Chapter 1

Introduction

1.1 On 14 February 2019, the Senate referred the provisions of the Treasury Laws Amendment (2019 Petroleum Resources Rent Reforms No.1) Bill 2019 (the bill) to the Economics Legislation Committee for inquiry and report by 1 April 2019.[1]

1.2 The bill amends: the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (OPGGS Act) and the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRT Act) to reduce the uplift rates that apply to certain categories of carried-forward expenditure; the PRRT Act to remove onshore projects from the scope of the petroleum resource rent tax (PRRT); and *Excise Tariff Act 1921* and *Income Tax Assessment Act 1997* to remove certain exclusions from the PRRT that are no longer necessary following the exclusion of onshore petroleum projects.

Conduct of the inquiry

1.3 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting written submissions. The committee received 8 submissions, which are listed at Appendix 1.

1.4 The committee thanks all individuals and organisations who assisted with the inquiry.

Overview of the bill

Background

1.5 The PRRT is a profit-based cash-flow tax on petroleum production, designed to ensure the Australian community receives a fair return on the extraction of Australia's finite petroleum resources while minimising disincentives for business to invest in the petroleum industry.[2]

1.6 Originally, the PRRT 'only applied to certain petroleum projects in Commonwealth waters and onshore petroleum projects were subject to other resource taxation arrangements, including state and Commonwealth royalties, crude oil excise and the Resource Rent Royalty'.[3] From 1 July 2012, the *Petroleum Resource Rent Tax Assessment Amendment Act 2012* extended the PRRT to onshore petroleum projects, including coastal waters within state and territory jurisdictions, and the North West Shelf.

1.7 In November 2016, following a marked decline in the PRRT revenues, the Government initiated a review of the PRRT (the Review) to examine whether the

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1 *Journals of the Senate*, No. 140, 14 February 2019, p. 4668.

2 *Explanatory Memorandum*, p. 4.

3 *Explanatory Memorandum*, p. 21.

PRRT is operating as it was originally intended and to address the reasons for the decline in Australia's PRRT revenues.

1.8 The Review, completed in April 2018, advised that:

> …while the PRRT remained the preferred way to achieve a fair return to the community without discouraging investment, changes should be made for new projects 'to make them more compatible with the developments that have taken place in the Australian oil and gas industry'.[4]

1.9 The Assistant Treasurer, the Hon. Mr Stuart Robert MP, in his second reading speech to the bill noted that:

> This bill strengthens the integrity of the petroleum resource rent tax, the PRRT, and implements the key parts of the government's response to the PRRT Review undertaken by Mr Mike Callaghan AM PSM.
>
> …
>
> Both schedules in this bill strengthen the integrity of the PRRT and ensure a fairer return for the Australian community for the extraction of our oil and gas resources.[5]

1.10 The Assistant Treasurer also noted that:

> Since the PRRT was introduced in 1988, the nature of Australia's petroleum production has changed, shifting from an industry dominated by crude oil and condensate to a more significant role for liquefied natural gas (LNG). For example, over the last 30 years, oil and condensate production has nearly halved and gas production has increased over sevenfold. Australia is now one of the world's largest LNG exporters.[6]

1.11 The Review identified that PRRT uplift rates for deductible expenditure are now overly generous.[7]

1.12 In relation to the 2012 reforms, the Review concluded that:

> A key feature of the extension of the PRRT to onshore projects and the North West Shelf … project in 2012 was that transitioning projects were provided with a starting base amount that is carried forward and uplifted at LTBR plus 5 percentage points until it is applied against the assessable receipts of the project. These projects have very large starting bases mainly because most used the market value approach, including the value of the resource, to determine their starting base and the valuation was done when oil prices were relatively high.

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4 The Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2019, p. 15.

5 The Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2019, p. 15.

6 The Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2019, p. 15.

7 *Explanatory Memorandum*, p. 7.

> The extension of PRRT to onshore projects has also meant that these projects can transfer exploration expenditure to other PRRT paying projects within a wholly owned group of companies, which is likely to have lowered PRRT revenue since 2012.[8]

1.13 In November 2018, the government released its response to the Review's findings. This response noted that the government will deliver its response through two tranches of legislation. This bill represents the first tranche that will:

- lower the uplift rates that apply to certain categories of carried-forward expenditure (Schedule 1); and
- remove onshore petroleum projects from the scope of the PRRT (Schedule 2).[9]

1.14 The government intends to progress a second tranche of legislation later in 2019 which proposes to:

- improve rules to identify petroleum projects to ensure the true scope of each project is recognised;
- allow more corporate groups to access the benefits of grouping, including group lodgement obligations and broader access to functional currency rules;
- create greater certainty for deductible expenditure arising before a petroleum project starts to derive assessable receipts by requiring taxpayers to lodge annual PRRT returns, and receive assessments, after they start holding an interest in an exploration permit, retention lease or production licence rather than when they start generating assessable receipts from production;
- allow taxpayers to use a substituted accounting period for PRRT purposes if they have adopted the period for income tax purposes;
- provide a new power to the Commissioner of Taxation to administratively exempt projects from PRRT obligations where they are clearly unlikely to pay PRRT in the foreseeable future until they start production or PRRT becomes payable; and
- strengthen the PRRT general anti-avoidance provisions to reflect changes made to Part IVA of the *Income Tax Assessment Act 1936*.[10]

1.15 The government also intends to progress consequential amendments to regulations in 2019.

Schedules of the bill

1.16 The bill contains two schedules. Schedule 1—Reform of the petroleum resource rent tax, contains three parts:

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8 Petroleum Resource Rent Tax Review, *Final Report*, 13 April 2017, pp. 8–9.

9 *Explanatory Memorandum*, p. 7.

10 *Explanatory Memorandum*, p. 7.

- Part 1—Uplifts for general expenditure for new projects;
- Part 2—Standard uplift expenditure; and
- Part 3—Other amendments.

1.17 Schedule 2—Removing onshore projects from the petroleum resource rent tax, contains three parts:

- Part 1—Amendment of the PRRT Act;
- Part 2—Amendments of other Acts; and
- Part 3—Application, transitional and savings provisions.

Schedule 1—Reform of the PRRT

1.18 Schedule 1 amends the OPGGS Act and the PRRT Act to reduce the uplift rates that apply to certain categories of carried-forward expenditure. This limits the excessive compounding of deductions and updates the PRRT design settings to better reflect Australia's petroleum industry. Doing so will 'ensure the Australian community receives a fair return on the extraction of Australia's finite petroleum resources while minimising disincentives for business to invest in the petroleum industry'.[11]

1.19 The Explanatory Memorandum (EM) notes that Section 22 of the PRRT Act outlines the formula on which PRRT is payable. A person is subject to PRRT on the taxable profit they receive for a tax year in relation to a petroleum project (section 21). The taxable profit is the person's assessable receipts (section 23) less the sum of their deductible expenditure (section 32) and exploration expenditure transferred to the petroleum project (Division 3A of Part V).

1.20 The categories of deductible expenditure as:

- general project expenditure;
- exploration expenditure, which must, in certain circumstances, be transferred between certain petroleum projects and within company groups;
- resource tax expenditure, which is grossed-up by the PRRT rate (40 per cent) to give credit for royalties and excise paid on a petroleum project's output;
- acquired exploration expenditure and starting base expenditure, which recognise investments made in petroleum projects that transitioned to the PRRT regime; and
- closing-down expenditure, which can give rise to a refundable credit to the extent of prior PRRT liabilities.

1.21 As such, the PRRT liabilities are calculated on a project basis meaning deductible expenditure can generally only be used to offset assessable receipts from the same petroleum project and cannot be transferred to other projects of the taxpayer. Exploration expenditure is an exception to this principle and must be transferred, for

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11 *Explanatory Memorandum*, p. 5.

example, between projects that satisfy the common interest rule in Clause 22 in Schedule 1 in the PRRT Act.[12]

1.22 For petroleum projects that successfully apply for a production licence from 1 July 2019 (based on the date specified in a production licence notice), the general expenditure uplift rate will be the LTBR plus five percentage points until the financial year ten years after the financial year in which a project fist derives assessable petroleum receipts. After that period, the uplift rate for remaining deductions will be equal to the LTBR.[13]

1.23 For exploration expenditure incurred or transferred from 1 July 2019, the uplift rate will be LTBR plus five percentage points until the financial year ten years after the year in which the expenditure was incurred. From that financial year, any remaining amount of exploration expenditure is maintained in real terms by applying the Gross Domestic Product factor until the expenditure is deducted.[14]

1.24 Where exploration expenditure incurred before 1 July 2019 is deducted within a petroleum project, the current uplift rate equal to the LTBR plus fifteen percentage points (if it currently applies) will continue to apply until 1 July 2019. From that date, the uplift rate equal to the LTBR plus five percentage points will apply.[15]

Schedule 2—Removing onshore petroleum projects from the PRRT

1.25 From 1 July 2019, Schedule 2 will amend the PRRT Act so that onshore petroleum projects will be removed from the PRRT regime. The changes proposed in this schedule will protect PRRT revenue, reduce regulatory burden and simplify the PRRT.

1.26 To date, no PRRT revenue has been collected from onshore petroleum projects since they were brought into the PRRT in 2012, and this is expected to remain unchanged into the future. Indeed, onshore projects that would never pay PRRT have been able to transfer their exploration deductions to profitable offshore project interests, effectively reducing the PRRT collected.[16]

1.27 Special transition rules will provide possible relief from lodgement of a 2018–19 PRRT return for onshore petroleum projects if there is no PRRT payable in relation to the project for that financial year and if there is no exploration expenditure that is required to be transferred to the project for that financial year. However, the Commissioner of Taxation may still require lodgement.[17]

12 *Explanatory Memorandum*, p. 6.

13 *Explanatory Memorandum*, p. 8.

14 *Explanatory Memorandum*, p. 8.

15 *Explanatory Memorandum*, p. 8.

16 The Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2019, p. 15.

17 *Explanatory Memorandum*, p. 28.

Commencement

1.28 The date of effect of the bill is 1 July 2019.[18]

Financial impact

1.29 The bill is estimated to have an unquantifiable gain to revenue over the forward estimates period and a $6.0 billion net gain to revenue over the medium term (to the 2028–29 financial year).[19]

Compatibility with Human Rights

1.30 As required under the *Human Rights (Parliamentary Scrutiny) Act 2011*, the government has assessed the bills' compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The government considers that the bill does not raise any human rights issues.[20]

18 *Explanatory Memorandum*, p. 3.

19 *Explanatory Memorandum*, p. 3.

20 *Explanatory Memorandum*, p. 3. See also Statement of Compatibility with Human Rights—Explanatory Memorandum, Chapter 3, paragraphs 3.1 to 3.5.