Australia's Oil and Gas Reserves Inquiry

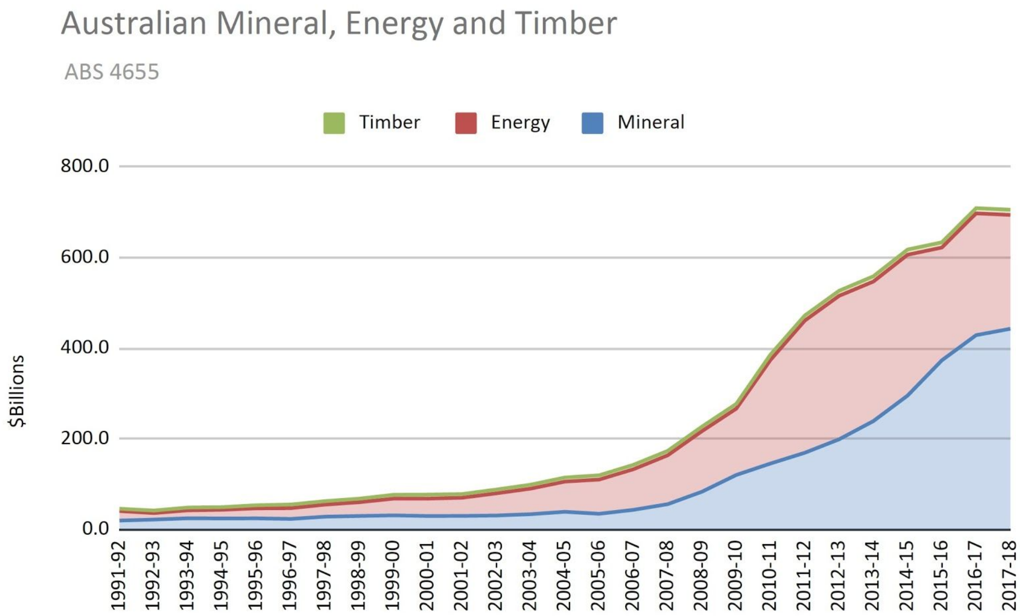
The Reform Agenda

An effective resource rent mechanism is paramount to guaranteeing the economic rights of all citizens. This ensures the public receives a fair share of the value extracted.

The ABS quantifies[1] that Australia's natural resources have increased in value:

Item	1988-89 ($billions)	2017-18	Uplift %
Timber	$5.1	$11.7	129.4%
Energy	$20.9	$244.0	1067.5%
Minerals	$19.8	$385.7	1848.0%

This looks like:



[1] https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4655.02019?OpenDocument

Australian taxpayers must recognise that this increase in valuation, of some 1,068% for energy and 1,848% for minerals, has occurred without any real effort of the owners of the resources. Whilst the commonwealth is the legal owner of these resources, they have been largely gifted to the extraction industry with little recompense. In a modern economy this must be addressed.

We will now look at Israel and Qatar's governance of natural resources.

Israel's Royalty System

In 2011, the state of Israel announced a new fiscal regime for petroleum. This included:

Royalties - 12.5%
Profit levy - 0-50%

Royalties were levied at the market value on the wellhead, from day one of production.

The Petroleum Profit Levy (PPL) is only applied after a 150% return on investment. From that point the levy increases on a sliding scale from 20 - 50% over a number of years depending on the size of the field.

When combined with the 23% corporate income tax, the total government tax take initially ranged between 52 - 62%.[2] However, the maximum PPL was reduced to 45.5% due to a change in the corporate tax rules in 2012,[3] leading to a top rate of 57.5%.

Qatar's Royalty System

Qatar calculates royalties via a 5% withholding tax. Tax treaties between nations can be used to minimise this rate.[4]

A 35% income tax rate is also applied to all mining and gas operations. This applies to all vertical and horizontal operations within the industry.

Qatar has a sophisticated compliance regime in relation to tax avoidance strategies. Interest payments to foreign entities are permitted, although interest paid to a related party are not permissible. Compliance includes the monitoring of debt loading. Transfer pricing can be addressed by the tax department with a comparative arm's length price.[5]

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[2] http://www.energy-sea.gov.il/English-Site/Pages/Regulation/Fiscal-Terms.aspx
[3] http://www.oecd.org/fossil-fuels/ISR_v2.pdf
[4] https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-qatarhighlights-2018.pdf
[5] ibid

With effective oversight, Qatar will raise $26 billion and Australia virtually none over the coming years,[6] with this nation instead opting to increase taxes on the rest of the economy.

Australia’s Royalty System

The mix of state royalties should continue. A federal minimum 10% royalty on resources at the mine gate (rebatable on state royalties paid) should be implemented. A per tonne valuation, updated quarterly will see a better return for Australian citizens. Volumes should be audited by the ATO and not rely on company estimates. This must be performed regularly using the latest technology.

Prosper’s commends the government for tightening the PRRT after the recent Callaghan Review. However the changes did not go far enough. Prosper contends the existing PRRT still remains unfit for purpose, firstly because it grandfathers existing projects with excessive carry forward losses. Secondly depreciation continues to undermine the tax base.

Prosper advocates for a simpler royalty rate applied to new and existing projects, as resource rent taxes encourage aggressive tax minimisation. Prosper first warned that the PRRT had an effective tax rate of 3.4%, rather than 40%, in 2012.[7] Transfer pricing and elaborate depreciation methods no longer become so relevant under a royalty regime.

Such royalties will only tax away at the monopoly rents of natural resources. Prices cannot be passed on to customers in the form of higher prices as Australia’s iron ore, for example, competes in a global marketplace. Other exporting nations that do not have such a royalty will out compete any company that tries to pass on the fee. Miners contend that because they can't recover the costs imposed by the tax, they will invest in countries other than Australia and so mining jobs will decline here. The same argument has been used in Norway where oil rents and company incomes account for 78% of revenues, but in the end there were more companies than licenses available because investors knew the returns were still higher than in other industries where scarcity rents aren’t available. Additionally state-owned Statoil has the potential to develop resources which are still reasonably profitable if private companies intentionally refuse to invest,

One of the main advantages for a resource rents system is the exploration and development of marginal sites. With the increased use of robotic vehicles and other automations, the drive to develop marginal sites to create employment is less important. The weight of environmental concerns further reduces the need to develop marginal sites.

The new federal royalty rate could be offset against the existing PRRT, but should not be deductible against company taxes.

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6 https://www.abc.net.au/news/2019-04-01/tax-credits-for-oil-and-gas-giants-rise-to-324-billion/10959236

7 http://www.prosper.org.au/wp-content/uploads/2013/12/TRRA_2013_final.pdf

PRRT Phase Out

The PRRT should be phased out over five years. This would give industry five years to write off the $342 billion in carry forward losses.

Elaborate depreciation rates must also be reviewed to maintain the company tax base.

The use and abuse of Depreciated Optimised Replacement Costs is another tool that owners of recently privatised assets adopt to massage taxable profits lower. Consultants for hire have conflicts of interests when they are paid to estimate the optimum replacement cost of an asset favourably. Consider a gas pipeline replacement being valued at twice the width, even though current capacity is more than adequate. Poles and wires paid off by past generations can be depreciated based on their optimum replacement cost. Australia is one of the few jurisdictions where this practise is allowed. A higher level of oversight is required on such costings.

A Hydrocarbon Holding charge is worthy of consideration. Such a levy should be enacted following the fifth year from the discovery of oil and gas reserves. This would allow for the initial exploration costs to be covered, as per Israel's system. A Hydrocarbon Holding charge will from that point on act to minimise the ability of natural resource owners to hoard oil and gas in order to manufacture scarcity rents.

Any such additional revenues should be used to reduce the tax burden on the productive sector.

An additional oversight is the quantification of economic rents from hydrocarbons as a tax expenditure. Australian taxpayers deserve the quantification of such gifts when they run into the tens of billions of dollars. It is a concern that the revenue potentials from the extraction industry have not already been included as tax expenditures.[8]

Gas distribution is another component of the energy market that must be more closely analysed. It appears that monopoly rents are being enjoyed by distributors. A COAG paper by Michael Vertigan states:

> Central Petroleum, a gas producer looking to transport gas from the Northern Territory to eastern Australia, has been quite vocal in its belief that pipeline operators are exercising their market power by monopoly pricing.'(T)he incumbent pipeline owner is incentivised to set tariffs at a level just below the higher new entrant alternative. As a result, the cost efficiencies that are inherent to existing pipeline assets are not shared with the markets upstream or downstream of that pipeline creating market inefficiencies and muted pricing signals to gas suppliers and customers'.[9]

[8] https://static.treasury.gov.au/uploads/sites/1/2018/01/2017-TES.pdf

[9] http://www.coagenergycouncil.gov.au/publications/examination-current-test-regulation-gas-pipelines-consultation-paper

A contributing factor is that regulators have looked at the sector's pricing according to a 'private profitability' test rather than a 'natural monopoly' test.[10]

With gas acting as the pricing alternative for energy, high gas distribution prices are allowing coal power generators to raise prices above marginal costs.

Lastly, environmental bonds must provide the capacity to meet the full 100% of environmental remediation. Effective remediation includes 'final voids' (the mining pit). These must be filled and revegetation provided. Many states have avoided this requirement. Audits must be taken to ensure the dumping of damaged machinery is not buried far underground or that seeps are left exposed due to mining.

Further protection for the public should ensure that any mining lease includes a clause forbidding the sale of the mining entity to a shelf company during its final years of operation. The use of shelf companies known as 'minnows' has been recognised as a process of avoiding remediation. This is less than optimal, particularly for local residents and indigenous custodians.

Conclusion

These reforms go to the heart of recognising the earth as a commons. All economic activity must ensure the land is left in as good if not better condition than we found it. If royalties can be effectively administered, there is potential for further income and company tax cuts.

[10] ibid