

16 May 2003

The Secretary
Senate Economics Committee
The Senate
Parliament House
Canberra ACT 2600

Attention : Dr Kathleen Dermody
Committee Secretary

Taxation Laws Amendment Bill (No.8) 2002 – Schedule 5

Please find enclosed a submission from the Australian Petroleum Production & Exploration Association (APPEA) in relation to the Senate Economics Committee Inquiry into certain aspects of Taxation Laws Amendment Bill (No.8) 2002, Schedule 5 (proposed petroleum resource rent tax amendments).

In summary, APPEA recommends that the proposed amendments be supported by the Committee, subject to consideration being given to the enclosed comments.

Please contact Mr Noel Mullen (tel 02 62670904) in relation to any aspect of the attached submission.

Yours sincerely



Barry Jones
Executive Director

Enc.

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Submission to the Senate Economics Committee Taxation Laws Amendment Bill (No. 8) 2002

Australian Petroleum Production & Exploration Association Ltd

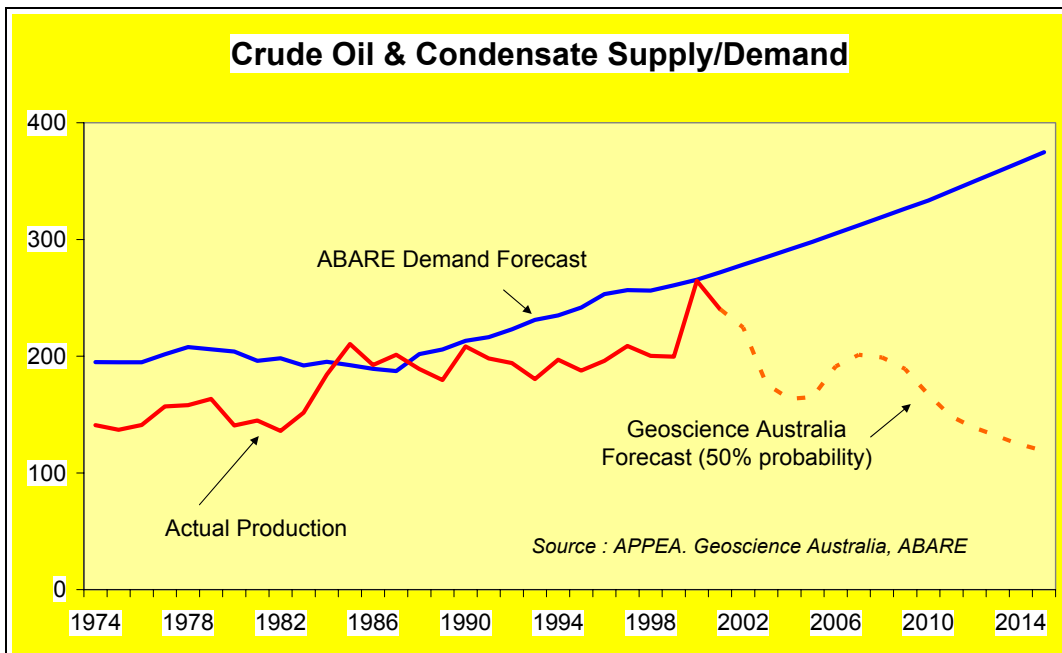
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The Australian Petroleum Production and Exploration Association (APPEA) is the national body that represents companies engaged in oil and gas exploration, development and production operations in Australia. APPEA membership covers companies that account for in excess of 95 per cent of Australia's petroleum (oil and gas) production.

The Petroleum Exploration & Production Industry in Australia

Liquids Production

Independent estimates show that Australia's self-sufficiency in petroleum liquids is about to decline rapidly. Geoscience Australia estimates that, with new discoveries at the 50 per cent level of probability, Australia will be importing more than 50 per cent of its liquid petroleum requirements by the year 2010.



Such a rapid decline has serious implications for a number of reasons, including:

- Australia's balance of payments position;

- a continuation of reliable and competitively priced energy supplies to users in the Australian economy;
- tax contributions to governments;
- regional development; and
- security considerations.

Gas Production

Australia has vast gas resources but these reserves are not all classified as commercial. More reserves must be commercialised if projected domestic demand in the period to 2020 is to be met and if export market opportunities are to be seized. This will require significant capital investments to develop and produce the gas and transport it over long distances to potential markets or liquefy it into LNG. The costs and risks are high and Australia's need to be able to compete with alternative global investment opportunities.

Impact of Taxation on the Industry

Overall, APPEA estimates that for the year 2001/02, taxation (in the form of company tax, resource taxes or other charges) accounted for 44 per cent of the total operational costs faced by the petroleum exploration and production industry in Australia. The Australian taxation framework must be internationally competitive to ensure that the potentially damaging impact of taxes on the viability of individual projects is minimised. In particular, it is important to recognise that oil and gas production companies in Australia are largely price takers and must absorb any increases in taxes. The regulated nature of the other industries (where tariff charges and/or prices may be externally set) are at least in part able to compensate for increases in tax imposts

Taxation Laws Amendment Bill (No.8) 2002 – Schedule 5 : PRRT Amendments

The changes are contained in *Taxation Laws Amendment Bill (No.8) 2002*, Schedule 5 (the Bill) and deal with the petroleum resource rent tax (PRRT) implications arising from:

1. certain aspects of the transition from a production licence to an infrastructure licence; and
2. the treatment where a licensee processes external (or third party) petroleum within the PRRT petroleum project.

The changes contained in the proposed amendments have been developed in part as a result of broader consultations with APPEA. They respond to concerns with the operation of the legislation in its current form.

1. Infrastructure Licence Provisions

In 2000, the *Petroleum (Submerged Lands) Act 1967* was amended to incorporate a new type of licence (an 'infrastructure licence') within the scope of the legislation. Subsequently, it has become clear that a potential difficulty could arise under the

Petroleum Resource Rent Assessment Act 1987 (the PRRT Act) in situations where a licensee effectively closes down a project for PRRT purposes (ie a production licence is relinquished), but where the licensee retains a facility or facilities under the new infrastructure licence provisions.

Specifically, it has been suggested that the licensee may be required calculate the 'notional' value of a facility at the time of the licence transition under the assessable property receipt provisions of the PRRT Act, but at the same time be denied the ability to estimate (and deduct) the cost associated with removing the facility.

In response to this potentially anomalous situation, the amendment in the Bill proposes that the PRRT Act be modified to provide a 'timing match' between when an assessable receipt crystallizes and the cost of removing the facility. Specifically, it proposes that this be the time of the transition from a production licence to an infrastructure licence. At that time, the licensee must make an estimate of the value of the facility and the current value of future closing down costs. In terms of estimating the future value of the closing down costs, the amendment proposes that the amount be adjusted through the application of a discount rate equivalent to the bond rate plus two (2) percentage points.

While APPEA generally supports the proposed terms of the amendment, we hold a concern with respect to the proposed discount rate, which in its current form, adds a premium to the relevant discount rate over an above the prevailing bond rate. APPEA can see no case for the adoption of a rate other than the relevant bond rate.

Recommendation : APPEA supports the proposed change, however we recommend consideration be given to using the prevailing bond rate as the relevant discount factor in determining the present value of future closing down costs.

2. Processing of External (Third Party) Petroleum

This proposed amendment addresses a potential difficulty that has been identified with the respect to the operation of the legislation in terms of the use of PRRT project facilities to process or toll petroleum that is not sourced from the project that the facilities are directly attached.

The current PRRT provisions are potentially complicated with respect to the identification and allocation of eligible deductible costs associated with a facility where such a facility also processes or tolls petroleum from outside its own project area. Indeed, it is arguable that in some cases, the legislation in its present form could lead to a mismatch between costs and revenues in relation to determining a PRRT liability. At best, the current provisions are unclear, and at worst, there could be a lack of symmetry.

Discussions over an extended period of time between the Australian Taxation Office, the Department of Industry, Tourism and Resources and APPEA had identified this as a potential area of concern with the legislation. It in part reflects a more general industry concern that the legislation in its original form was designed around a simpler operating model that tended to exist in the 1980's, the time that

the legislation was originally developed. As a result of those discussions between the various parties, one option that was identified forms the basis of the proposal now contained in the amending legislation.

The explanatory memorandum to the Bill identifies a number of scenarios in which external petroleum can be processed. External petroleum (ie petroleum from outside the PRRT project) can be purchased by a licensee and processed through the facility or petroleum can be processed for a separate or third party (ie it is tolled). The amending legislation proposes a type of 'all-in' approach whereby all revenues earned from tolling and sales activities are to be included as part of the assessable receipts, while all capital and operating costs incurred by the processing party are to be regarded as being deductible. This represents a practical, rather than a perfect solution.

While the proposal does provide a conceptually neat approach, it does however extend the scope of the PRRT provisions to activities that are wider than originally envisaged. For example, the coverage under the definition of 'assessable receipts' of the proceeds of the sale of petroleum that is sourced from outside the project, it can be argued, was never intended under the legislation. It is therefore possible that petroleum could be exposed to resource taxation more than once.

Recommendation : While APPEA does not intend to oppose the amendment, we would like it make it clear that as a general principle, industry opposes any extension of the scope of the PRRT regime to cover activities that may not solely relate to the operations of the petroleum project. In addition, APPEA considers that a commitment should be given to revisit this arrangement if it can subsequently be shown that the practical application of the provision is adversely impacting on project economics.

PRRT Regime – The Need for Further/Future Amendments

The introduction of amendments to treat circumstances where external or third party petroleum is processed through a PRRT project highlights a more general concern that APPEA has identified with some aspects of the legislation in its current form. While a number of 'policy' changes have been made to the regime since its introduction in the mid 1980's, an ever increasing number of technical concerns are being identified with respect to the operation of the Act. This led APPEA to develop a detailed technical submission in early 2002 that recommended a range of enhancements to the legislation (nearly 20 individual 'technical' issues were raised).

A number of the items covered in APPEA's technical submission had formally been raised with the Australian Taxation Office a number of years earlier, but have yet to be resolved. Indeed, the changes proposed in *Taxation Laws Amendment Bill (No.8) 2002* address but two concerns that are held with the technical operation of the Act. Many of the issues raised by APPEA have to some extent recently been given active consideration, in part because of the involvement of The Treasury. For those changes that are ultimately deemed to require legislative action, APPEA suggests that they be given a high priority to remove the unacceptable levels of uncertainty that presently confront taxpayers.

Recommendation : The Committee notes that a range of technical issues remain outstanding and that their resolution be accorded a high priority.

APPEA
May 2003