

The Senate

Economics Legislation Committee

Provisions of:

Petroleum Resource Rent Tax Assessment
Amendment Bill 2006

Petroleum Resource Rent Tax (Instalment
Transfer Interest Charge Imposition) Bill 2006

June 2006

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Senate Economics Legislation Committee

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CHAPTER 1

Introduction

Background

1.1 The Petroleum Resource Rent Tax Assessment Amendment Bill 2006 and the Petroleum Resource Rent Tax (Instalment Transfer Interest Charge Imposition) Bill 2006 were introduced into the House of Representatives on 25 May 2006 by the Minister for Revenue and Assistant Treasurer, the Hon. Peter Dutton, MP. The Bills passed the House on 14 June 2006 and were introduced into the Senate on 15 June 2006.

1.2 On 14 June 2006, on the recommendation of the Senate Standing Committee for the Selection of Bills, the Senate referred the provisions of the Bills to the Economics Legislation Committee for inquiry and report by 21 June 2006.

Conduct of the inquiry

1.3 The Committee contacted the Australian Petroleum Production and Exploration Association and the Departments of Industry, Tourism and Resources and the Treasury and invited them to attend a public hearing on 19 June 2006. The hearing was held at Parliament House in Canberra. Witnesses who presented evidence at the hearing are listed in Appendix 2.

1.4 The Committee received one submission to its inquiry which is listed at Appendix 1.

1.5 The Hansard transcript of the Committee's hearing and copy of the submission are tabled with this report. These documents, plus the Committee's report, are also available on the Committee's website at: http://www.aph.gov.au/Senate/committee/economics_ctte/petroleum_tax/index.htm.

1.6 The Committee thanks those who participated in this inquiry.

CHAPTER 2

The Bills

Background

2.1 The petroleum resource rent tax (PRRT) is a tax on net income derived from all petroleum projects in Commonwealth offshore areas excluding the North West Shelf project area off the coast of Western Australia.¹ It is assessed on a project basis and the liability to pay the tax is imposed on a producer/company in relation to its interest in the project. This liability is based on the project receipts less project expenditures.²

2.2 The amendments in the Bills are intended to reduce compliance costs, improve administration and remove inconsistencies in the *Petroleum Resource Rent Tax Assessment Act 1987*. The changes were announced by the Treasurer and Minister for Industry, Tourism and Resources in a joint press release on 10 May 2005.³

Petroleum Resource Rent Tax Assessment Amendment Bill 2006

2.3 The Bill comprises five Schedules that principally amend the *Petroleum Resource Rent Tax Assessment Act 1987* as follows:

- Schedule 1—Allows deductibility of transferable exploration expenditure when calculating quarterly PRRT instalment payments (currently such expenditure is deductible on an annual basis at the end of the financial year⁴);
- Schedule 2—Allows internal corporate restructuring within company groups to occur without losing the ability to transfer exploration expenditure between the petroleum projects of group members. (Currently company groups maintain inactive companies because they cannot undertake a corporate restructure without losing the ability to transfer unused exploration expenditure⁵);
- Schedule 3—Allows the present value of certain expected future expenditures associated with closing down a particular petroleum project ('abandonment costs') to be deductible against the PRRT receipts of the project. (Currently

1 Minister's second reading speech.

2 An overview of the petroleum resource rent tax can be found on the Department of Industry, Tourism and Resources website at:
<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectid=4A1DE71A-BF9F-4DED-B1667CC766651FA7&searchID=120780>

3 Joint press release no. 054, 10 May 2005.

4 Explanatory Memorandum, p. 3.

5 Explanatory Memorandum, pp 3-4.

there may be incentives in the Act for a PRRT taxpayer to close down a project at the end of its productive life so it can claim the associated closing-down costs against its PRRT liability. This would preclude the continued use of existing infrastructure under an infrastructure licence and could lead to more marginal petroleum resources remaining unexploited);

- Schedule 4—Allows PRRT taxpayers to fully self assess their PRRT liability payable, as is currently the case with income taxpayers; and
- Schedule 5—Allows fringe benefits tax to be deducted for PRRT purposes; introduces a transfer notice requirement for vendors disposing of an interest in a petroleum project; extends the lodgement period for PRRT annual returns; and makes a number of unrelated minor technical amendments.

Schedule 3

2.4 Generally, the Committee focused its inquiry on exploring issues relating to Schedule 3 of the Bill. Amendments broadly similar in wording to those in Schedule 3 were last before the Parliament during 2002/2003 as part of the Taxation Laws Amendment Bill (No. 8) 2002.⁶ However, the Senate removed the provisions from that legislation during its passage and prior to enactment. At the time the Committee also conducted an inquiry into the Bill and refers readers to the Committee's report for a more comprehensive discussion of the issues than the current time constraints of this inquiry allow.⁷

2.5 The need for the amendments in Schedule 3 of the Bill arises as a consequence of differences between production and infrastructure licences. Production licences govern petroleum projects during the life of the project. These projects are likely to have substantial expenditures on closing down, including associated environmental restoration costs. Such costs are part of deductible expenditure for Petroleum Resource Rent Tax (PRRT) purposes.

2.6 However, some project facilities may go on to non-project use under an infrastructure licence. Infrastructure licences were introduced to the PRRT regime in 2000.⁸ They are granted to allow the use of petroleum infrastructure facilities in Commonwealth (offshore) waters for specified activities. A typical example is where the petroleum reserves for a project have been exhausted and rather than close down the project infrastructure related to these reserves, an infrastructure licence is granted to process petroleum piped in from an alternative source located nearby. The owners of the infrastructure would receive a fee for providing this service to a third party.

6 In 2003, the name of this Bill became the Taxation Laws Amendment Bill (No. 3) 2003.

7 Economics Legislation Committee, *Provisions of the Taxation Laws Amendment Bill (No. 8) 2002 Report*, June 2003, PP 152/03, available at:
http://www.aph.gov.au/Senate/committee/economics_ctte/completed_inquiries/2002-04/tlab8_02/index.htm

8 Explanatory Memorandum, p. 42.

2.7 When project facilities stop being used for the initial project, but remain in use, any later costs of closing down their use under the infrastructure licence are currently not recognised (either directly or indirectly) for PRRT purposes.

2.8 In its submission, the Australian Petroleum Production & Exploration Association Limited (APPEA) stated:

Under the current system, [PRRT] taxpayers are effectively required to pay tax on a notional calculation of the value of the assets when a PRRT project is closed down, but can be denied or are required to wait for potentially long periods of time prior to obtaining deductibility of abandonment related costs. A matching or symmetry in the timing of assessable receipts and abandonment costs represents both an efficient and equitable outcome.⁹

2.9 APPEA argues that the amendments in Schedule 3 are in response to:

...a distortion that currently exists under the act whereby there is a potential mismatch between the time when a taxpayer must account for the residual value of the facility and when the costs associated with removing that facility are allowed, if ever, as deductible expenditure.¹⁰

2.10 Schedule 3 amends the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRT Act) to allow the present value of expected future expenditures associated with closing down petroleum project assets that continue to be used under an infrastructure licence to be deductible against the PRRT receipts of this project. This change is made so far as these costs are currently not recognised for PRRT purposes.

2.11 Departmental officers told the Committee that while there are currently no known petroleum projects that would take advantage of the amendments in the Bill in the short term, as petroleum projects mature over the medium term there could be several projects approaching the stage where operators will need to decide whether to shut down the existing facilities completely, or seek an infrastructure licence to allow other continuing uses. The Government and industry wish to ensure that such decisions are made on the basis of commercial imperatives rather than for their taxation implications:¹¹

From APPEA's perspective the importance of this change is that it sets the framework in place so that when we reach a point where someone wants to move from a PRRT or a project area licence to an infrastructure licence, there will not be this impediment in place for that commercial decision.¹²

9 *Submission 1*, Australian Petroleum Production & Exploration Association Limited (APPEA), p. 2.

10 *Proof Committee Hansard*, 19 June 2005, p. 2. [Mullen]

11 *Proof Committee Hansard*, 19 June 2005, pp 4 and 7, [Mullen] and p. 9. [Anderson]

12 *Proof Committee Hansard*, 19 June 2005, p. 4. [Mullen]

Petroleum Resource Rent Tax (Instalment Transfer Interest Charge Imposition) Bill 2006

2.12 The Petroleum Resource Rent Tax (Instalment Transfer Interest Charge Imposition) Bill 2006 seeks to give constitutional validity to the instalment transfer interest charge that is introduced in the Petroleum Resource Rent Tax Assessment Amendment Bill 2006 by item 10 in Schedule 1.

Conclusion

2.13 The Committee notes that the representative body for the petroleum industry (APPEA) supports the amendments in the Bills. It concludes that the amendments are likely to reduce compliance costs, improve administration and remove certain inconsistencies in the PRRT regime.

Recommendation

2.14 **The Committee recommends that the Senate pass the Bills.**

Senator George Brandis
Chair

LABOR SENATORS DISSENTING REPORT

Schedule 3 to this Bill amends the PRRT Act to allow the present value of expected future expenditures associated with closing down a particular petroleum project, where these future expenditures relate to so much of this project as continues to be used under an infrastructure licence, to be deductible against the PRRT receipts of this project. This change is made so far as these costs are currently not recognised for PRRT purposes.

The proposed treatment of platform closing down costs in the assessment of PRRT involves *estimating* the present value of future closing down costs and claiming them as a deduction before they have been incurred. This treatment violates the fundamental basis of the PRRT; that of a tax based on actual cash flows.

Moving from a tax based on actual net cash flows is a dangerous practice. One of the great attractions of the PRRT has been its stability over time. It replaced the crude oil levy that was varied from year to year. The instability of the crude oil levy created damaging uncertainty for investors.

Labor is dismayed at the Treasury claim in the Explanatory Memorandum that the proposed changes would not entail any cost to the revenue. This is ludicrous. Industry would not be seeking the change if it did not favourably affect profitability. The Treasury assertion is based on an assumption that, in the absence of this concession, all platforms would be shut down at the end of petroleum production and there would be no move to using platforms for processing facilities. There is no basis for making such a blanket assumption.

Alternative ways of allowing for *actual* platform closing down costs to be claimed as deductions should have been considered, that do not violate the cash-flow basis of the PRRT. Once the base of the PRRT is corrupted, the danger is that industry and government will seek further corruption of the PRRT base. This would undermine the stability of the PRRT, unnecessarily increasing sovereign risk to the detriment of both investment and government revenue.

Senator Ursula Stephens
Deputy Chair

Senator Ruth Webber

Appendix 1

Submission received

**Submission
Number**

Submitter

1. Australian Petroleum Production & Exploration Association Limited (APPEA)

Appendix 2

Public hearings and witnesses

Monday, 19 June 2006 - Canberra

ANDERSON, Mr John, Indirect Tax Division, Department of the Treasury

COLMER, Mr Patrick Joseph, General Manager, Indirect Tax Division
Department of the Treasury

CRAWSHAW, Mr William Arthur, Safety, Taxation and Projects Branch, Resources
Division, Department of Industry, Tourism and Resources

LIVINGSTON, Mr Peter, MCE Secretariat Branch, Energy and Environment
Division, Department of Industry, Tourism and Resources

MULLEN, Mr Noel, Deputy Chief Executive, Australian Petroleum Production and
Exploration Association

SPECTOR, Mr Donald, Member, Fiscal Committee
Australian Petroleum Production and Exploration Association