THE TAX INSTITUTE

26 October 2011

Mr David Monk
Inquiry Secretary
Standing Committee on Economics
PO Box 6021
Parliament House
CANBERRA ACT 2600
AUSTRALIA

By email: economics.reps@aph.gov.au

Dear Mr Monk

INQUIRY INTO LEGISLATION ON THE PETROLEUM RESOURCE RENT TAX

Schedule 2, Tax Laws Amendment (2011 Measures No.8) Bill 2011

The Tax Institute is pleased to make a submission to the House of Representatives Standing Committee on Economics (the "**Committee**") in relation to Schedule 2 of *Tax Laws Amendment (2011 Measures No.8) Bill 2011* (the "**Schedule**").

Our comments relate to the application date of the Schedule, specifically Section 3 of the Schedule which specifies that "[t]he amendments made by this Schedule apply in relation to the year of tax commencing on 1 July 1990 and each later year of tax." We do not seek to make any comments in relation to the proposed Section 2E of the *Petroleum Resource Rent Tax Assessment Act 1987* as set out in the Schedule.

Principles underpinning tax law amendments

The importance and relevance of tax laws to taxpayer decision making and behaviour cannot be underestimated. As such, The Tax Institute strongly supports working within a framework of guiding principles when introducing tax laws in order to provide taxpayers with greater certainty in relation to their tax liabilities and affairs.

Of these principles, among the most fundamental is that legislative changes should not apply retrospectively except in very specific circumstances and after thorough public consultation. Where the Government considers a deviation from this principle to be warranted, any such deviation should be thoroughly consulted on and explained.

It is our view that the application of this principle should not be dependent on the business, investment or tax profile of the taxpayers that may be affected by any specific tax law amendment.

Retrospective legislation

The Tax Institute does not recommend or support retrospective tax law amendments that may be disadvantageous to taxpayers for a number of reasons, including:

- Taxpayers enter into transactions on the basis of the law as it is, not the law as it is rewritten after transactions have occurred. As a result, retrospective changes in tax law that alter a taxpayer's tax liability are likely to disturb the substance of a bargain struck between taxpayers who have made every effort to comply with the prevailing law as at the time of the agreement. In addition, typically taxpayers undertake transactions based on what they considered to be known exposures to tax liabilities. Retrospective amendments could give rise to unexpected joint and several liabilities.

- A significant change in tax liability may render incorrect the inputs taken into account in calculating tax expense and current tax liability/assets as disclosed in a company's financial accounts. Subsequent changes to the financial statements as a result of retrospective legislation would have adverse implications for investors and capital markets that have relied on the financial statements.

- Taxpayers have committed to investment decisions on the basis of a particular tax profile for an entity. Retrospective amendments to change such a tax profile can materially impact the financial viability of investment decisions and the pricing of those decisions.

- Foreign investors have recently expressed concerns in relation to the increased "sovereign risk" of investing in Australia due to significant changes in tax policy. A retrospective amendment with an application date of more than 21 years before the date of enactment, especially without thorough consultation with the taxpayer community or clear reasons for the retrospectivity, is likely to exacerbate these concerns.

The Tax Institute acknowledges that in some rare circumstances retrospective legislation may be appropriate, such as for instance where the amendment corrects an unintended consequence of a provision and taxpayers have applied the law as intended, or in order to address a significant tax avoidance issue.

However, where the Government is of the view that such circumstances exist:

- Thorough consultation should be undertaken with the taxpayer population in relation to the appropriate date of application of the amendments; and

- Should a retrospective date of application be determined to be appropriate following such consultation, the rationale for the retrospectivity should be clearly enunciated and publicised via any relevant press release on introduction of the Bill and via the Explanatory Memorandum to the relevant Bill.

Parliamentary procedures to safeguard against retrospective legislation

We also note that Parliament, especially the Senate has expressed reluctance to pass retrospective laws except in very limited circumstances. Specifically, Senate Standing Order 24 and the resolution of the Senate of 8 November 1988 set out the Senate's concerns with respect to deliberations regarding retrospective legislation. Relevantly, Senate Standing Order 24 provides as follows:

> "24. (1)(a)….the Scrutiny of Bills Committee shall be appointed to report, in respect of the clauses of bills introduced into the Senate, and in respect of Acts of the Parliament, whether such Bills or Acts, by express words or otherwise: i) trespass unduly on personal rights and

liberties…"

….

The following commentary by the Committee is also relevant to Senate Standing Order 24:

"2.5 The Committee endorses the traditional view of retrospective legislation. Its approach is to draw attention to Bills which seek to have an impact on a matter which has occurred prior to their enactment. It will comment adversely where such a Bill has a detrimental effect on people. However, it will not comment adversely if:

- apart from the Commonwealth itself, the Bill is for the benefit of those affected;
- the Bill does no more than make a technical amendment or correct a drafting error; or
- the Bill implements a tax or revenue measure in respect of which the relevant Minister has published a date from which the measure is to apply and that publication took place prior to that date."

As we understand it, if retrospective laws are introduced, the Scrutiny of Bills Committee will comment that the provisions breach the principle in Order 24. This is a limitation that the Senate has sought to impose to essentially protect the 'rule of law', and the objectionable nature of retrospective legislation.

Retrospectivity of this amendment

In our view, the following comments in the 2011-12 Budget Paper No.2 (page 40) which assert that the amendments in the Schedule seek to confirm the law as it is being currently applied:

> *The Government will amend the tax law to provide greater certainty around how the taxing point is calculated for the purposes of the Petroleum Resource Rent Tax (PRRT), with effect from 1 July 1990. This measure will confirm existing application of the PRRT in relation to the taxing point and will provide greater certainty for PRRT taxpayers.*
>
> *The location of the taxing point within a PRRT project is used in determining PRRT liabilities, and was the central issue recently considered by the Federal Court in Esso Australia Resources Pty Ltd v The Commissioner of Taxation.*
>
> *The amendments will provide further statutory support for the Court's judgment, and will be consistent with the established application of the PRRT law.*

as well as following comments in the Explanatory Memorandum to the Bill:

> *"2.45 The amendments apply retrospectively to remove any uncertainty regarding the long-established operation of the PRRT. This is particularly important in light of the extension of the PRRT to all Australian oil and gas projects, including onshore projects, from 1 July 2012.*
>
> *2.46 The amendments do not impose any new tax burden, as they merely clarify and confirm the current application of the PRRT, consistent with the policy intent."*

do not constitute clearly enunciated reasons for the retrospectivity of the amendments.

In addition to the above, the timing of the introduction of these amendments has not in our view been explained or consulted upon sufficiently. In this regard we note that Esso Australia Resources Pty Ltd ("**Esso**") has been in dispute with the Commissioner of Taxation (the "**Commissioner**") for almost 20 years in relation to this issue. As such, it is difficult to understand why these amendments are being made at this time. If the Commissioner's interpretation of the provisions is

correct, the Full Federal Court will dismiss Esso's appeal. If his interpretation is incorrect it is inappropriate to amend the *Petroleum Resource Rent Tax Assessment Act 1987* to the disadvantage of Esso. If retrospective amendments are required to provide certainty to other taxpayers, they should not apply retrospectively to the Bass Strait Project, given that Esso and BHP Billiton Ltd commenced litigating the dispute in good faith long before the amendments were foreshadowed.

Furthermore, when these reasons are considered in light of the lack of public consultation undertaken in relation to either the retrospective application date or whether the amendments are "consistent with the established application of the PRRT law", it is clear that these amendments should be subject to greater scrutiny prior to enactment.

Recommendations

On this basis, we urge the Committee to recommend to Parliament that:

- The Schedule be amended so that the application date of the amendments is either the date of Royal Assent or if appropriate the date of the relevant announcement of the measure (10 May 2011) i.e. a recommendation of rejection of the retrospective nature of the amendments; or

- The Schedule be removed from the Bill and the application date of the Schedule be the subject of greater public consultation.

* * * *

Should you have any queries with respect to any of the matters raised above, please do not hesitate to contact me on (02) 8223 0011 or The Tax Institute's Tax Counsel, Deepti Paton on (02) 8223 0044.

Yours sincerely

Peter Murray
President