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8 November 2021

Mr Mark Fitt
Committee Secretary
Senate Standing Committees on Economics
PO BOX 6100
Canberra ACT 2600

Dear Committee Members,

RE: Inquiry into the Laminaria-Corallina Decommissioning Cost Recovery Levy Bills

The Australian Petroleum Production & Exploration Association (**APPEA**) is the peak national body representing upstream oil and gas explorers and producers active in Australia. Australia's oil and gas industry plays a fundamental role in our nation's economy, providing essential energy to power businesses and homes in Australia and across the world. It also invests billions of dollars to generate cleaner energy, creating jobs and economic growth for the communities in which we operate.

APPEA remains concerned about the signal this levy sends to an industry seeking to further invest in new energy supply and emissions reduction technologies. The levy poses fiscal and investment challenges by setting a dangerous legislative precedent and sovereign risk concern in that financial culpability is unlikely to receive the necessary focus if it is shouldered by the broader industry despite the failures of regulation, regulators, and a few industry participants. This includes where those that derived no commercial or financial benefit from the resource will be held to account to meet the costs if anything goes wrong, even in circumstances where the sale and transfer of the asset(s) were approved by the government without broader industry consultation or involvement.

Nevertheless, we welcome the opportunity to provide a submission to the committee which can be found in **attachment A** to this letter. Primarily, our feedback encourages the committee to consider improvements to the design of the legislation to ensure it achieves the intended policy outcome. That is, to make sure the levy operates in a manner that recovers the costs of the government decommissioning and remediating the Laminaria and Corallina oilfields and associated infrastructure, and only these costs.

We would welcome the opportunity to discuss this matter further with you. Should you require further information or would like to discuss the contents of this submission, please do not hesitate to contact me on 0457 363 936.

Yours sincerely,

[redacted]

Andrew McConville
Chief Executive

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ATTACHMENT A

APPEA submission to the Senate Economics Legislation Committee Inquiry into the Offshore Petroleum Laminaria and Corallina Decommissioning Cost Recovery Levy Bills

For the purposes of this submission, the following definitions apply:

- **imposition bill** refers to the *Offshore Petroleum (Laminaria and Corallina Decommissioning Cost Recovery Levy) Bill 2021.*
- **administration bill** refers to the *Treasury Laws Amendment (Laminaria and Corallina Decommissioning Cost Recovery Levy) Bill 2021.*
- **explanatory materials** refer to the Explanatory Material for both the imposition bill and the administration bill.
- **bills and explanatory materials** refer to the imposition bill, administration bill and the explanatory materials collectively.

Key recommendations

<u>Improvements to the current drafting of the bills that require serious contemplation</u>

1.1 Legislate that the levy applies for no more than four (4) years and end on 30 June 2025.

1.2 Automate the termination of the levy once all costs related to the decommissioning activities of the Laminaria-Corallina oilfields and associated infrastructure have been recovered by the federal government.

1.3 Legislate that the Australian Taxation Office can vary the levy rate down in circumstances where the amount collected by the levy in any year would exceed total unrecovered costs without the need for a legislative instrument.

1.4 Legislate an annual transparency review and reconciliation process that discloses the amount of decommissioning expenditure incurred by government, the amount of expenditure the government expects to incur over the following 12 months, and how much has been recovered by the government through the levy to that point in time.

1.5 Legislate mechanisms for dealing with overpayments.

<u>Adjustments to the existing levy bills to improve the design and increase certainty</u>

2.1 Make all payments of the levy deductible for taxation purposes (consistent with the deductibility of the Major Bank Levy) as would be the case under ordinary decommissioning frameworks.

2.2 If the levy is not deductible, legislate any amounts received by a petroleum producer that are directly or indirectly attributable to the levy as being treated as non-assessable non-exempt income for broad taxation purposes.

2.3 Amend the Petroleum Resource Rent Tax Assessment Regulation 2015 to ensure that payments of the levy are treated as a specifically excluded cost.

1. Improvements to the current drafting of the bills that required serious contemplation

1.1 Levy year

The current drafting of subsection 7(1) of the imposition bill states that the levy will run until 30 June 2030. APPEA estimates indicate that the levy is likely to collect approximately $380 million per annum, potentially resulting in a ***minimum*** $3.4 billion being collected over the life of the levy. In our view, this far exceeds the timeframe and cost needed for relevant decommissioning activities and hence the total amount of expenditure that would need to be recovered. Importantly, despite the potential for the levy to be terminated earlier, industry will assume that it will run until 30 June 2030 in economic modelling for new investment decisions – with a concomitant impact on the ability of those projects to attract competitive capital.

Whilst we note there are mechanisms in the current drafting of the bills and explanatory materials that the levy can be terminated early or the rate applicable be varied down, we observe that the legislation requires the Resources Minister[1] to decide when to terminate the levy and that any such decision will be a disallowable instrument. This brings added uncertainty as to the way the levy is managed by those that are liable for the levy in any particular levy year. Without certainty, the levy is likely to have long standing impacts into the preparation of financial accounts, reserves assessments, investment decisions and what should be contemplated at the end of a field life.

APPEA recommends that the imposition bill be drafted to apply for no more than four (4) years and end on 30 June 2025.

We see this as reasonable given that we estimate that $1.6 billion would be collected over the four-year period recommended, providing significant coverage of the government's costs of decommissioning the Laminaria-Corallina oilfields. This approach significantly lowers the risk of overpayments occurring whilst also ensuring that the legislation is consistent with the policy intent of the levy.

1.2 Automatic termination of the levy

APPEA recommends that the levy automatically terminate once all costs have been recovered. In doing so, the imposition bill should be amended to make it explicitly clear that the levy only recovers the costs of the government decommissioning and remediating the Laminaria and Corallina oilfields and associated infrastructure, and only these costs. Absent this, the difficulties associated with the existing mechanisms for terminating the levy early (see below) could inadvertently cause the levy to continue well beyond what is required to cover the decommissioning cost.

In our view, there is no justification for the levy to terminate by a regulation that requires discretion or a parliamentary process. This is because there is a finite cost associated with the cost recovery nature of the levy. Having the levy terminate automatically would ensure that the levy is not at odds with the announced policy and design of the levy. Further, this process must be supported by a legislated annual transparency review and reconciliation process (see later at section 1.4 of this submission).

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[1] As defined in the *Offshore Petroleum (Laminaria and Corallina Decommissioning Cost Recovery Levy) Bill 2021*

Subsections 7(2) to (4) of the imposition bill provides the framework for when the levy may be terminated and that it may terminate where the Resources Minister is satisfied all costs are recovered. The strictness of subsection 7(4) of the imposition bill makes it difficult to terminate the levy early. Specifically, paragraphs (a) and (b) of subsection 7(4) both need to be satisfied – they refer to "and" not "or". Amending the legislation to replace "and" with "or" will assist with alleviating concerns about the levy extending beyond the recovery of the costs of the decommissioning and remediating the Laminaria and Corallina oilfields and associated infrastructure.

The wording of (b) uses the term "unlikely" without providing any guidance or threshold as to what is meant by the term "unlikely". This not only makes it open for regulatory challenge by special interest groups, but also makes it difficult for the Resources Minister to make a determination to terminate the levy.

In addition, regulations are subject to ordinary parliamentary processes and can be delayed or deprioritised on the parliamentary program. This may result in the levy being collected for the financial years up until 30 June 2030, well after the costs of the decommissioning activities have been recovered. In the event the levy runs longer than needed, the government will then be deriving a revenue gain or will be profiting from the levy which is beyond the remit of the approved policy and design. This will distort future investment by setting a dangerous precedent from a sovereign risk and moral hazard perspective.

The imposition bill provides the ability for the Resources Minister to vary the levy rate to $0.00 to shortcut the need to pass a regulation. We observe that this would be a disallowable legislative instrument in accordance with subsection 8(2) of the imposition bill, and this legislative instrument would be subject to the same challenges outlined above with respect to early termination. If the rate were able to be varied to $0.00 but the levy not terminated, this would raise a deregulation issue as petroleum producers will still be required to comply with their reporting obligations under the administration bill.

Without change the current design only increases the risk of overpayment occurring and it needs to be rectified as a matter of priority.

1.3 <u>Varying down the levy rate</u>

APPEA recommends that the varying of the levy rate be automatic without the need for a legislative instrument. This is consistent with our comments in relation to the termination of the levy above.

The imposition bill provides a mechanism for the levy rate to be varied down because of the Commonwealth's unrecovered cost of the levy year calculation in subsection 8(2). We see no policy as to why this variance cannot be executed by the Australian Taxation Office (**ATO**) without the need for a legislative instrument, especially where a legislated annual transparency review and reconciliation process is introduced.

With a transparent annual review and reconciliation report being published, the ATO can use the data from the report and the production volumes reported to determine the appropriate rate for the relevant financial year. This should help to limit the risk of overpayments and the 'moral hazard' risk that the levy be treated as a hollow log to pay for other programs.

1.4 Legislating an annual transparency review and reconciliation process

APPEA is disappointed that there are no transparency requirements in the bills and explanatory materials. Industry is held to a standard of transparency of dealings and taxation payments by the government and administrators, and in our view the government should be held to an equal standard of transparency.

APPEA recommends that a legislated annual transparency review and reconciliation process should be mandated on the government by inserting the appropriate mechanisms into the bills that compel the Resources Minister to conduct this process.

This mandate must include a report that transparently publishes the amount of decommissioning expenditure incurred by the government, the amount of expenditure the government expects to incur over the following 12 months, and how much has been recovered by the government through the levy to that point in time. This information will already be available to the government, Department of Industry and the ATO as it would be required to determine the Commonwealth's unrecovered amounts per section 8 of the imposition bill, and the amount of the levy for a levy year in accordance with section 11 of the imposition bill.

The process would support the management and transparency of the levy. We note that this would be similar in structure to that which is already contemplated by the Junior Minerals Exploration Incentive (JMEI) in Subdivision 418-G of the *Income Tax Assessment Act 1997* (**ITAA 1997**). Whilst the objective of the JMEI report is to measure additional exploration and prospecting that is attributable to the scheme, the foundation of what is achieved is ensuring there is a layer of transparency with respect to government spending and the administration of the JMEI.

1.5 Overpayments

As we note above, the current drafting of the imposition bill increases the risks of overpayments occurring. While section 8 and section 11 of the imposition bill allows for the Resources Minister to make a determination to adjust the rate of the levy where the amount recoverable would be exceeded by collections, mechanisms need to be inserted to ensure that overpayments are appropriately dealt with. The absence of such mechanisms may suggest or at least appear to suggest that the government is looking to collect additional revenues from the levy rather than just satisfying the policy and design intent of the levy.

Our estimates indicate that if the levy were to run for nine years, the government would collect approximately $3.4 billion when our estimates indicate the decommissioning expenditure is estimated to cost circa. $1.2 billion. In fact, the $3.4 billion could be far higher given the proposed length of time the levy applies, and that it will apply to increased production levels and new projects coming online between 2021 and 2030.

Given the challenges we identify above with rate variation and termination, the absence of self-executing provisions and a legislated annual transparency review and reconciliation process would result in significant overpayments occurring. The administration bill needs to have appropriate mechanisms for dealing with overpayments. Simply put, any overpayments must be returned to levy payers.

APPEA recommends that the administration bill and relevant explanatory materials be amended to provide a mechanism for dealing with overpayments, ensuring that:

- Any overpayments be returned to petroleum producers as soon as practical and subject to the same interest rates that apply to overpayments for individuals, taxable trusts, companies, and superannuation funds;
- any amounts returned are not later assessable for income tax and Petroleum Resource Rent Tax (**PRRT**);
- any interest (on overpayments) returned should not be assessable, if the levy is not assessable; and
- any interest on funds held (due to overpayments or timing differences) should be reported and either returned or reinvested.

2. Adjustments to the existing levy bills to improve the design and increase certainty

2.1 Non deductibility of the levy for taxation purposes

Whilst we understand that it is the government's preference to specifically legislate that the levy be non -deductible for all impacted taxes, this approach is at odds with the general deductible treatment of levies, rents, and royalties that are not linked to taxable income. For example, the major banks were specifically entitled to claim a tax deduction for the Major Bank Levy that was imposed in the *Major Bank Levy Bill 2017* and the *Treasury Laws Amendments (Major Bank Levy) Bill 2017*. There appears to be no policy justification for non-deductibility beyond an act of sovereign retribution on industry to punish it for the failures of regulation, the regulator, and a few industry participants.

We are of the view that the proposal to deny a tax deduction for the levy is not only inconsistent with existing law, but it is discriminatory across different industries. The oil and gas industry should not be treated any differently from the banking industry in respect of the tax deductibility of a levy imposed by a government. It can be viewed as unfair whilst setting a dangerous inequitable precedent. Even if the levy were akin to a tax, it would be tax deductible.

Outside of being made explicitly deductible for income tax like that which is provided for under section 25-5 of the ITAA 1997 for the major bank levy, the levy should be deductible by taxpayers under general deductibility provisions (i.e., section 8-1 of the ITAA 1997). This would align with normal taxation and accounting outcomes that would have occurred under a normal decommissioning arrangement.

APPEA recommends that consistent with the Major Bank Levy, the Committee consider and recommend treating the levy as tax deductible for the whole amount incurred.

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2.2 Amounts received by a petroleum producer that are directly or indirectly attributable to the levy

As mentioned above, whilst we understand that it is the government's preference to specifically legislate that the levy be not deductible for all impacted taxes and royalties, there should be symmetry in the way government seeks to tax payments and receipts associated with the levy. Otherwise, the government would be seen to be profiting from the levy.

If the levy remains non-deductible, then ***APPEA recommends*** that any amounts received by a petroleum producer that are directly or indirectly attributable to the levy imposition must also be treated as non-assessable non-exempt income for broad taxation purposes, including amounts refunded of the levy previously assessed. This symmetrical treatment will help to reduce the impact of the levy on consumers.

2.3 Impact of the levy on the Residual Pricing Methodology (RPM)

Consistent with our comments above, APPEA is concerned that the consequential adjustments considered in the administration bill do not appropriately consider the impact the levy will have on the RPM methodology. That is because Regulation 32 of the *PRRT Assessment Regulation 2015* specifically states in regulation 32(e) that expenditure listed in paragraphs 44(1)(a) to (h) of the *PRRT Assessment Act 1987* are excluded costs for the purposes of determining the RPM.

APPEA recommends that the *PRRT Assessment Regulation 2015* be amended to include the new paragraph 44(ia) of the administration bill as a specifically excluded cost.

Failure to make this alteration to the *PRRT Assessment Regulation 2015* will result in an inflated taxable receipt amount which would then be subject to PRRT. In effect, the government would potentially be collecting an additional forty cents for every dollar of levy liability paid, therefore profiting from its own levy.