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Perth Branch



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10 January 2019

Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600
Attention: Mr Mark Fitt, Committee Secretary

Re.: Inquiry into the Timor Sea Maritime Boundaries Treaty Consequential Amendments Bill 2018

Dear Committee Members,

Eni is pleased to provide its submission to the inquiry on the "Timor Sea Maritime Boundaries Treaty Consequential Amendments Bill 2018" referred by the Senate to the Economics Legislation Committee on the 29th November 2018.

Background

Eni is a major integrated energy player, operating in 71 countries worldwide and employing around 33,000 people, active in oil and gas exploration, production, refining and selling operations, renewables, electricity and chemistry. Eni is heading increasingly towards the decarbonisation of the energy system leveraging on innovation while contributing to the development of the countries of presence.

Eni has been operating in Australia since 2000. Eni invests in establishing successful and positive relationships with its host communities through constructive contributions and the ability to assist with their sustainable development.

Eni owns and operates the Blacktip gas field, supplying gas to Australia's Northern Territory for power generation and industrial uses. Eni operates also 5 exploration and retention license and one production license in Australia. In 2017, Eni became operator of Evans Shoal, a multi-Tcf gas field located in the NT/RL7 offshore license in northern Australia, near to the Darwin LNG plant. Eni is also actively engaged in the decarbonisation process and initiatives in the renewable energy sector.

Eni is also operating in the Joint Petroleum Development Area (JPDA), an offshore region between Australia and the Democratic Republic of Timor-Leste (Timor-Leste) established in 2002 under the Timor Sea Treaty (TST)¹.

Eni's principal activity in the JPDA is the exploration, development and production of oil and gas resources. Eni has been active in the JPDA through its wholly owned subsidiaries:

¹ Timor Sea Treaty between the Government of East Timor and the Government of Australia (Dili, 20 May 2002).

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- 1) Eni JPDA 06-105 Pty Ltd - 40% equity share and operator of the Kitan oil field (production from 2011 to 2015)
- 2) Eni JPDA 11-106 BV - 40.533% equity share and operator (an exploration well foreseen for the first half of 2019)
- 3) Eni JPDA 03-13 Limited owner of a non-operating share (10.986%) in the Bayu Undan Joint Venture integrated project.

The TST provides for a temporary settlement of the dispute regarding the maritime boundaries of the two countries.

The TST and the TST Taxation Code established a framework for the title and revenue sharing of petroleum produced from the JPDA pursuant to which 90% of revenue arising from a Production Sharing Contract (PSC) is taxable under Timor-Leste's taxation laws (less deductions allowed under those laws) and 10% is taxable under Australia's taxation laws (less deductions allowed under those laws).

On 6th March 2018, Australia and Timor-Leste entered into the Treaty establishing their Maritime Boundaries in the Timor Sea (the Treaty). The Treaty will be ratified by the two governments and enter into force once the relevant new PSC and associated arrangements replacing the existing framework have been agreed by all parties. After ratification, 100% of all future upstream petroleum revenue shall fall under Timor-Leste jurisdiction.

Under the Treaty, the governments of Australia and Timor-Leste have agreed that petroleum activities undertaken or still to be undertaken under the existing relevant PSCs shall continue on terms of 'conditions equivalent'², meaning the contractor(s) under the PSCs (the Contractors) will be able to continue to operate in the new jurisdiction with no negative fiscal or operational impact as a result of the new Treaty.

As such, certain measures and transitional arrangements will need to be put in place to ensure the value of the project is maintained for the Contractors of the PSCs.

Transition to 100% Timor-Leste Jurisdiction

A condition of the transition from JPDA to exclusive Timor-Leste jurisdiction is that petroleum activities shall continue on terms of 'conditions equivalent' (legal, fiscal and operational).

The details of how 'conditions equivalent' will be achieved under the new legal and fiscal regime in Timor-Leste is still the subject of negotiation, and is to be agreed by all parties. The PSCs in the JPDA are subject to project-specific legal, fiscal, and operational regimes, and accordingly there are effectively unique rules for each PSC.

Re-drafting of the PSCs is required to recognise the change in sovereignty and maintain conditions equivalent, and is a joint effort between the representatives of Australia and Timor-Leste Governments and the Contractors of the PSCs.

² A principle also provided for in the Article 22 of the Timor Sea Treaty.

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Eni, following the 6th March 2018 signing of the Treaty, is committed to assisting the authorities of Australia and Timor-Leste in ensuring conditions equivalent are met and Treaty ratification can occur in the earliest timeframe.

Regulatory and operational equivalence

Petroleum activities in the JPDA are currently regulated by the TST, the PSC and existing JPDA code, regulations and subsidiary instruments. Under the terms of the Treaty, to ensure regulatory stability is maintained and that petroleum activities continue on conditions equivalent, existing petroleum activity approvals granted under the existing regime will continue to apply under the new regime and the JPDA Petroleum Mining Code and other JPDA regulations and subsidiary instruments will be incorporated into Timor-Leste's domestic legislation. Under the TST, operations in the JPDA are subject to various provisions which facilitate streamlined operations for goods, services and labour between Timor Leste and Australia. For operations to continue to proceed as they would under the JPDA, mechanisms will need to be provided for in the new Timorese Decree Laws and PSCs.

Regulatory and operational stability is paramount for Eni to ensure that it can continue with its petroleum operation in a safe, efficient and effective manner.

Fiscal equivalence

From Eni's perspective, fiscal 'conditions equivalent' would be achieved by amending the Timor-Leste Tax Law to mirror the current legislation of the JPDA, however Eni understands that such an approach may be difficult to achieve due to Timor-Leste parliamentary approval requirements. Economic analysis and modelling have been presented to the Timor-Leste and Australian regulators to illustrate the implications of proposed changes in fiscal rules and to identify the key drivers.

A significant driver of equivalence from a fiscal point of view is the Timorese Supplemental Petroleum Tax (SPT)³ which is currently applied at an effective rate of 22.5%⁴ to the assessable taxable income in Timor-Leste, when a project has a rate of return above 16.5%. The SPT is not applicable to the income generated in Australia.

Among the other key differences between the current and the Timor-Leste Exclusive Area (TLEA) we underline the following:

- indirect taxes- the implications depend on the mix of goods and services that are required to perform the activities⁵.
- depreciation rates between the current JPDA fiscal rules and the TLEA⁶
- abandonment cost is deducted annually in the TLEA in accordance with the pre-agreed schedule⁷, whereas in Australia it is deducted in the year of spend

³ For JPDA 03-13 the tax is named Additional Petroleum Tax (APT) and has the same mechanism of SPT.

⁴ Rate at 32.14% and it is deductible from Corporate Income Tax: $32.14\% \times (1-30\%) = 22.5\%$

⁵ JPDA is VAT at 9% and withholding tax at 5.4% on services, whereas TLEA is VAT at 0%, import duties 6%, sales tax 6% (applied to all goods imported) and withholding tax on services applied at 6%

⁶ Australia depreciation for the 10% allows 200% declining balance depreciation and effective useful life of the asset whereas TLEA is 10 year straight line for development asset or effective life (whichever is the less). In TLEA depreciation on Unit of Production (UOP) basis is eligible for small fields.

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- Eni's companies operating in the JPDA have various future tax attributes which would otherwise have been utilised under the existing JPDA regulations⁸

Further, the TST provides for protection from double taxation and prevention of evasion of individuals or contractors operating in the JPDA. Eni has its local corporate office in Perth, Western Australia and leads activities in the JPDA from there (in conjunction with Eni's Timor-Leste office and an office located in Darwin), including provision of corporate and technical services to the JPDA.

Eni, in accordance with its tax strategy,⁹ would want to ensure similar taxation provisions are applied under the new framework.

Conclusions

Eni would like to thank the Australian authorities for the discussions and options that have been tabled. Eni believes that the collaboration between Australian and Timor-Leste authorities will make conditions equivalent achievable and that the above described discrepancies will find a solution with mutual benefits, ensuring taxes at corporate and personal levels continue to be applied fairly between the two jurisdictions.

Eni is interested to understand the Australian legislative mechanism which will lead to fiscal equivalence.

Eni is keen to continue to provide the authorities of Australia and Timor-Leste with any conceivable support to facilitate the Treaty ratification in the earliest timeframe .

Yours sincerely,¹



Ernie Delfos
Managing Director
Eni Australia Limited

⁷ Decommissioning Cost Reserve

⁸ Including, but not limited to undepreciated tax written down value and carry forward tax losses. Eni has written to the Treasury Department kindly requesting consideration of mechanisms which may allow for those future tax benefits to be utilised in a similar timeframe to when they would have been used under the existing JPDA regulations.

⁹ The primary objective of Eni's Tax Strategy is to ensure payment of taxes in the various countries in which Eni operates, in accordance not only with the letter but also the spirit of applicable laws. Our complete tax strategy is available for review on our corporate website:

https://www.eni.com/en_IT/sustainability/integrity-human-rights/tax-strategy.page