foreign oil and gas production are another plank to Japan's energy policy.[17] This extends to partial Japanese Government ownership of Ichthys, one of the five new LNG projects off the coast of Western Australia. The Japanese Ministry of Economy, Trade and Industry holds an 18.94% stake in Japanese company Inpex, the operator of Ichthys.[18]

Risk of repeating past mistakes

Australia has failed to effectively manage past resource booms, missing the opportunity to secure a fair return to Australians for the extraction of natural and non-renewable, commonly-owned resources.

Promises of large government revenues were made when these projects were put to government for approval, promises that have failed to materialise. This "corporate risk" is the flip side of "sovereign risk". For instance, Chevron's Draft Environmental Impact Statement for Gorgon promised that government revenues would be so large that they modelled the economic impact of the cut in personal income tax rates that would be possible.[19] More recently Chevron provided an economic analysis report by ACIL Tasman to the Senate Inquiry on Corporate Tax Avoidance that suggested $338 billion in federal government revenue from 2009 to 2040. This report remains prominently featured on Chevron Australia's website today.[20]

This $338 billion figure is grossly misleading. Only $108 billion of the total was forecast to be paid by the Gorgon and Wheatstone projects directly, with the remainder being the consequence of "multiplier impacts".[21] Importantly, the analysis fails to distinguish between resource taxation and royalties – which are the way the resources sector pays for its inputs – and corporate and other taxes that are paid by all companies in the economy.

Recent developments internationally show that governments can act to address the problem of corporate risk. In May 2016, another of the top 10 LNG exporters - Oman – increased corporate tax on LNG companies from 15% to 55%. At the same time, corporate tax on all other petrochemical firms was increased from 15% to 35%. The primary company operating in Oman, Oman LNG, is 30% owned by Shell.[22]

Oman is considered by the US State Department to be conducive to foreign investment with a business-friendly environment.[23] Already in 2009, its government received an estimated 12% of its revenues from the developing LNG industry[24], a value of AU $2.77bn.[25]

Citi Research has argued that oil and gas companies have overstated the potential for sovereign risk if changes are made to the PRRT. They ague that companies in the industry "have already been subject to numerous changes around PRRT, carbon tax, EBA terms, and onerous environmental compliance; none of which has scared companies away from continued investment in Australia. We think that so long as future project returns are compelling compared to portfolio alternatives, companies will continue to invest."[26]

In fact, the USA – under President George W. Bush – twice increased royalty rates on offshore oil and gas, demonstrating that the problem of corporate risk is well understood. Then-Secretary for the Interior, Dirk Kempthorne, has said that the increase from 12.5% to 18.75% was of particular interest to President Bush, who believed the original rate was far too low.[27]

Part II: solving the problem

Designed for oil, not gas

The design of the PRRT has not kept up with changes in the Australian petroleum industry. It is not generating any revenue from new integrated gas-to-LNG projects, in large part because it was developed in a different time. The concept of the PRRT emerged in response to significant windfall profits captured by oil producers in Australia and around the world in the 1970s.[28] This is still evident in the operation of the PRRT today.

The largest payer of PRRT is BHP Billiton-Esso Australia's Bass Strait project, which produces both oil for export and gas for domestic consumption. About half of annual PRRT revenues can be attributed to this project. BHP Billiton contributes approximately a quarter of the remaining total PRRT payments to government from its Pyrenees oil fields, operated by its subsidiary BHP Billiton Petroleum (Australia).[29]

PRRT payments	2013-14 $	2014-15 $
Bass Strait joint venture (BHP Billiton Petroleum (Bass Strait) Pty + ESSO Australia Resources Pty Ltd)	1,098,351,719	558,991,303
PRRT tax paid on taxable profit (total, all companies)	1,787,000,000	1,221,000,000
Bass Strait as % total PRRT	*61%*	*46%*
Bass Strait plus BHP Billiton Petroleum (Australia) Pty Ltd as % total PRRT	*83%*	*74%*

Unlike oil, the global gas industry is not characterised by "super" profits. Most gas sales are done through long-term contracts, enabling producers to enjoy relatively stable and predictable revenues over time. The point at which projects are sufficiently profitable to pay PRRT is set too high for gas projects.

Level the playing field with royalties

A simple, effective solution is to extend the existing Commonwealth royalty regime – a 10 per cent rate similar to the North West Shelf royalty – to the five new offshore LNG projects. This would ensure that there is a minimum price for extracting and selling Australia's finite natural resources. Equalising royalty rates would level the playing field for all Australian oil and gas projects, onshore or offshore. As with the existing royalty regimes, it would be fully deductible from the PRRT.

The royalty rate that applies on the North West Shelf is in line with that levied by the States and the Northern Territory; and is internationally competitive.

Onshore and offshore royalty rates: Australian and selected Canadian and US governments	
Alberta, Canada	5 to 40%[30]
Victoria, NSW, South Australia, Queensland, Northern Territory	10%[31]
Tasmania	12%[32]
Western Australia	10 to 12.5%[33]
North West Shelf project area	10 to 12.5%[34]
US Federal Government - onshore	12.50%[35]
North Dakota, USA	16.67 to 18.75%[36]
US Federal Government - offshore	18.75%[37]
Texas, USA	25%[38]

Onshore and offshore royalty receipts (US $m, 2014): selected Australian, Canadian and US governments	
Western Australia	$7.57[39]
Queensland	$37.87[40]
North West Shelf - grants to Western Australia	$906.55[41]
Australia - PRRT	$1,817.64[42]
US Federal - onshore	$2,795.91[43]
Texas, USA	$5,773.65[44]
US Federal - offshore	$5,923.11[45]
Alberta, Canada	$6,573.09[46]

RECOMMENDATION 1: EXTEND A TEN PER CENT ROYALTY, SIMILAR TO THAT PAID BY THE NORTH WEST SHELF PROJECT, TO THE FIVE NEW LNG PROJECTS IN COMMONWEALTH WATERS

Extending the existing ten per cent Commonwealth royalty to these large offshore LNG projects that are only subject to the PRRT, unlike all other gas projects in Australia, would raise $4-6 billion over four years, according to projections by the International Transport Workers' Federation (ITF), a member of TJN-Aus. The ITF has commissioned independent economic modelling of the proposed royalty extension which will be published shortly.

No other industry is able to obtain its basic inputs for free. This is a vital step that can secure government revenues and ensure that Australians receive a fair return for the nation's oil and gas.

Inappropriate valuation of sales gas

A second consequence of the structure of global trade in gas is that there is no transparent market price. This makes it difficult to independently audit PRRT returns, which are based on taxpayer reporting of sales revenues or "assessable petroleum receipts".[47] This is exacerbated in the case of integrated gas-to-LNG projects, where no true "arm's length" sales price exists.

RECOMMENDATION 2: FOR INTEGRATED GAS-TO-LNG PROJECTS, TREAT LNG SALES – NOT MINIMALLY PROCESSED GAS – AS THE POINT OF RESOURCE TAXATION

Excessive PRRT credits

A feature of the PRRT is its generous provisions that allow corporations to accumulate credits against existing and future liabilities. There are ten categories of deductible expenditure that can be used for this purpose. The scale of the problem is demonstrated by the value of PRRT credits that are currently held by producer companies.

According to the most recent data, the value of PRRT credits held by industry has reached $237.87 billion. This means that even if the PRRT is modified to be more suited to contemporary petroleum industry, it is unlikely to generate revenue for years or even decades.

The value of PRRT credits increases annually due to both additional expenditure and the application of uplift rates to existing credits. In just one year, the value of carry forward expenditure rose by $50.36 billion or 27%, from $187.51 billion to $237.87 billion.[48] It is now

widely recognised that the PRRT's schedule of "uplift" rates at which tax credits are accumulated has been overly generous.[49] No other industry enjoys this kind of tax treatment.[50]

The priority reform of the PRRT must be to end the ability to accumulate PRRT credits at excessive, compounding uplift rates.

RECOMMENDATION 3: LIMIT THE UPLIFT FACTOR ACROSS ALL CATEGORIES OF BOTH CARRY FORWARD AND NEW DEDUCTIBLE EXPENDITURE TO NO MORE THAN LTBR + 5%

The likelihood that the Government will ever receive PRRT revenues from new offshore LNG is further diminished by the operation of the tax when projects close down operations. The PRRT contains decommissioning provisions under which companies could become eligible for tax refunds. This could result in PRRT revenues to government turning negative.[51]

The ATO's website suggests that industry members are currently seeking confirmation of their rights to claim closing-down expenditure refunds; and the status of any un-deducted expenditure when a production license reverts to a retention lease.[52]

RECOMMENDATION 4: ELIMINATE REFUNDS FOR DECOMMISSIONING COSTS

The ability for corporations to reduce assessable receipts by accumulating PRRT credits creates a number of additional distortions that encourage inefficient capital allocation. Australian Tax Office deputy commissioner Jeremy Hirschhorn revealed at 2017 Senate Budget Estimates hearings that the costs of cleaning up oil spills at an exploration well could be eligible for PRRT credits at the exploration expenditure uplift rate; while the slightly less generous general expenditure uplift rate would apply to oil spills at a production well.[53] In Queensland, three companies built LNG export terminals side-by-side, at a cost of around $10 billion. Chevron's US $54 billion Gorgon project in WA had huge cost overruns of US $17 billion during construction. In all cases, this inefficient spending was eligible for PRRT credits with uplift.

A 2016 media report revealed that BP may be able to claim 150% of the exploration costs associated with its failed Great Australian Bight project, against future PRRT liabilities, on other projects.[54] Exploration spending benefits from very high uplift rates and the ability to transfer certain types of exploration expenditure between projects. Most classes of exploration expenditure attract the highest uplift rate of the LTBR + 15%. Certain types can be transferred from unsuccessful projects to offset future PRRT liabilities on other projects. The order of deductions creates further distortions, with some classes of exploration expenditure – including some attracting the maximum uplift rate – only deducted after non-transferrable general and exploration expenditure. This structure maximises the benefits to producing companies as expenditure carried forward each year is able to compound annually at the relevant uplift rate.[55]

Analysis of comparable jurisdictions by University of Calgary Jack Mintz, detailed above, shows that the generous treatment of exploration expenditure is the primary factor behind a situation where companies are "over-incentivised" for investing.[56]

RECOMMENDATION 5: RING FENCE ALL EXPLORATION EXPENDITURE BY PROJECT

RECOMMENDATION 6: PROVIDE PUBLIC, DETAILED GUIDANCE REGARDING THE TYPES OF SPENDING THAT ARE INCLUDED IN EACH CLASS OF DEDUCTIBLE EXPENDITURE

Failure of self regulation

Track record of low corporate tax payments and aggressive tax avoidance

Over five years (2009/10 – 2013/14), despite a corporate tax rate of 30%, the industry's corporate tax payments have averaged 23% of total revenue after subtracting amortisation, depreciation and general operating costs.

The oil and gas industry does make significant investment and employment contributions and tax payments. However, oil and gas multinationals have used aggressive tax avoidance practices, some of which are being addressed by the ATO, which severely limit the benefits to Australians from the exploitation of their natural resources.

Based on ATO data, in 2013/14, the Australian operating companies of international oil and gas majors BP, Shell, Exxon and Chevron had total income of $65.6 billion, but paid company tax of less than $603 million, or under 1% of total income. In 2014/15, they had total income of $58.5 billion and paid company tax of $1.3 billion, or just over two per cent of total income.

While there are clearly legitimate reasons for lower corporate tax payments, including significant investment costs, there is also evidence of aggressive tax minimisation. TJN-Aus applauds the ATO's efforts to crack down on aggressive corporate tax avoidance by multinational oil companies, but clearly much more needs to be done. If these multinationals can reduce profits for corporate income tax purposes, why would they not attempt to reduce profits under the PRRT system?

Contradictory evidence in industry position on PRRT: case study of Chevron

Chevron is the operator of two of the five new offshore LNG projects, Gorgon and Wheatstone, and has a one sixth interest in the North West Shelf project. In its submission to the PRRT review, Chevron argues that the PRRT is working as intended; and in public statements, has argued that any change would risk future investment.

Yet Chevron Corporation's annual report for 2014 reveals that Chevron's costs in Australia are low and the realised value on production is high. Largely through its interest in the North West Shelf project, Australia was the source of four per cent of Chevron's global production and produced US$2.4 billion in net revenue. The average sale price per barrel (US$95) in Australia was higher than any other region, income tax charges were comparably low and the cost of production was far lower than any other region. The average production cost per barrel ($5.53) in Australia was less than on third of Chevron's global average ($17.69). In 2014, Chevron Australia's annual financial statement filed with ASIC reveals a net corporate income tax refund of $5.7 million.

Senator Sam Dastyari has named Chevron "the godfather of tax minimisation". In 2016, Chevron lost a federal court case against the ATO for excessive interest charges to reduce profits and tax in Australia, a case which is currently under appeal. This court case has major implications for the current lending scheme that could - in Chevron's own estimate - reduce Australian corporate tax payments by $15 billion. Chevron's submission to the PRRT Review shows that it made income tax payments in only two of the last seven years; a period in which the Interest Withholding Tax ($635m) was greater than income tax payments by over $200 million.

The submission also demonstrates that royalties are a relatively transparent and effective way to secure a fair payment for the use of commonly-owned resources. In the last seven years, royalties and excise payments from the North West Shelf were more than 5.5 times Chevron's corporate income tax payments. In fact, the royalty and excise payments ($2.4 b) amounted to 60% of all federal and state taxes ($4 b) over the period. There have not been any recent complaints about the tax burden on the NWS.

Different Message for Analysts

Chevron comments in its submission that "proximity to Asian customers has historically provided a shipping cost differential compared to US and Middle East suppliers", but several factors have eroded this differential. Since this submission was made, Jay Johnson, Chevron Corporation's Executive Vice President for Upstream said on a 7 March conference call with analysts:

"When you combine our large resource base and liquefaction capacity with the transportation cost advantage to Asia that Australia has over the US and Middle East suppliers, we like our position. Over time, we will work this advantage and monetize the gas through our equity facilities at Gorgon, Wheatstone and North West Shelf, as well as through other available third-party capacity."[57]

Chevron states that it "is the largest holder of natural gas resources in Australia", but that these "Australian projects must compete for capital against other potential projects around the world." On the same 7 March conference call with analysts, Chevron Corporation's CEO John Watson strikes a very different tone. Australia is repeatedly highlighted as the first of three legacy assets that will drive the company's global profits.

"Our upstream portfolio is second to none. We are anchored by three legacy positions: a leading gas position in Australia that is now becoming a significant cash generator with resource development opportunities to keep Chevron and industry plants utilized and growing."

Chevron's submission also asserts that "Australia's fiscal and regulatory regimes are increasingly uncompetitive." However, there is no evidence provided except possible corporate tax cuts by the Trump administration in the US. The current corporate tax rate in the US is 35%; 5% higher than Australia. The current US federal royalty rate for offshore oil and gas is 18.75%. Numerous studies have shown that the fiscal regime for oil and gas in Australia is highly competitive and amongst the lowest in the world.

Foreign ownership in the industry

The industry's track record shows significant capacity for aggressive tax avoidance. Oil and gas companies regularly use a highly complex international corporate structure with marketing operations and headquarters in low-tax jurisdictions. The ATO has identified financing arrangements in the industry as an issue requiring additional oversight and potentially linked to tax avoidance.[58] Production from new offshore LNG will be 87% foreign-owned, with 7.5% of output owned directly by foreign governments.

PRRT reliance on industry self-assessment

An ATO audit of the PRRT has described the system as one of "voluntary compliance".[59] Its approach is based on self-audit by taxpayers, with the ATO identifying major risks to PRRT compliance. A report by Citi Research found that this "creates the potential for aggressive

accounting treatment to minimize net back pricing to reduce PRRT payments."[60] As noted above, this potential is greatest with regards to integrated gas-to-LNG projects.

Members of the industry have themselves identified a lack of clarity regarding the deductibility of different types of expenditure as a problem with the PRRT. Recent tax rulings have been necessary to confirm the more restrictive treatment of exploration expenditure under the PRRT compared with income tax.[61] This more restrictive treatment should be maintained, given the erosion of community trust in the integrity of the PRRT.

RECOMMENDATION 7: END SELF-AUDIT SYSTEM AND INCREASE TRANSPARENCY REQUIREMENTS FOR PRRT TAXPAYERS, INCLUDING REPORTING OF CARRY FORWARD EXPENDITURE IN EACH CATEGORY ON A PROJECT-BY-PROJECT BASIS

RECOMMENDATION 8: REMOVE TRANSFER PRICING FOR THE ALLOCATION OF PROFITS BETWEEN UPSTREAM AND DOWNSTREAM OPERATIONS IN INTEGRATED GAS-TO-LNG PROJECTS. REQUIRE PUBLIC REPORTING OF PRICING ARRANGEMENTS AGREED BETWEEN TAXPAYERS AND THE ATO

RECOMMENDATION 9: MAINTAIN THE PRRT DEFINITIONS OF EXPLORATION SPENDING, INSTEAD OF ADOPTING THOSE USED FOR INCOME TAX, TO PROMOTE COMMUNITY TRUST IN AUSTRALIA'S RESOURCE TAX SYSTEM.

Background on the Tax Justice Network Australia

The Tax Justice Network Australia (TJN-Aus) is the Australian branch of the Tax Justice Network (TJN) and the Global Alliance for Tax Justice. TJN is an independent organisation launched in the British Houses of Parliament in March 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. TJN works to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. TJN's objective is to encourage reform at the global and national levels.

The Tax Justice Network aims to:

(a) promote sustainable finance for development;

(b) promote international co-operation on tax regulation and tax related crimes;

(c) oppose tax havens;

(d) promote progressive and equitable taxation;

(e) promote corporate responsibility and accountability; and

(f) promote tax compliance and a culture of responsibility.

In Australia the current members of TJN-Aus are:

- ActionAid Australia
- Aid/Watch
- Anglican Overseas Aid
- Australian Council for International Development (ACFID)
- Australian Council of Trade Unions (ACTU)
- Australian Education Union
- Australian Services Union
- Baptist World Aid
- Caritas Australia
- Columban Mission Institute, Centre for Peace Ecology and Justice
- Community and Public Service Union
- Friends of the Earth
- GetUp!
- Global Poverty Project
- Greenpeace Australia Pacific
- International Transport Workers Federation
- Jubilee Australia
- Maritime Union of Australia
- National Tertiary Education Union
- New South Wales Nurses and Midwives' Association
- Oaktree Foundation
- Oxfam Australia
- Save the Children Australia
- SEARCH Foundation
- SJ around the Bay
- Social Policy Connections
- Synod of Victoria and Tasmania, Uniting Church in Australia
- TEAR Australia
- Union Aid Abroad – APHEDA
- United Voice
- UnitingWorld
- UnitingJustice
- Victorian Trades Hall Council
- World Vision Australia

[1] These are Origin Energy-operated Australia Pacific; Shell's Curtis LNG; and Santos' Gladstone LNG.

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https://www.business.qld.gov.au/industry/mining/applications-compliance/applying-resource-authority/petroleum-gas-authorities/petroleum-lease;
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