About ExxonMobil Australia

ExxonMobil Australia Pty Ltd and its subsidiaries (ExxonMobil) have had a significant role in the development of Australia's oil and gas resources and have a business history in this country stretching back over 115 years.

ExxonMobil is one of Australia's largest oil and gas producers. Our activities cover exploration and production of oil and gas, petroleum refining and supply of fuels (including natural gas), lubricants, bitumen and chemical products.

ExxonMobil is a substantial investor in the Australian economy and a major contributor to the wealth of the nation. Annually ExxonMobil pays around $2.2 billion in taxes to local, State and Federal Governments. Our cumulative investment in Australia exceeds $16 billion and we provide direct employment for around 1,700 people and indirect employment for many thousands more.

Esso is a wholly owned subsidiary of ExxonMobil Australia. Esso is a participant in, and operator of the Bass Strait Project. Our co-venturer in this operation is BHP Billiton.

The Bass Strait project has produced almost two-thirds of Australia's cumulative oil production and around 30 percent of Australia's gas production. Since 1969, oil and gas production in Bass Strait has contributed more than $200 billion to Gross Domestic Product (GDP) or some $2.2 billion per annum in nominal terms, and have stimulated approximately 50,000 permanent additional jobs in Victoria (14,000 in regional Gippsland alone). The Bass Strait project has been responsible for generating approximately $300 billion in Federal Government revenues in real terms (2.1 percent of all Government revenues collected in the period).

ExxonMobil continues to invest billions of dollars in Australia with annual capital expenditures of around $2 billion. Our ongoing investment in the Bass Strait Kipper Tuna Turrum Project represents a multi-billion dollar investment to develop cleaner-burning natural gas supplies to help secure Australia's energy future. We are a co-venturer in the Gorgon Project in Western Australia, one of the world's largest natural gas projects and the largest single resource natural gas project in Australia's history. We are also a participant in and operator of the Scarborough gas field in the Carnarvon Basin offshore Western Australia which is currently in concept selection stage.

Globally, Exxon Mobil Corporation — the parent company of ExxonMobil Australia — is the world's largest publicly traded international oil and gas company, providing energy that helps underpin growing economies and improve living standards around the world. An industry leader in almost every aspect of the energy and petrochemical business, we operate facilities or market products in most of the world's countries and explore for oil and natural gas on six continents.

We hold an industry-leading inventory of global oil and gas resources. We are the world's largest refiner and marketer of petroleum products. But we are also a technology company, applying science and innovation to find better, safer and cleaner ways to deliver the energy the world needs.

Petroleum Resources Rent Tax

PRRT is a secondary tax imposed by the *Petroleum Resources Rent Tax Act 1987* according to rules prescribed by the *Petroleum Resources Rent Tax Assessment Act 1987* (the PRRT Act). PRRT was enacted in 1987 with effect from its announcement in 1984. It applies in addition to the normal income tax, Goods & Services Tax, Fringe Benefits Tax, excise and other taxes imposed in Australia.

In its May 2009 report into the administration of PRRT the Australian National Audit Office stated that as of October 2008 there were only ten PRRT paying projects in Australia, and only nine groups of companies paying PRRT. It also reported that over $22 billion in PRRT had been collected since inception. By the close of the 2007-08 tax year, ExxonMobil had paid over $10 billion in PRRT in respect of the Bass Strait Project alone. We expect that BHP Billiton will have paid a similar amount. In the 2007-08 year, 95% of the collected PRRT was from five projects and from five company groups.

As currently enacted, PRRT only applies to petroleum projects located in Commonwealth waters. However the Government proposes to extend PRRT to 'onshore' projects. An Exposure Draft (ED) Bill to achieve this was released for public comment on 26 August 2011. The Explanatory Memorandum (EM) to the ED states that the PRRT *"is designed to ensure that the Australian community receives an appropriate return from the development of its non-renewable petroleum resources located offshore."*[1]

When originally enacted, PRRT only applied to 'greenfield' projects that commenced after June 1984. The Bass Strait project was excluded from the PRRT as it had been producing oil and gas since 1969. At the time, these operations were subject to a royalty and excise regime of secondary taxation. This changed when the 1990 Budget announced the extension of PRRT to the Bass Strait project with effect from 1 July 1990. Esso neither sought nor consented to this change. Esso was given no choice in this matter, and at the time considered the change inequitable. The inclusion of the Bass Strait project into the PRRT scheme was projected to give rise to a present value loss (in 1991 dollars) of $500m to the Bass Strait project for the period to 2010. This resulted because the existing royalty and excise was trending down, whereas the PRRT was projected to have the effect of increasing Government revenue over the long-term, thereby increasing the net cost to the Bass Strait project.

PRRT is levied on participants in 'petroleum projects' on their 'taxable profits' from the project for a 'year of tax'. As a general rule, taxpayers cannot offset profits and losses between different projects. A 'year of tax' is a year ended 30 June. The rate of tax is 40%.

Taxable profit is calculated by deducting allowable expenditure from assessable receipts. Assessable receipts include consideration received from the sale of certain hydrocarbons, or if the hydrocarbons reach their 'taxing point' before sale, the market value of those hydrocarbons at that point. The 'taxing point' of hydrocarbons produced in a project is a central concept in determining 'taxable profit' of the project and is at the core of the dispute between Esso and the ATO.

During the period of Esso's dispute, PRRT was not a 'self-assessed' tax; taxpayers making 'underpayments' during this time could be liable for penalties of up to 200% of the amount underpaid – this is in addition to having to pay the disputed amount. It is therefore not surprising that Esso has taken a conservative position in lodging tax returns, while at the same time, consistently objecting to the contentious issues after lodging each assessment. Once an objection had been lodged, it was not within the taxpayer's ability to commence litigation until

[1] Para 1.4

the ATO had made a formal decision in respect of the objection. In the current case the ATO did not prioritize Esso's objections and did not make a formal decision until 2004.

The term 'marketable petroleum commodity' (MPC) is one of the key provisions in the Act used to determine the 'taxing point' of hydrocarbons. MPC is a defined term in the PRRT Act. The Bill seeks to repeal the existing defined term and replace it with a new definition with effect from 1 July 1990. The Second Reading Speech for the Bill states that the amendment "*reinforces the long-established interpretation, recently affirmed by the Federal Court, of how the 'taxing point' is determined for the purposes of the PRRT".* It also states that *"[b]ecause the measure serves only to clarify and affirm the current application of the PRRT, it does not impose any additional tax burden".* The Explanatory Memorandum to the Bill states that the retrospective change of law *"remove[s] any uncertainty."*[2] These statements are misleading.

Whilst the defined term MPC is a key provision in determining 'taxing point', it is not the only relevant provision. The Government of the day made a number of changes to these other provisions in 2002. We understand that, amongst other things, these changes were intended to deal with the 'taxing point' disputes with Esso. Importantly though, they only applied prospectively.

Importantly, the Full Court of the Federal Court recently considered the definition of a 'marketable petroleum commodity' as contained in the Act, and confirmed that "[t]here is an ambiguity in this definition" [2011 FCAFC 134, paragraph 4]."

We understand that there has only been limited consultation with industry stakeholders in respect of the proposed change to the definition of MPC contained in the Bill.

The Dispute between Esso and the ATO

Esso has been in dispute with the ATO on the precise identification of the 'taxing point' in the Bass Strait project since 1994 and has objected to all 'years of tax' from 1991 through to 2006. However, the industry raised concerns about the interpretation of the 'taxing point' provisions as early as 1990. Furthermore, a senior officer of the ATO publicly advocated in 1992 the contra view to that now advanced by the ATO.[3] Despite the publicly stated position of the ATO, a report tabled in Parliament in November 1992 by the then Minister for Resources, stated on the topic of 'taxing point', *"[n]o practical problems have thus far emerged in the administration of the existing arrangements. The definition of an MPC clearly specifies that that an MPC is a product produced from petroleum".*[4] This statement was extraordinarily optimistic.

The 1992 position paper of the ATO is not legally binding on the ATO. It is however, the ATO's only public advice on the topic and has not been publicly withdrawn or repudiated.

The ATO did not make any rulings on 'taxing point' until 2004, when it rejected Esso's objections for the years of tax from 1991 to 2002. The ATO has not made any public rulings[5], and there have been no other Court decisions on the topic. Esso appealed the objection decisions of the ATO to the Federal Court and currently remains in litigation. ExxonMobil is not aware of any other taxpayer (other than its Bass Strait co-venturer) with a similar dispute or past circumstances dependent upon the outcome of this dispute with the ATO.

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[2] Para 2.45

[3] Presentation by Frank La Scala, Principal Advising Officer, Complex Advising, Australian Taxation Office, *"Petroleum Resources Rent Tax – An Overview of the Legislation With Questions And Answers",* 6 March 1992.

[4] Report On the Operation Of The Petroleum Resources Rent Tax Assessment Act 1987

[5] Taxation Ruling TR 2008/10: Applying PRRT Regulations to gas-to-liquid operations, touches on 'taxing point' but does not directly address the issues raised in the Esso v ATO dispute.

Middleton J of the Federal Court accepted the ATO's current position of 'taxing point' in its 13 April 2011 decision – but did so for quite precise legal reasons. The judge did however conclude that if he were wrong on those precise legal reasons, he would have decided much of the case in Esso's favour. Esso formed the view that there were a number of errors of law in the decision and appealed the decision to the Full Federal Court.

It is important to note that the ATO does not allege that Esso has engaged in any fraud or evasion, or is otherwise mischievous in its claims. What Esso is in fact seeking to do is have the Court's determine the proper interpretation of the law and then have that law properly applied to its facts.

The Australian Government Solicitor (AGS) wrote to Esso on 18 October 2011 noting the introduction of the Bill and that the *"proposed retrospective amendments"* were *"directly relevant"* to the issues between the ATO and Esso and the subject of appeal. It also noted the intention of the Government to secure passage of the Bill through Parliament in the current sitting. The letter sought the consent of Esso to vacate the appeals hearing. Esso did not consent and the AGS subsequently introduced a Notice of Motion to have Esso's appeal hearing vacated. The Full Court of the Federal Court rejected this application in its 28 October 2011 decision [FCAFC 134].

If Esso's appeal is upheld, the matter will need to be remitted back to the trial judge to determine the amount of tax in dispute – however, Esso is of the view that it has significantly overpaid tax during the twelve years in dispute. If Esso's appeal is upheld, the Bill will in fact impose a significant additional tax burden (contrary to the view expressed in the Second Reading Speech).

If Esso's appeal is not upheld, then there is no need for this Parliament to undermine business confidence in Australia's tax systems or tarnish the nation's international reputation by enacting retrospective legislation.

The appeal was heard earlier this week (7-9 November 2011).

ExxonMobil was not consulted on the proposed change prior to the Government's Budget night announcement and has not been consulted on the contents of the Bill.

One of the arguments put forward by the ATO and referred to in the Advisory Report of the House of Representatives Standing Committee on Economics, on the Tax Laws Amendment (2011 Measures No. 8) Bill and the Pay As You Go Withholding Non-compliance Bill 2011 (the Advisory Report) is that ExxonMobil's interpretation of the taxing point "would increase complexity[6]". This was explicitly rejected by Middleton J of the Federal Court in his judgment of 13 April 2011, when he stated "I do not place much store upon these complexities in reaching conclusion as to the operation of the PRRT Act. The methodologies that may need to be used for allocations and apportionment are not novel, and are well known to the law."[7]

The Advisory Report also references unseen evidence provided by the Treasury that refers to an inconsistency in how ExxonMobil "viewed the law during the early stages of the tax".[8] This too has been dismissed as relevant to the current matter, with Middleton J stating "[t]hat arrangement was the product of a commercial compromise. It cannot determine or be relevant to liability to pay tax under the PRRT Act[9]".

[6] Advisory Report para 2.5.
[7] 2011 FCA 360, para 241.
[8] Advisory Report para 2.10.
[9] 2011 FCA 360, para 209.

Retrospectively and Investment

It is not uncommon for modern oil and gas projects to cost tens of billions of dollars to develop and take decades for that investment to be repaid. Investors in such projects (and their financial backers) value predictability, stability, and certainty in fiscal arrangements when committing to such investments. This is particularly so for marginal projects; as is the case with many of Australia's stranded offshore gas fields. The propensity for a Government to retrospectively change the fiscal rules to suit itself undermines predictability, stability, and certainty, and therefore investor confidence. To do so while simultaneously overriding judicial process is even more alarming.

The Government has commissioned two enquiries in recent years into aspects of the administration of tax law. Both inquiries canvassed retrospectivity in tax law.

The current Government commissioned the 'Tax Design Review Panel - Better Tax Law Design And Implementation' report delivered on 30 April 2008. The Panel's report stated that it *"considers that tax measures announced by the Government should generally operate prospectively (ie: take effect only after they are enacted). This would enable taxpayers to structure their affairs according to the enacted law and respect the role of Parliament to make laws."*[10] Further, it stated *"while it may occasionally be appropriate to announce measures that apply before the legislation is enacted, these should be kept to a minimum. Where amendments apply before the legislation is enacted, the announcement should clearly state why retrospective application is necessary."*[11] The Government appears to have accepted this advice[12] but now appears to be ignoring it.

The former Government commissioned another report - the 'Review of Income Tax Self-Assessment - Report on Aspects of Income Tax Self-Assessment' – released by Treasurer Costello on 16 May 2004. The report stated[13]:

> *"While ideally, tax measures imposing new obligations should apply prospectively, retrospective start dates may be appropriate where a measure;*
>
> - *corrects 'unintended consequences' of a provision and the Tax Office or taxpayers have applied the law as intended*
> - *address a tax avoidance issue*
> - *might otherwise lead to significant behavioral change that would create undesirable consequences, for example bringing forward or delaying the acquisition or disposal of assets"*

The proposed retrospective change to the PRRT law does not fall within any of these heads for retrospective amendments. The Government states that the retrospective law is to *"remove uncertainty"* (not a justification canvassed by the 'Review of Income Tax Assessment') but fails to elaborate or substantiate this claim. In contrast, the Policy Transition Group (PTG) Report to Government on New Resource Tax Arrangements dated December 2010, examine the 'taxing point' issue and stated "*stakeholders indicated that they are generally comfortable and familiar with the concepts defining the taxing point in PRRT"*.[14] Had uncertainty existed at this time, it

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[10] At 3.17
[11] At 3.19
[12] Assistant Treasurer Bowen Press Release No. 069 – 22 August 2008
[13] At 7.3
[14] Page 101

would be expected that the PTG may have referenced it in their report (as they did with PRRT deduction provisions[15]).

A discussion paper by the Chartered Institute of Taxation in the UK on ‘Retrospective Taxation’ released November 2010[16] stated *“Retrospection is damaging to confidence in the tax system as it undermines the principles of stability and certainty. In an internationally competitive world, frequent retrospection reduces the attractiveness of the UK to potential inbound investors.”* Whilst acknowledging the ability of the UK Parliament to legislate retrospectively it cautioned that “*the use of retrospective legislation will always damage the key principle of certainty in the UK tax system to some extent.”* Later, it said that retrospectivity *“should be used with extreme care and justified at length.”*[17]

As noted in the draft EM to the ED Bill to extend PRRT onshore, PRRT *“is designed to ensure that the Australian community receives an appropriate return from the development of its non-renewable petroleum resources located offshore.*” It is in essence the fiscal bargain between the Government and business to allow the development of these non-renewable resources by business. The Bill seeks to change this bargain up to 21 years after the taxpayer, Esso, has fulfilled its obligations under the bargain. It is akin to government increasing the rate of a royalty 21 years after the resources have been extracted and sold. It is the antithesis of predictable, stable, and certain fiscal arrangements. We are not aware of any precedent for this type of action in this country.

In addition, the Advisory Report states that “[l]egislating retrospectively should not be done lightly because it is very easy for it not to be fair and for it to create uncertainty.”[18] ExxonMobil supports this position and firmly believes that in this instance the application of retrospective legislation is far from fair, and creates significant business and investor uncertainty that extends to both the legislative and judicial processes.

ExxonMobil is not seeking to convince the Committee on the validity or otherwise of our ‘taxing point’ dispute with the ATO. This is a question that should, quite rightly, be determined by the Courts. However, it is clear that the proposed Bill is designed to usurp the role of the judiciary by reinforcing a disputed decision. It is extraordinary and disregards consistent advice received by Governments past and present about retrospectivity in tax legislation. In short it will do enormous damage to Australia’s international reputation and perceptions of sovereign risk in this country. It will damage business confidence and may well cause some investors to consider whether Australia is an appropriate destination for their mobile capital.

It is also worth drawing the Committee’s attention to the current Government’s growing propensity for retrospective legislation. In addition to the issue under discussion here, earlier this month the Assistant Treasurer, the Hon W R Shorten MP announced proposed changes to Australia’s transfer pricing rules - to be applied retrospectively from 1 July 2004[19]. The combined impact of 2 retrospective announcements within a 6-month period is of great concern to the Australian business and investment community and will impact Australia’s international reputation.

<u>Recommendation</u>

The Committee should recommend to Parliament that it reject the retrospectivity of the proposed Bill.

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[15] Page 109
[16] http://www.tax.org.uk/tax-policy/public-submissions/2010/RetrospectiveTaxationACIOTdiscussionpaper
[17] Para 1.3 to 1.5
[18] Advisory Report para 2.18
[19] Assistant Treasurer Shorten Press Release No. 145 – 1 November 2011