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Proof Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Reference: Tax Laws Amendment (2004 Measures No. 7) Bill 2004

TUESDAY, 1 MARCH 2005

ADELAIDE

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Tuesday, 3 May 2005

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SENATE

ECONOMICS LEGISLATION COMMITTEE

Tuesday, 1 March 2005

Members: Senator Brandis *(Chair)* Senator Stephens *(Deputy Chair)*, Senators Chapman, Murray, Watson and Webber

Participating members: Senators Abetz, Boswell, Brown, Buckland, George Campbell, Carr, Cherry, Colbeck, Conroy, Cook, Coonan, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Fifield, Forshaw, Harradine, Hogg, Kirk, Knowles, Lightfoot, Ludwig, Lundy, Mackay, Marshall, Mason, McGauran, O'Brien, Payne, Robert Ray, Ridgeway, Sherry, Stott Despoja, Tchen, Tierney and Wong

Senators in attendance: Senators Brandis, Chapman, Murray, Stephens and Watson

Terms of reference for the inquiry:

Tax Laws Amendment (2004 Measures No. 7) Bill 2004

WITNESSES

Committee met at 1.03 p.m.

KONZA, Mr Mark, Deputy Commissioner, Small Business, Australian Taxation Office

PETERSON, Mr Brett, Assistant Commissioner, Small Business, Australian Taxation Office

O'CONNOR, Mr Mark, Principal Adviser, Individuals and Exempt Tax Division, Department of the Treasury

ROLLINGS, Mr Jonathan, Manager, Small Business Unit, Business Tax Division, Department of the Treasury

CHAIR—I welcome officials from the Australian Taxation Office, who are giving evidence via teleconference, and officials from the Department of the Treasury, who have joined us here today. We are here today to take evidence on the Tax Laws Amendment (2004 Measures No. 7) Bill 2004. On 9 February 2005, the Senate referred the provisions of the bill to this committee for inquiry and report by 7 March 2005. The bill is an omnibus bill, introducing a range of measures to affect various pieces of taxation legislation. The Selection of Bills Committee report identified two schedules of particular interest, those being schedules 1 and 5. Schedule 1 proposes to allow an entrepreneurs tax offset of 25 per cent on income tax liabilities attributable to business income where the business has an annual turnover of $50,000 or less. The proposed offset is intended to assist very small businesses in the simplified taxation system. Schedule 5 of the bill is intended to provide a tax incentive for petroleum exploration in designated frontier areas. Exploration expenditure, within certain limitations, will be uplifted to 150 per cent, with this amount being deductible for the purposes of petroleum resource rent tax.

I remind witnesses that all witnesses appearing before the committee are protected by parliamentary privilege with respect to their evidence. Parliamentary privilege refers to the special rights and immunities necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by that witness before this committee may be a breach of privilege. These privileges are intended to protect witnesses. I also remind you that giving false or misleading evidence to the committee may constitute a contempt of the Senate. We commence proceedings this afternoon with the consideration of schedule 1 of the bill. Do any of you have an opening statement?

Mr O'Connor—It is not an opening statement, but the Minister for Revenue and Assistant Treasurer's office received a request yesterday from Mr Brendan Long asking for some details in relation to data on STS take-up and those sorts of things. That was copied to Senator Stephens. We did not receive that until about 2 o'clock yesterday afternoon. We have referred it to our tax analysis division, which needs to also speak to the Taxation Office's revenue analysis branch and, as of late last night, we had not got the firm figures. So I would like to take that on notice if I could. Unfortunately, we just have not got the data.

CHAIR—That is fine. As there are no other preliminary matters from the officers, we will pass the call to Senator Stephens.

Senator STEPHENS—Thank you very much for taking those questions on notice. They are very straightforward questions about the organisation of those arrangements. Before I start looking at the actual legislation before us, are you aware that the explanatory memorandum has disappeared off the bills web site?

Mr O'Connor—No. It should be there.

Senator STEPHENS—Indeed it should. I went yesterday to download a fresh copy because I had written all over mine and the link was no longer there.

Mr O'Connor—I will check on that when I get back.

Senator STEPHENS—If you could look at that and ensure that it gets up there, that would be helpful because it is quite a complex bill and it needs the explanatory memorandum. The explanatory memorandum suggests that a taxpayer may be eligible for the offset on more than one occasion as a sole trader or as a taxpayer in a partnership. There is also the question of whether a taxpayer might enjoy the benefits of the offsets that flow from a trust or a company in addition to those benefits. Does that not suggest that the ETO holds the potential to be an income-splitting device?

Mr O'Connor—The grouping rules attached to the simplified tax system are very robust; they have been working for the simplified tax system since 2001. To our knowledge—and, I understand, the knowledge of the ATO—there have been no concerns with them. There is a very strong and robust link there to what is referred to as an STS affiliate, which is that basically anyone who is related to you could act under your direction or

control and also be held to be acting in concert with you. It is a very wide application of a grouping provision. We do not anticipate this measure giving rise to people seeking to split businesses—and I think that was also referred to in the explanatory memoranda. We do not see that, by splitting their businesses, they would be able to overcome the grouping provisions. There are other circumstances that would give rise to people not wishing to split businesses, such as the cost. In the *Hansard* of the debate in the House of Representatives, I noticed there was concern about the cost of getting accounting advice. The cost of restructuring a business from, say, a sole trader to a corporate or a trust is fairly significant, seeking legal and accountancy fees.

We also see other blockers to restructuring a business, such as the incurrence of potential stamp duty on transfer of assets and potential triggering of capital gains tax provisions when assets are moved from one entity to another. Given that (1) you have the integrity of the grouping measures and (2) there are outside forces and market forces, such as the cost of setting up a company or a trust and the ongoing compliance costs associated with that, we did not think there was a large compliance risk in this measure. I am not sure whether my colleagues from the ATO would like to add to that.

CHAIR—Would the gentlemen from the ATO care to comment?

Mr Peterson—There is not a lot I could add to what Mr O'Connor has said. I would agree with him.

Senator STEPHENS—Mr O'Connor, getting back to your comments about the grouping arrangements, the arrangements relate to an entity of $1 million and you are now applying them to a business with a turnover of $50,000. It seems to me that that is an interesting turnover test to be applied to such a small business.

Mr O'Connor—No. The turnover test of the $50,000 and, for that matter, of the $1 million is simply an eligibility test to enable you to benefit from the two measures: the STS and this measure. The grouping rules are generic and similar to those in other areas of the income tax law where we look to group related parties; those rules could apply across the income tax laws. All that the eligibility test is doing—and this is what the grouping rules were designed to do—is ensuring that entities, where they purport to be acting independently but are similar or related, are grouped for the purposes of testing whether or not they satisfy those thresholds; in this case, $50,000. So I do not think there is a difference in level.

Senator STEPHENS—Perhaps Mr Konza and Mr Peterson can advise whether or not there has been a cost-benefit analysis by the ATO on the audit process that you are going to put in place for the ETO.

Mr Konza—In the ATO, we do not generally engage in a cost-benefit analysis in the way you might be inquiring about. We do advise Treasury of what we think our administrative costs might be. We have budgeted for some compliance work, but I would not say that we have rated the risk as significantly high. We are looking to put a range of tests into our computer systems that will identify, for example, cases where we believe a taxpayer is receiving the offset in respect of more than one business, so we will be able to test the circumstances in which they make those multiple claims. We will respond appropriately when we see those cases and test what is happening. For a range of reasons, including those advanced by Mr O'Connor in answer to your previous question, we generally agree that the risk is not significantly high.

Senator STEPHENS—What number of taxpayers do you expect to enjoy this offset?

Mr O'Connor—That question goes to some of the questions that we have taken on notice. The government announced in its election policy that there were around 300,000 taxpayers. I am not sure whether my ATO colleagues have anything up to date on that.

Senator STEPHENS—I noticed in the explanatory memorandum that farming businesses were being targeted through this measure. I wonder whether you could take on notice the anticipated number of farming businesses that might benefit from this. Mr Konza, you said that you are investigating some tests that could be used in your computer programming to identify cases where perhaps the offset is being accessed in, I think your expression was, 'multiple circumstances'. What other enforcement options were considered by the ATO?

Mr Konza—To be absolutely truthful, all enforcement options are still under consideration. We have not settled on any enforcement options, because we have not yet seen the final shape of the law. But we did anticipate that a risk might be in people trying to access the offset multiple times. That is one reason we thought that the computer test might be worth while. We also saw a risk that the same income might be split and people might try to claim the offset a couple of times. So we were looking for tests where we could see taxpayers who are related. We might be able to test to see what claims each of them is making. But we are waiting to see the law. The first returns coming in and claiming the offset will not be received until the 2006 financial year so we have some little time to design our compliance program.

Senator STEPHENS—Would that include a special form that requires greater disclosure or additional disclosure requirements?

Mr Peterson—Our proposal for the form would be to add some labels. Our proposal is to have three labels. I will just refresh my memory about what they were. One of them is the offset claim itself. We will be taking two approaches, in effect. Where we have taxpayers with just one eligible stream of STS income we will ask them to let us know the amount of their STS income. On the strength of that we will be looking to calculate the size of their offsets. So we will take the manual calculation out of the process for taxpayers to the extent we can. For taxpayers who may have multiple offsets available to them, rather than multiply the number of labels on the form our approach will be to provide a third label whereby a taxpayer can—probably using a calculation product we will provide or will be provided through software providers—calculate and add a single figure to the label, claiming the offset from multiple STS entitlements. That, in turn, will be subject to the edit checks that Mr Konza has talked to you about.

Senator STEPHENS—What extra resources have been allocated by the ATO to enforce the grouping rules for the offset?

Mr Peterson—We will need to check the detail. I am not sure any of us have the detail with us at this stage. It is a fairly modest investment and it will not just be on enforcing the grouping rules, of course.

Senator STEPHENS—One particular issue that jumped out at me was in paragraph 1.17, which makes special mention of the net proceeds of gambling. Is Treasury concerned that a professional gambler who pays tax on his winnings might be able to use the offset to reduce his tax liability?

Mr O'Connor—No. That reference in the explanatory memorandum was just explaining how the value of taxable supplies is calculated in the gambling industry. It is slightly different to other calculations—it is really a GST issue. Following up from the previous question about administration costing, in paragraph 1.61 of the regulation impact statement there are estimated administrative costs of $7.3 million over four years. They are broken up into $0.6 million for 2004-05, $1.9 million for 2005-06, $2.6 million for 2006-07 and $2.2 million for 2007-08.

Senator WATSON—I refer to the submission by William Buck (SA) Pty Ltd. I assume you have read the submission?

Mr O'Connor—Yes.

Senator WATSON—The submitter raises some doubt about the commencement date. Could you clarify that for the members of the committee? It is either what is in the schedule or what was in Senator Coonan's earlier press release.

Mr O'Connor—The announcement made by Senator Coonan on 4 March provided rollover relief for the partial change in the ownership of a partnership. That measure was introduced in the House on 4 December 2003 and received royal assent on 23 March 2004. That measure in Senator Coonan's announcement is now law and has been law since March 2004. The measure contained in schedule 7 of this bill provides rollover relief where at least one entity was the holder of the asset prior to the change. That is slightly different because that could result where you have dissolution of the partnership—for example, where one partner in a partnership resigns, so the partnership is dissolved, but the assets of the partnership and the business remain to be carried on by the remaining partner. This measure will provide rollover relief in that circumstance.

These two measures were not linked in any way. The measure contained in schedule 7 to this bill was announced in the 2004-05 budget, on page 33 of Budget Paper No. 2. In Budget Paper No. 2 it was stated that the measure would have effect from the income year following the date of royal assent of the enabling legislation. I am not sure whether William Buck has confused the two, but they are two separate measures. One has been enacted already and the other one was announced in the 2004-05 budget.

Senator CHAPMAN—Does the fact that the subsequent provision only applies from the date of royal assent have any detrimental effect on people moving into the STS?

Mr O'Connor—Not any detrimental effect on people moving into the STS. It will make it more attractive to move into the STS.

Senator CHAPMAN—But the fact that it is applying from a date later than the commencement of the STS will not have any detrimental effect?

Mr O'Connor—No, I would not think so. The main reason for having prospective legislation is generally to ensure that you do not have uncertainty in the law—for example, from the date of announcement until the

date of royal assent. That also creates a number of problems for the ATO in their administration, because they have other concerns such as the Financial Management and Accountability Act and the Constitution in relation to appropriating funds. It is always preferable to have an amendment apply from after it receives royal assent, so the preference is always to have prospective legislation. Retrospective legislation does have its place where there is a series of ordinance issues that are of concern to government or where there is a need to change behaviour from a particular date. I think the ideal situation is that legislative amendments should be prospective so we do not have uncertainty. There are a lot of questions out there about uncertainty—for example, we do not know how the law is going to be when it is enacted, but it will apply from this date—so the preference is for prospective legislation.

Senator WATSON—I refer to the 25 per cent entrepreneurs tax offset. What is the whole concept of having different options in relation to the turnovers of $50,000 or $75,000, which are the significant features of this particular concession? We are talking about 'top slice of income' and 'bottom slice of income'. I have never come across such terms in this context before. Could you help us with that? They are unusual terms.

Mr O'Connor—The general reference to options—and those options appear in the regulation impact statement to the explanatory memorandum—are basically designed for a given policy objective: what administrative options are available to deliver that objective and which is the preferred approach. In this situation where a person satisfies the test and is eligible for the calculation of the offset, the options are about how you calculate that. 'Top slice of income' refers to assuming that the amount of income you receive from your eligible STS business is the highest part of your income. So it is the last amount of income that you derive. If you have salary and wages of $50,000, say, and $20,000 of simplified tax system income, that $20,000 is derived after the $50,000.

The reference to bottom slice is the converse of that. There is a fairly major difference in implementation options from the top and the bottom slice. If you take the bottom slice and say that a person has a simplified tax system income of $6,000 and $50,000 of, say, salary and wage income, they would not get any benefit from this offset. The $6,000 would be deemed to be the first amount derived, in which case the tax-free threshold would apply to that, and there would be no offset because the tax liability on $6,000 worth of income is zero. If it were the top slice of income, you would apply the rate at the person's marginal rate, which in that other example may have been, say, 47 per cent. So they would get an offset on $6,000 calculated at 47 per cent or an offset on $6,000 calculated at zero.

The preferred option that the government took—and in between those two—is an average rate of taxation. How that is achieved is through the STS calculation. The rate is basically where you compare the proportion of your STS income as a proportion of your total income and then apply that to the tax liability on your total income. So if your STS liability proportion of your total income is 10 per cent, you apply that as 10 per cent of the tax liability on your total income and then apply the offset of 25 per cent to that. It is an averaging formula.

Senator WATSON—So in a nutshell, it applies in situations where a person has a number of business entities that are quite separate from each other—is that right?

Mr O'Connor—Or a number of sources of income. For example, you might have salary and wages, which are not business income, and you might have business income from your home office or place of work.

Senator WATSON—It is possible that a person could have a dry-cleaning business as a separate entity, a fruit retail business as a separate entity and another business as a separate entity.

Mr O'Connor—Yes.

Senator WATSON—So the purpose of this top-and-bottom slicing is to give those sorts of businesses some type of benefit, isn't it?

Mr O'Connor—It is mainly to ensure that the benefit of the government's policy is put through in the best way it could be. The example of that bottom slice where somebody gets zero was not the most attractive.

Senator WATSON—But what I am saying is that this provides an incentive for people to have multiple businesses that all stay unincorporated just to get some sort of tax advantage. They might have had a start-up and, if the start-up happens late in the financial year and they are still within the $50,000 range or $75,000 range, they get something of a benefit.

Mr O'Connor—Yes, they would, but if they had separate businesses that is where we would look at the grouping provisions to see whether those businesses are—

Senator WATSON—This is where I am confused. You have grouping provisions, which I would have thought offset what you said earlier, whereby people can operate separate establishments and still get some benefit out of the provisions.

Mr O'Connor—The grouping provisions and this averaging are totally separate.

Senator WATSON—What about the bottom half of the top slice—all that sort of thing?

Mr O'Connor—They go to how you calculate the benefit. The grouping provisions say: 'Are you entitled to it; are you eligible for the offset? If the answer is yes, then these are options as to how to calculate that offset.'

Senator CHAPMAN—Eligibility being the turnover?

Mr O'Connor—Eligibility being the turnover, through calculations on income.

Senator CHAPMAN—So the grouping provisions would mean that your group of businesses has to have a turnover of less than $75,000?

Mr O'Connor—Yes, that is correct.

Senator CHAPMAN—And not just any one individual.

Mr O'Connor—That is correct.

Mr Rollings—Just to elaborate on and clarify what Mr O'Connor was saying, these options are not features of the law; they were options that were considered in designing the law. There is only one method by which your offset is calculated. The regulation impact statement is just canvassing several ways that that could have been done in the design process to give effect to government policy, but in the end one option was selected by the government. So they are not features of the law or options for a taxpayer in terms of the different ways in which we might calculate their offset; they were just options in the design phase. I am not sure if that helps.

Senator WATSON—The explanatory memorandum does not explain what the law is but what it might have been?

Mr Rollings—No, that is—

Senator WATSON—Surely that could not be right.

Mr O'Connor—That is the role of the regulation impact statement. The explanatory memorandum explains exactly what the law is and then at the end of the chapter in the explanatory memorandum the regulation impact statement explains that there were a number of options available to government to implement this measure and that the government has taken this option. It explains what the consequences of the options were. It should be a function of most explanatory memorandums these days, to have a regulation impact statement.

Senator WATSON—I do not mind the regulation impact statement, but I do not think you should make it more cumbersome by going through a whole range of options that the government, the tax office or Treasury may have considered before coming to this decision. When people are looking at the bill, or particularly the explanatory memorandum, which most people look at, they look at the situation—as I did—and think: 'This is an interesting option. That's an interesting option. Which should I choose?' I just think this is adding to a tax law confusion which we do not really need. On first reading it, I find it quite strange that Treasury are now embarking on giving arguments as to why they came to the decision, because, when we look at this sort of thing, people really want to know what the law is.

Senator CHAPMAN—Isn't the regulation impact statement to guide the government in its decision making? It is not so much for the public's explanation; it is more for—

Senator WATSON—It is here.

Senator CHAPMAN—That is transparency of government, showing what process the government went through. But I think the actual impact statement is to guide the government in its decision. It is in there for the purposes of transparency, to show how the government reached its decision.

Senator WATSON—If you are a practitioner, you are really interested in knowing what the law is and how it is going to operate.

CHAIR—I think we have established that it is in the regulation impact statement, and Mr O'Connor has explained why. Are there any other matters, Senator Watson?

Senator WATSON—Is this the first time you have introduced including all the options to look at? It can raise some very interesting questions. If you are doing it for this, we might demand it for a whole lot of other taxation laws in the future.

Mr Rollings—For all significant new measures, there would be a regulation impact statement accompanying the measure.

Senator WATSON—That regulation impact statement will look at all the alternatives, combinations and permutations that could have been arrived at before the government came to its agreed position.

Mr Rollings—It will canvass the main implementation options with a view to assessing which is least likely to impose regulation costs on the taxpayers.

Senator WATSON—It is an interesting development but I am not sure that it will help people understand the income tax laws. In other words, it could favour people who start up in the last week or the last couple of weeks of a business, because, if you are not running for the full 12 months and you start in the last couple of weeks, you could qualify for it—is that right?

Mr O'Connor—If you were deriving net income from that business—that is, the business was profitable—yes, it could you give you a benefit over and above, say, if it were the bottom slice. If it were the bottom slice and you commenced your business, say, three months—

Senator WATSON—You said that the bottom slice and top slice were just in terms of how you came to your final decision.

Mr O'Connor—Yes.

Senator WATSON—I have a situation whereby, for example, I start a business on 1 June and I have a turnover for the month of $40,000. That means I could qualify for the full tax offset.

Mr O'Connor—For that year, yes.

Senator WATSON—That gives me a great advantage over another guy who had been operating a start-up business and who had $60,000 for the full 12 months.

Mr O'Connor—Yes, that would be right. If for the year their turnover exceeds the threshold, there is no entitlement to the offset. But the calculation is based on the income year. If in the income year—

Senator WATSON—Yes. I am just saying that I have just started my new little business and I have a turnover of, say, $40,000. I have only been in operation for a few weeks or a month or even two months, and I get the full advantage of the tax offset.

Mr O'Connor—Yes.

Senator WATSON—That is very generous in terms of people who have just started a business and in terms of equity between someone who has been in business for 12 months and someone who has just started a very profitable business.

Senator STEPHENS—Or someone who has earned $40,000 for the year as a salaried employee.

Senator WATSON—To make matters even more worse, you could have a person whose income for the last three days in a new business was $40,000 and who is still entitled to the first full tax offset.

Mr O'Connor—Yes.

Senator MURRAY—My question is to Treasury. I have been watching the exponential growth of home based businesses over the last decade or so. It is absolutely astonishing the way the numbers have grown. I have equally been watching the health, strength and number of small businesses. Is there any sign that there isn't an entrepreneurial spirit in Australian small business? Where is the evidence that people need to be encouraged in the entrepreneurial area more than they are at present?

Mr O'Connor—I am not sure there is any evidence suggesting that people are not entrepreneurial.

Senator MURRAY—The Prime Minister's statement said that a re-elected coalition government would introduce tax incentives to encourage the development of an entrepreneurial spirit within the small business sector, particularly among those businesses operating from home. I used the word 'exponential' deliberately—there has been 1,000 per cent growth over the decade. Why are we giving a tax break to people who do not need one as an incentive? They might need one for another reason—I accept that—but why are we doing it to create an entrepreneurial spirit? Where is the evidence that we need to?

Mr O'Connor—I am not sure. That would be an issue that goes to government policy.

Senator MURRAY—It does not go to policy. The question is: is there any evidence that there isn't an entrepreneurial spirit? Either there is or there is not. That is not a policy question.

Mr O'Connor—Not that I am aware of. There is no evidence suggesting there is not.

CHAIR—Perhaps the Prime Minister meant to say 'stimulate the entrepreneurial spirit'.

Senator MURRAY—I am not sure you can stimulate it more than it has been. I again stress the word 'entrepreneurial'. Let us go to some of the kinds of people that might be affected by this. I would like the tax officers to feel free to comment. Take a home based business which is service oriented, like cleaning. You have a cleaning lady who has two clients a day, five days a week, and who perhaps earns $40,000 a year. Is she entitled to this benefit?

Mr O'Connor—On the assumption that that person is carrying on a business, yes, she would be entitled to this offset if she fell within all the other criteria such as turnover tests and those sorts of things.

Senator MURRAY—Take a man who runs a home based service business cutting grass on verges. He has four clients a day, five days a week, and earns $65,000 gross a year. Is he entitled to access this?

Mr O'Connor—Again, yes. On the assumption that $65,000 is his gross turnover, he would be in the offset area.

Senator MURRAY—So you would knock off his repair, maintenance and machinery expenses and so forth and his net income would fall within this range, wouldn't it, provided he is running a business?

Mr O'Connor—There are two tests. The first is eligibility, which is based on turnover. If, as in your example, a person had $65,000 of turnover and $25,000 of expenses, yes, they would be entitled to the offset but it would be calculated on $40,000 of net income.

Senator MURRAY—Have you any evidence that there is a shortage of cleaning ladies or grass cutters in Australia and that the entrepreneurial spirit needs to be encouraged in that area because we are short of those services?

Mr O'Connor—No, I have no evidence.

Senator MURRAY—Are there any particular categories within small and micro businesses where there is a shortage of supply which would need to be stimulated? I am aware, for instance—and let me help you—that in some sectors of small business contracting, such as trades, there is a shortage of plumbers, bricklayers and carpenters in some parts of the country. Is this going to help those people? If so, why isn't it targeted at them alone? Why is this broadly based, both to areas where there is plentiful supply and to areas where there is insufficient supply?

Mr O'Connor—The government's announcement was directed towards small, home-based type businesses with a turnover of, say, under $50,000. I would assume that the examples you mentioned—those tradespeople—would generally have a turnover far in excess of $50,000.

Senator MURRAY—Many do not net of expenses. The tax office people are on the line and they will confirm my understanding of the tax statistics: many of those sorts of people do fall, as businesses, within the range of this tax offset allowance.

Mr O'Connor—In net income terms, that may be correct, but the test is on turnover—what their total sales are for the year. They may, for example, have total sales of $100,000—that would be the gross turnover—so they would not be entitled to it—

Senator MURRAY—We have the tax people on the line, so let's ask them. Mr Peterson or Mr Konza, can you confirm that there are plumbers, carpenters and bricklayers who presently fall within this income range?

Mr Peterson—I could not tell you for certain. I would be surprised if there weren't some. But, as Mr O'Connor said, it is a turnover test. If the turnover reaches or exceeds $75,000, then the income does not qualify, notwithstanding the size of the deductions that might be available to the taxpayer.

Senator MURRAY—I do not want to put you to any extra effort, but if I were to ask you to look at your statistics and do a snapshot, and then come back and let us know, from your records, what percentage of plumbers or carpenters—a trade—fall below $75,000, would you be able to do that?

Mr Peterson—I believe we would be able to do that reasonably quickly. I will have to take it on notice and take some advice about the ready availability, because I understand that you want to turn this around fairly quickly.

Senator MURRAY—I just want an indicative statistic.

Mr Peterson—Are you asking about turnover or are you asking about net income?

Senator MURRAY—I am asking: in a particular trade—and you can choose plumbers, carpenters or bricklayers—what percentage falls within the turnover threshold below which they would get this offset?

Mr Peterson—I undertake to do my best for you.

Senator MURRAY—I appreciate that, Mr Peterson. The thrust of my question, Mr O'Connor, is that, if you are going to incentivise entrepreneurial spirit, as an economist I would argue that you target it where you need to generate additional supply. You do not want to incentivise areas where there is sufficient supply. You have told us—and that is very clear—that you have no evidence either way. You do not have evidence that there is or is not entrepreneurial spirit, but intuitively I would suggest to you that there is entrepreneurial spirit because of the numbers and the growth. Your evidence to us is also that this is a broad based measure which is not targeted to areas of skills shortage or where there is a demand or a need for further supply. That is correct, isn't it?

Mr O'Connor—That is right. It is targeted on the basis of the turnover size, which is directed more at the size of the business—it is directed at small and home based businesses.

Senator MURRAY—So it is a category tax cut, basically.

Mr O'Connor—I am sorry, but I am not sure I understand the meaning of that.

Senator MURRAY—It is a category of Australian taxpayers who are getting a tax cut. It is not targeted in any of the senses that I have outlined to you. It is directed at a category which falls within this framework you have structured.

Mr O'Connor—Within those thresholds, yes.

Senator WATSON—I will take up Senator Murray's issue of the cleaners. I have observed from Senator Murray's comments that it could be seen as an incentive for people to opt out of the PAYE system. The other point was that, if used judiciously, say with regard to cleaners, it could lead to a proliferation of very small business people just wanting to go out and clean one office—it may be $30,000 or something, a few offices—rather than wanting to grow large. There would be a definite pricing advantage for those people if they are in, say, an income range of $40,000 to $50,000 in opting out of the PAYE system and going for this particular benefit. They could adjust their prices downwards on account of the tax offset to give themselves a competitive advantage, compared with businesses that are slightly larger, particularly those with a turnover of over $50,000 or $60,000.

Mr O'Connor—One of the other criteria for the offset is that a person must be carrying on a business. I am not sure—

Senator WATSON—He would be carrying on a business like a cleaning business.

Mr O'Connor—in that example where you had one client—

Senator WATSON—One client probably would not—unless it were a very big office establishment—

Senator MURRAY—You would have to pass the alienation of services income test.

Senator WATSON—There is no doubt about it, I can envisage many women joining the bandwagon to get the considerable tax advantages over and above the PAYE system or over and above working for a cleaning company.

Senator CHAPMAN—Mr Rollings, wouldn't they have to meet the other tests?

Mr Rollings—Just as a general point—

Senator WATSON—They can meet all the business tests—provide their brooms and brushes, cleaning liquids and that sort of thing.

Mr Rollings—The personal services income legislation generally is designed to stop that kind of manipulation of people.

Senator WATSON—There is no manipulation.

Mr Rollings—People who are essentially in an employee relationship trying to hold themselves out as businesses, trying to—

Senator WATSON—No, you just opt out and say, 'We can make more money—at the end of the day, tax wise—by being an entrepreneur and taking advantage of the tax concession.'

Senator MURRAY—If they have three clients away from home, they are through. It is a very easy test.

CHAIR—Mr O'Connor, do you want to comment on what has been said?

Senator WATSON—I am all in favour of providing people with incentives, but I think you have to be very careful that you do not give people an incentive that will give one section of the community a price advantage over other sections of the community. It is a concept of the level playing field for all.

CHAIR—Do either of you gentlemen want to respond to the observations of Senator Watson and Senator Murray?

Mr Rollings—No.

Mr O'Connor—No, I have nothing to add.

Senator WATSON—Don't you agree it could provide a price incentive?

Mr O'Connor—I am not sure. As Mr Rollings mentioned, the other tests need to be satisfied as well. They need to be looked at on a case basis. I am not sure whether the ATO have any comments about that.

Senator WATSON—Perhaps the ATO could comment on it.

Mr Konza—I agree with Mr Rollings's comments. The key factor for us is that people are carrying on a business.

Senator WATSON—There is no problem with that.

Mr Konza—The government has already responded to issues about people moving from PAYG into small businesses by enacting the personal services legislation. Other than that, I can only agree with your last observation that it is designed to be an incentive and so it is an incentive. That is probably all we can really add.

Senator MURRAY—It is an incentive to move out of PAYG. How can it be an incentive to create more cleaners or more grass cutters? If you are going to respond like that, Mr Konza, you have to give evidence.

CHAIR—That is a debating point. Mr Konza has given a response, and that is the response.

Senator STEPHENS—It occurred to me that one of the consequences of this legislation could well be for employees to be terminated and encouraged to establish their own small businesses and become subcontractors, such as in the cleaning industry. Therefore they could access this entrepreneurial tax offset but would be forgoing their employee protections such as workers compensation, occupational health and safety and sick leave entitlements. Have Treasury and the ATO considered that that could be a consequence of this legislation and that employees would be losing protection by this measure?

Mr O'Connor—I think that is a similar issue to what Mr Rollings referred to with the alienation issue. People were suggesting that people were being forced onto a contract basis so that legislation is designed for that. I do not think this would create any further push in that direction. I am not sure whether the ATO has any comments.

Mr Konza—It is our observation, rather than this encouraging people to be forced out and forgo their entitlements under workers compensation and so forth, that when we consult with industry they generally tell us that the major motivation for employers to go into contracting are workers compensation and payroll. So indeed the drivers are those costs. This offset, as you speculate, might marginally increase the incentive for the employee to accept such an arrangement but, from what we have seen, it is unlikely to greatly increase the drivers of that because those drivers are occurring in other places.

CHAIR—I have a couple of questions that you may want to take on notice. To be eligible for the ETO a taxpayer has to be an STS taxpayer, which requires an assessment to be made of STS group turnover. The STS has been running since the income year commencing on 1 July 2001. Has Treasury consulted with the ATO about the effectiveness of the grouping rules as an antiavoidance measure and has the ATO advised Treasury of any problems with the grouping rules?

Mr O'Connor—I refer to some of the comments that Mr Peterson raised earlier. The ATO have been looking at the grouping rules and there does not seem to be any concerns that have been raised since the STS has been introduced. Perhaps Mr Peterson would like to elaborate on that.

Mr Peterson—We certainly have been looking at the grouping rules. We have a taxation ruling out covering the issue. We have a fact sheet out dealing with the grouping rules. The level of requests for advice we have seen around grouping provisions has been extremely low, although our level of detailed examination of the grouping rules in operation has been relatively low too in all the circumstances. In connection with the entrepreneurs tax offset, we had officers at a fairly senior level working through a range of scenarios and possible uses and abuses of the grouping provisions. The advice that I have from that process is that they appear to be sufficiently robust for present purposes.

CHAIR—Thank you. What is Treasury's estimate of the number of small businesses which will benefit from these provisions?

Mr O'Connor—I think that is a similar question to the ones that have already been put to us, which we have taken on notice.

CHAIR—What is Treasury's estimate of lost revenue as a result of the proposed amendments? Has Treasury done a formal cost-benefit analysis of the proposed amendments?

Mr O'Connor—In relation to the cost to the revenue, those figures would be contained in the general outline to the explanatory memorandum which refer to $400 million in 2006-07 and $390 million in 2007-08.

CHAIR—How does a small business taking advantage of the full 25 per cent ETO with, say, a taxable income of $35,000—this has perhaps been covered—compare with a wage earner with the same taxable income?

Mr O'Connor—A wage earner with the same taxable income would not have any income which would be subject to this offset, so they would receive no benefit. A person with the same $35,000 in pure business income would get a 25 per cent offset in relation to tax on that income.

Senator WATSON—What is that worth?

Mr O'Connor—I will have to take that on notice.

Senator WATSON—I presume you are not responsible for the issues regarding petroleum.

Mr O'Connor—No.

Senator WATSON—And similarly family trusts and interposed entities?

Mr O'Connor—No, it has not been referred to us.

CHAIR—Thank you, gentlemen.

[2.02 p.m.]

JONES, Mr Barry, Executive Director, Australian Petroleum Production and Exploration Association Ltd

MULLEN, Mr Noel, Commercial Director, Australian Petroleum Production and Exploration Association Ltd

CHAIR—Welcome to the hearing. The committee prefers that all evidence be given in public. However, if at any stage you want to give part of your evidence in private you may ask to do so and the committee will consider your request. I invite you to make an opening statement.

Mr Jones—Petroleum—that is, oil and gas—makes up about 54 per cent of Australia's primary energy supply and about 74 per cent of our final consumption. It is our view that there is a strong governmental commitment both at the Commonwealth and at the state and territory level to the need to develop Australia's petroleum resources. There is also strong Commonwealth and state ministerial support for the greater use of natural gas, particularly because of its role in reducing greenhouse gas emissions domestically and internationally but also its development implications and the significant economic wealth it can create. The Council of Australian Governments, the Ministerial Council on Energy and the Ministerial Council on Minerals and Petroleum Resources have all over the last three or four years endorsed goals or vision statements directed at facilitating petroleum resource development. The Commonwealth government's energy white paper also clearly recognises this need. These policy statements recognise that there are both direct and indirect economic and social benefits from additional petroleum development.

Economically, the industry pays substantial taxation revenue to governments. Over the last 20 years it has paid approximately $25 billion in company tax. Over the last 13 years it has paid approximately $60 billion in resource taxation. As our submission points out, there are substantial trade benefits, there are substantial employment benefits and there are significant direct multipliers into the economy. For example, the North West Shelf project alone generates about $1 billion in indirect economic benefits annually. The governments in their policy statements have recognised that petroleum resource development also confers economic benefits in the form of enhanced energy supply reliability, enhanced market competition, sustainable energy production and enhanced sustainable energy use.

I would like to take a couple of seconds to talk about those last two points—sustainable energy production and sustainable energy use. We in APPEA are all in favour of level playing fields. I would be more than happy to see the principle applied to all energy sources that anything that is in fact a public resource has a royalty or, better still, resource rent tax applied to it. My view would be that rainfall, wind, wave and solar energy are all public resources in exactly the same way as oil, gas and coal. Maybe we should have a level playing field in the form of a royalty on everything. I could probably upset my coal colleagues and make the point that at current coal prices a resource rent tax would probably be a quite desirable thing for the coal industry as well. If we were not going to do that, I would be more than happy to have the MRET scheme extended to apply to natural gas or maybe for a natural gas cities program to be adopted by the Commonwealth government, maybe even having CSIRO put about the same amount of money into research and development on gas that they are putting into renewable energy and hydrogen.

I also make the point that we have a demonstrated track record, which is acknowledged by all the environment departments of this country, of having world's best practice in environmental management. The standards that we have adopted here in Australia, particularly in relation to whales and seismic, have become the industry norm right around the world. It is one of the circumstances where we have taught the rest of the world a few things.

For the record, I emphatically say something that I have said again and again: we have absolutely no interest of any kind whatsoever in exploring in the Great Barrier Reef World Heritage area. I also note that this particular piece of legislation and the announcement associated with it had four licences in Western Australia, one in Tasmania and one in the Northern Territory. I quite frankly do not understand how any one of those licences has any connection with the Barrier Reef or, for that matter, the Sydney Basin. Nor do I see the Sydney Basin as a pristine marine area, given the amount of sewage that is disposed raw out of the Sydney sewerage system into that particular area. I almost make that comment as a member of the National Oceans Advisory Board, rather than as a member of APPEA.

Senator MURRAY—And as a swimmer?

Mr Jones—As a swimmer as well—I try to dodge Bondi as much as I can. In terms of sustainable energy use, I make the point that natural gas is recognised globally as being the least carbon intensive of all the fossil fuels. I also make the point that there is no large-scale, commercially viable option to replace petrol in the market at present—there just is not a substitute for it. Another point, of course, is that petrol consumption in this country pays the Commonwealth government about $13 billion a year, which I suspect is more than enough to cover any externality which might not be directly taken account of in the decision.

However, that was a little digression to explain my view on the objectives which governments, Labor and Liberal, have set in this country. The aim of this measure is to stimulate petroleum resource exploration. Australia needs to find both more gas and more oil. On the best supply projections that are available on natural gas, the Northern Territory potentially has a supply problem in about 2010. The eastern seaboard system, even with substantial development of coal seam methane and the construction of the Papua New Guinea pipeline, has a potential supply problem in the period 2015-20, and that supply problem will come forward if New South Wales and Victoria make a major push into the use of natural gas for electricity generation for greenhouse reasons.

If we, the industry, are to meet the objective which the Commonwealth, Northern Territory and Western Australian governments have set for LNG export, then somewhere around the period 2020 we need to find more gas in the north-west of Australia to meet that export objective. Despite the fact that there is 120 TCF of gas up there at present, even if all the energy projects were built we would still not meet our nationally declared objective of 30 per cent of the Asian market by 2030; we would need to find more gas to do that. I am not for a moment suggesting that Australia is going to run out of natural gas. Australia is geologically a gas-prone province; it has a high probability of finding natural gas. The real requirement is to get the capital there for both the exploration and the development; there is certainly not a resource problem.

I make the point that, to the best of my knowledge, I have never heard anyone in recent times suggest that global gas production is peaking, that global natural gas production is going to turn over and decline sometime in the near future. That is just not the case, if one looks at the potential reserves of the former Soviet Union and the Middle East. I also note that there is absolutely no connection between global oil prices and domestic gas prices and, at current levels, there is little connection between the export gas price and global oil prices. There is not a very strong connection between the long-term oil price that you need for exploration and investment in oil and the day-to-day spot price for oil.

In addition to finding more natural gas, Australia does face a problem in the crude oil area: production is declining, and demand continues to increase in spite of the relatively high prices of the last six years. If those prices persist and the government's best supply forecast is met, that would potentially add about $30 billion a year to the national export bill by 2015. Even with the best development outlook in the world, there is no way that LNG exports will generate sufficient revenue to pay for this.

There are a lot of contentious statements in the media that the world is running out of crude oil, that the crude oil production curve has peaked, is about to peak, might peak or something like that. What is not made clear in the media is that the science of the so-called Hubbard curve is as contentious as much of the science to do with greenhouse. There are a lot of people in the oil industry who believe that Hubbard fitted his data to his preconception of the curve rather than looking at the data and analysing it—and there is a reasonably lively debate about what a decline curve actually looks like in the oil and gas industry. But, at the end of the day, economics will say that oil will never run out. We may develop substitutes, and things may change, but that is the reality.

To achieve the government's best production forecast in Australia, I would not for a moment argue that we do not need a substantial exploration and investment effort; but, even if we find that, I do not see exploration as closing the emerging demand-supply gap in this country. We will still have to do energy sufficiency measures, we will still have to look at demand-side management and we will still have to look at alternative fuels. To deal with that issue requires a suite of measures, of which more exploration is only one. From our point of view, Australia needs to invest more in exploration for both natural gas and oil. We need to recognise that exploration is a high-risk business: in Australia, only one in 16 wells drilled leads to a commercial discovery. It is a high-cost business: one deepwater well can cost in excess of $50 million. The proposed PRRT change recognises this risk, particularly in deep water. It recognises that there are public benefits to be gained if exploration is successful and that market forces alone will not drive that investment.

I think we also need to recognise that there will be strong competition for exploration capital globally over the next decade. One company source suggests that, merely to produce sufficient liquids globally to meet

projected demand and deal with the decline in some of the large oil fields, the industry needs to invest $US100 billion per annum. The International Energy Agency roughly comes to the same figure. Of course, that is before we even start looking at the amount of money that needs to be invested to bring the major gas discoveries online to meet the world's demand.

The world out there is a highly competitive market. Other countries such as Norway, the UK, the USA and New Zealand have already adjusted their fiscal systems to maintain their international investment competitiveness. In our view, Australia should do the same. This measure is one step along the way. We also think that this measure has a public good associated with it. One of the difficulties for all of us in this country is that we know very little about Australia's EEZ and the resources that are in it. Any exploration or seismic or electromagnetic surveys that are done out there will be in the public domain and will add to Australia's general store of scientific knowledge about its offshore continental area.

CHAIR—Mr Mullen, do you have anything to add?

Mr Mullen—No.

Senator STEPHENS—Thank you for your submission. I will go to the referred section of the legislation. First of all, can you tell me whether the association was consulted about the proposed amendment?

Mr Jones—About three years ago the association put a package of measures to the Commonwealth and Western Australian governments which covered a range of things to do with oil and gas development. It included increased funding for GeoScience Australia, things to do with the depreciation regime on certain projects, how to stimulate investment in exploration in the frontier areas and the issue of the uplift factor under the petroleum resource rent tax. I think we went through that package at some length with the Prosser inquiry two years ago. We had a number of views on options that could be used to stimulate investment in the frontier areas. Out of that range of options the government has come up with this one. We think it is a workable option.

Senator STEPHENS—It has been speculated that this new provision will not actually result in any new wells being sunk. Do you think that is the case?

Mr Jones—The one thing I know about the way the industry operates is that we will never know. I am sorry; that is not an accurate statement. The initial announcement had six licence areas attached to it. I presume that Minister Macfarlane will make the next round of announcements in April of this year and that it will have another set of licences attached to it. If there were no bids for both the first and the second round then you have an answer to your question. I would say that you have to do the first and the second round. Because of the election and the parliamentary recess and the uncertainty about whether this measure will actually come into force before the bids close for the May 2004 round of acreage, companies may find themselves in the situation where they cannot make a bid as they were not sure about what legislation they would be dealing with. Therefore, I do think you have to go to the second round before you make your judgment.

Senator STEPHENS—In your submission you recommend that the relevant government agencies provide guidance on the technical factors they propose to consider in determining the annual nominated frontier acreage. In what ways is the currently available information inadequate and what specific enhancements are you seeking?

Mr Jones—GeoScience Australia publishes a map of Australia's offshore basins, which are classified in three levels: mature, immature and frontier. There are some significantly large areas in that frontier group. For example, there is a massive area around Lord Howe Island called the Lord Howe Rise—it is thousands of square kilometres. We need to know how the government is going to choose the 20 per cent. Presumably it is going to be from within the areas on the GeoScience Australia frontier map. That is criterion No. 1. What is the next set of criteria which follow from it? Is there going to be a consultation process with industry? Is GeoScience Australia, as part of its ongoing program from the funding two years ago going to target certain areas, run seismic over them and then release them? What is actually going to be the process by which the 20 per cent is clarified?

Senator STEPHENS—On page 6 of your submission you suggest that the estimated cost to revenue represents the upper range of the cost over the period due to a combination of factors. Would you like to elaborate on the dot points you raise there?

Mr Jones—I have already spoken about one of them—that is, the first one. The way the system works is that acreage is released in April, bids close roughly 12 months later and then it takes another six months for the bids to be allocated. So even the six blocks that were in the first round will not in fact be announced until

September-October this year. There is quite a long process involved in that. Whether this particular measure is then activated will depend on the type and nature of the company that wins the bid. Basically the question comes down to: is it a company which is going to pay PRRT? For example, if it is Woodside, Santos, BHP Billiton or ExxonMobil, then there is a tax cost because they are all PRRT-paying companies and the expenditure on exploration can be brought to account straight away. If they are not in the paying tax category, they really have to find something, develop the field, start paying PRRT and then bring the expenditure to account. Again, given the leads and lags in the system, with the best will in the world they go out, they explore, they find something straight off and it looks pretty good but it is still going to be three years before you have a production platform out there, be it oil or guess. These are three- or four-year financial estimates that we are talking about. You are probably more capable of dealing with the third one, Noel—the interrelationship between the PRRT and the company tax system.

Mr Mullen—We have made the assumption with the costings that they take into account the fact that there is an offsetting change in the company tax payment that will arise if there is a lower PRRT payment. Again, using the suite of companies that Barry indicated, if those sorts of entities take up the incentive, they will see their income tax payments rise, which will mean that again there will be an adjusting movement. There is a multitude of factors that will determine the cost. Barry touched on one at the beginning—that is, the length of time that it takes for this process to kick in, to complete your exploration program, which can be up to six years.

Senator WATSON—They are going to be a lot worse off, are they not?

Mr Mullen—In which sense?

Senator WATSON—The combination between resource rent tax and income tax—if they have a lower resource rent tax than previously, their income tax will go up quite substantially because of the offset.

Mr Mullen—The way the system works at the moment is that, if you have a PRRT liability, that is a deduction that is allowable in your income tax payments.

Senator WATSON—That is right.

Mr Mullen—So while you would effectively get the benefit of a lower PRRT payment, there would be a clawback of approximately 30 per cent, which would be the income tax adjustment, so an entity taking up this option would still be 70 per cent better off than they would be without it.

Mr Jones—I think I have already dealt with the last one and also to some extent with the second-last one, because what we are really saying there is, depending on how much information we generate and the quality of that information, that information will actually allow GeoScience Australia to use its limited funds in a better way and then potentially they do not have to ask the government for so much.

Senator WATSON—I was interested in your observation about resource rent tax applying to a highly profitable coal industry which you have referred to. This concerns an issue that I raised when the concept of resource rent tax was first introduced in the parliament: why restrict it to petroleum type products? Can you offer some explanation as to why a boundary was put around one industry?

Mr Jones—I suspect it is that, at the time, we had gone through two oil price spikes. When the Gippsland field was found, the world crude oil price was about $US2.10 to $US2.50 and Gippsland was profitable. Not too long after that, the world oil price, depending on which particular set of economic indicators you want to use, hit the infamous $US50, $US70 or $US90 a barrel. Very clearly there was a windfall gain and it was not only Bass Strait oil that it applied to; it applied to the oil and gas industry around the world. The government of the day said in public policy, 'The community is entitled to part of that windfall gain and the economically most efficient way to do it is the resource rent tax'. I think in economic theory terms that is a factual and indisputable statement.

Senator WATSON—It did not come off when the peak became a trough.

Mr Jones—I think there are a number of difficulties with the system. At the time it was designed it was designed basically for oil projects in shallow water. Sorry, let me go back. In economic theory, you would in fact have a different tax for every project, because the level of risk and of economic rent would differ from project to project and from resource to resource. That is obviously impractical in a legal sense, so you would have to make some big generalisations. From my point of view, one of the problems with the system is that we are taxing gas in the same way as we are taxing shallow-water oil. That produces a problem which we are still debating with the government. Coal prices have done the same thing that oil prices have done: they have been

exceedingly low; they are now exceedingly high. If you were going to design a tax for any other energy resource, you would have to do it in a way that reflected that fact. Theoretically, there is no reason for doing it, but I suspect that at the time it was just the fact that oil prices had created a cash register.

Senator WATSON—It is interesting to note your comment that there is no relationship between prices for gas and oil, yet in a later part of your presentation to us you refer to the industry sectors being highly competitive. In a normal situation in economics where you have highly competing products serving an energy purpose, for example, you would expect some relativity between the two prices, yet you came out and bluntly said there was none. What were the reasons for there being none?

Mr Jones—I was a little more careful than that. I said that, domestically, there is no relationship between the price of crude oil and the price of natural gas. Natural gas in Australia is used for two purposes domestically. It is used for what we call process energy—for sterilisation in hospitals, baking bricks, baking paint onto motor vehicles, sterilising bottles, laundries and things like that—and for electricity generation. In the case of process energy, the comparative point is in fact the price of electricity or the price of fuel oil; that is effectively what natural gas is competing against. In the case of electricity generation, it is the price of coal. At the end of the day, for the greater part of the country—with the exception of the Northern Territory and now Tasmania—the choice in electricity generation is between coal and natural gas, and the coal prices in this country set the price for natural gas for all intents and purposes. It is not a direct one-on-one relationship because the energy content and the energy efficiency of the power plants and things like that all differ, but basically the world crude oil price has nothing to do with the way you sell domestically.

Internationally, the part of the world we currently sell natural gas into does have natural gas contract prices which are partly related to the price of crude oil, but there is an upper and a lower range within which the price moves. My understanding is that the prices in the upper range are well below the prices which are prevailing in the market at the moment and well below the prices which OPEC are talking about as being their benchmark—which the EU have just suggested they would accept—of $30 to $35 a barrel. That is the upper range. But that is only one part of the market. In the Atlantic basin, where we do not sell, the relationship is different. Of course, in the United States market, into which we do want to sell, the price trade is going to be against other natural gas prices in the United States grid, which will ultimately all go back to Oklahoma and the Henry Hub price of gas. There will be a net back arrangement which will apply.

There is a view in the global gas industry that eventually the LNG price is in fact going to be driven by the price of clean coal technology and there is a view that selling gas into the United States can continue until it is at the stage where it is more commercially viable to build an IGCC coal plant in the United States—and that effectively sets the cap price for natural gas sales from the Caribbean, from Africa and potentially from Australia into the United States, so it is not a simple relationship.

Senator WATSON—My third question concerns offshore services. Why are the frontier services limited to offshore? Given the problems with the Northern Territory, wouldn't you regard some of those remote areas, like the west of Western Australia, as frontier territories just as much as those that are a few miles off the coast?

Mr Jones—The short answer is: we have a federation. We would take the view that you have just espoused that there are in fact onshore frontier areas. But of course PRRT does not apply to onshore production in Australia; that is under the state royalty system. We would take the view that there are parts of the Northern Territory, parts of Western Australia and potentially parts of South Australia where there is a probability of finding oil and that they would fit into the frontier category. How we would deal with that basically requires the states to make some change to their royalty system. More importantly, it requires the states to spend more money on geoscience and on boosting their geological surveys which, almost nationally, have been run down over the last 10 years in terms of funding.

Senator WATSON—Is that in Australia's best interest?

Mr Jones—In my view, if we need to find more oil and we need to find more gas, it is obviously cheaper to develop oil and gas onshore than it is to develop it offshore. As a starting point, you do not have to build a platform or a subsea completion. So, yes, anything that can be done to stimulate frontier exploration onshore is a distinct plus.

Senator WATSON—It is not available through this legislation.

Mr Jones—No, because the PRRT does not apply onshore.

Senator WATSON—That also raises the question of vulnerability. This is giving a tax concession to offshore where, in terms of national emergencies, your platforms would probably be more highly vulnerable, particularly those up north. You might have lots of shipping coming and going and it is harder to identify vessels, particularly fast-moving vessels, or submarines compared with onshore operations. Does it strike you as odd that in terms of looking at what I call the national interest, maintaining self-sufficiency of Australia in an emergency, we should give extraordinary concessions only to that section of the industry that is operating in a potentially more vulnerable area than one which is operating in a less vulnerable area, such as onshore, inland for example in many parts of Australia, such as Queensland, which we might like to regard as frontier areas because of their remoteness, small population level and so on?

Mr Jones—There are three points I would like to make in response. APPEA has encouraged and will continue to encourage the states to make their exploration regime more attractive, exactly for that reason. We should not fall for the myth that the only place in this country where we might potentially find large or even significant oil and gas fields is in the offshore area. I would make the point that in this context onshore includes a particular part of water in Western Australia as well, the areas about Barrow Island, the Montebello Islands and things like that, which is technically under the state regime and which is a highly prospective area where gas and oil finds are being made. So, yes, I would agree with you that anything that can be done in a public policy sense to encourage the states to be more facilitative—

Senator WATSON—To follow that line of argument, it seems extraordinary, given the potential that could be available to state revenues, for them not to be at least looking at this possibility of working closely in conjunction with the federal government to attract onshore exploration.

Mr Jones—I guess my answer has to be the duck dive at this stage.

CHAIR—It is probably not a question about the legislation.

Mr Jones—I am not sure I always understand the drivers in the political process.

Senator WATSON—Sometimes the reason behind the legislation is also what interests us, isn't it, Senator Murray?

Senator MURRAY—Yes.

Mr Jones—The reality of life is that at present 90 per cent of Australia's oil and gas production does come from offshore, particularly if you include the offshore area of Western Australia. Going on to the two other points I would like to make to you, I do not for a moment underestimate the vulnerability of the North-West facilities but I have to make the point that the North-West is not the be-all and end-all of the Australian oil and gas industry, much as it occasionally thinks that it is.

Some of the frontier areas we are talking about are in a considerably less vulnerable strategic situation than the immediate area in the North-West. Even in the North-West there are gradations. While Bayu Undan and the Timor Sea are relatively close to vulnerable areas, the further you go down—firstly to the Browse and then into the Carnarvon basin—in the North West Shelf down towards Gorgon and Apache, the capacity for small vessels and commando forces and all the scenarios to apply becomes increasingly more difficult. That is not to say that it still cannot happen, that it is not a risk and that it is not a priority for the industry to maintain the security of those facilities.

Senator WATSON—You mention that in this round there is no proposed drilling anywhere near the Barrier Reef, but this legislation is not restricted to the surround; it is possible that there could be a find within the area of the Great Barrier Reef. What does APPEA regard as a safe area from the Barrier Reef in terms of a drilling operation? Are we talking about a thousand kilometres, a hundred kilometres? The Barrier Reef does excite a lot of political interest in the federal parliament because of its uniqueness and its size.

Mr Jones—I am a North Queenslander by birth, Senator. I had better declare myself up front.

Senator Murray interjecting—

Mr Jones—I have been going south ever since! I understand it is a highly emotive issue. I do find it rather amusing that it is totally permissible to turn Queensland sugar cane into biofuel and ethanol and sell it and that is an environmentally desirable thing to do, when it is a well-established fact that the greater part of the threat to the environmental sanctity of the Great Barrier Reef is in fact shore based and a large part of it comes from agricultural exploitation along the Queensland coastal belt. That fact is never discussed except in the realms of marine science. If externalities are going to be discussed, let us discuss all the externalities.

Senator WATSON—I disagree with that. People are worried about the entry of nitrogenous products into the waterway off Queensland.

Senator MURRAY—It has been extensively discussed in parliament, but the point you make is a good one.

Mr Jones—The second point I would make is that this country is gas prone and—

Senator WATSON—Gas prone?

Mr Jones—You are more likely to find natural gas than you are to find oil. The argument that I hear about the Great Barrier Reef goes something like this: if you explore, you might find oil; if you find oil and you put a production facility in, one day that production facility—or the tanker—may have a breakdown and then oil will spill and the oil will drift into the Great Barrier Reef and that will damage the Great Barrier Reef. Firstly I make the point that natural gas does not do that and the probability is that you would find natural gas—just looking at the statistics of what we find in Australia as opposed to anything else. 'Oils are not oils' was the old Caltex ad; there are grades of oil. Australia does not produce heavy, gluggy oil. There are pictures we see, such as the infamous ABC cormorant, that come out every time this is discussed. That is in fact a bird caught in a diesel fuel spill in the Northern Hemisphere. That is not what you produce out of an oil well. In fact in that part of the world, if you produce light oil the greater probability is that it would vaporise within 24 hours of a spill. It is kerosene. If you put it at 35 degrees temperature on the top of the ocean, it vaporises. It is as simple as that.

When you find something, there are well-known, demonstrated and tried and true techniques of identifying what sort of oil you have, what vaporisation rate you have and in what direction the currents go. There are computer programs that tell you how far any potential oil spill is likely to drift in any direction when put in your type of oil, the current and the temperature. They are tried and true techniques. They are used repeatedly—for example, in Western Australia around Barrow Island, Thevenard Island, Veranus Island, the Montebellos and Ningaloo. You could explore within relative proximity of Ningaloo, which is just as important a reef in this country from marine diversity points of view as the Great Barrier Reef; but if you talk about the Great Barrier Reef you have to be 1,000 kilometres away from it, and even then that is potentially not acceptable. I have seen private members' bills in the federal parliament which would in fact put the buffer zone for the Great Barrier Reef at the limit of Australia's EEZ. I would regard that as being a probabilistic assessment of the worst order—nonsense.

The answer to your question is that it depends. The way the rules work in this country is that if the oil was found in an area where the currents—meaning moving water—and temperature conditions would lead to a drift potentially at any time into the Barrier Reef World Heritage area, the development would not be allowed. That is the way the rules work. We in industry understand those rules. All the arguments about whether it is 70, 100, 150 or 1,000 are irrelevant. It is a matter of what you are going to find, what the drift factors are and what the development conditions are.

Senator WATSON—And with gas it is a lot less.

Mr Jones—With gas it is considerably less.

Senator WATSON—That is very helpful. Thank you.

Senator MURRAY—Mr Jones, twice in your answers I heard you mention Barrow Island. I think I will just record for the record that if you look on my web site you will find that the Democrats support Barrow Island development, which is in complete contrast to the Greens who oppose it. I want to ask you about how you measure incentives. To help you answer, I will put it into context for you. In 1996-97 the Democrats opposed two government changes. The first one we thought was a very effective exploration taxation incentive. I seem to remember the clause was 39E, or something like that. We argued that withdrawing that taxation incentive would result in a loss of onshore, principally, exploration capacity. Since then, you can actually measure the deterioration in exploration activity. Therefore, removal of that incentive has had a negative effect. So we were right and the government was wrong, in my view. The second example I want to give you is the 150 per cent R&D tax incentive. When that was applied there was a lift in Australia's R&D. We opposed its removal. When it was taken away there was a measurable drop in Australia's R&D. We think we were right and we think the government was wrong.

Here is this incentive and I have two questions relating to it. Firstly, how will you measure whether it has the desired effect—after the event, obviously—or how do you think it can be measured? Secondly, is it an incentive at all? In your world, $17 million is absolutely zip, zero, meaningless nonsense, almost; it just does not have any impact. That is the amount of the financial impact in the statement: $17 million over the period

2004-05 to 2007-08—three years. We have had a fascinating interchange with you, and it has been very instructive. I am amazed you even bothered to turn up. Surely, $17 million is not meaningful to your industry. It is a public relations exercise, I would have thought.

CHAIR—Everyone is entitled to get their views on the public record, Senator Murray.

Mr Jones—I would agree with that.

Senator MURRAY—I wasn't being aggressive about it. I am thinking, as a West Australian, about when I see the North West Shelf. They are about to put the fifth train in. We talk billions. Your industry talks billions. I just cannot put $17 million into that context.

Mr Jones—You asked me two questions: how would I measure success? The first indicator would be bids: are bids made for these blocks and, if so, what is the nature of those bids and do they deliver something at the end of the day? I go back to the comment I made at the end. To me there will be two sets of benefits. Obviously there is the commercial benefit if we find something. There is also just the straight knowledge benefit. Every piece of seismic survey that we run adds to the public knowledge of what is available in that area. The primary measure will be the number of bids.

Senator MURRAY—These are the bids that used to occur.

Mr Jones—At present nothing is occurring in those areas, or very limited is occurring. The number of bids you get, the amount of seismic activity and eventually whether a discovery is made will all be indicators. Of course, if we make a mega discovery, if we find the 1,000 million or the 10,000 million barrel field, or the 50 or 60 tcf gas field, then we have a very obvious benchmark. Does $17 million matter? I think it is a wrong comparison to look at the development cost as opposed to an exploration cost. You do not build a production platform for much short of $500 million—probably a lot more in this sort of water. You will probably need to have tanker offtakes and FPSOs, floating production storage and offtake platforms—things like that—and they all cost money.

But the cost of seismic is an entirely different matter, and that is what we are talking about. The cost of desktop surveys is an entirely different matter. They will be the first two stages of the process. If a substantial 3D seismic survey is run as part of this exercise, if someone finds something and develops it, then the revenue implications are obviously not $17 million. But as I said, given the leads and lags, we are talking outside the forward estimates period, I think, at least for that development cost part of the equation. Whether that, by the way, is a net loss to Commonwealth revenue is a moot point. The short answer may be that it is a choice between nothing and something. I suspect it is more likely to be in that category.

Senator MURRAY—Let me just ask you this question so I am clear. You are saying that is a meaningful incentive even though, both in the experience of the committee in terms of the numbers we deal with and in terms of your own industry, it is a relatively small amount.

Mr Jones—I think it is a good first step. The other point I want to make to you is that, while it would be highly desirable to have the oil majors—the Exxons, the BPs, the Shells, the ChevronTexacos, the ConocoPhillips—go into these areas because they have the technology, they have the capital, to actually go to the development cost, the chances are that the sorts of companies that will bid first time around will be relatively small companies. I think we should be very careful not to categorise the oil and gas industry in this country as being at one end of the scale Exxon, Shell and BP and then down to Woodside, BHP Billiton and Santos. I have 50 producer member companies, roughly, and only 12 fit into that mega category. The others are small businesses.

Senator MURRAY—The Snowdons of the world?

Mr Jones—The ARCs—you would know of ARC Energy—and Dongera, Strike Oil and Beach Petroleum.

Senator WATSON—It's a pity I didn't buy some shares.

Mr Jones—I am not making a stock market projection. The record of the industry globally is that those guys are the ones who are more risk tolerant and who are more likely to have a go at this sort of thing. Yes, it would be nice to get one of the majors out there, but, equally, in the context of a consortium of three or four of the smaller companies deciding that they will pool their money and have a go and that the risk-reward arrangement is adequate for them, $17 million is a significant figure.

Senator MURRAY—Thank you, that is helpful. This is my last question. I was interested in your interchange with Senator Watson. The PRRT is a novel taxation scheme which came out of a novel circumstance, as you outlined. But are you suggesting that, as a by-product of this inquiry, this committee

should recommend that the government examine whether the PRRT type scheme should apply across the entire energy sector? You make a valid policy point—that is, that taxation should have an equal and non-discriminatory application in concept and then you discriminate in terms of outcome, because you can favour low alcohol beer versus high alcohol beer; you can favour gas versus crude oil and so on. Are you suggesting that we should seriously look at that sort of recommendation as a by-product of this inquiry?

Mr Jones—I have to confess that some of those opening comments reflected having read the other submissions which have been put to this committee. As Senator Watson quite rightly says, I have absolutely no intention of sitting in front of you and leaving those comments on the record unchallenged. I really do think that much of what is there is, in polite language, spurious and factually inaccurate. I do not believe that that can be left unchallenged, and I do apologise to the committee if I use ridicule as a vehicle for doing that, but it is a well-known technique. But I would make two points to you. In my view it is a perfectly valid economic argument to consider the nature of resource taxation across this country and consider having a level playing field across all energy resources.

Senator MURRAY—Both discriminating against and discriminating for, on sound policy grounds.

Mr Jones—Yes, on sound policy grounds. For example, I would say that if we are going to pursue a policy which internalises externalities—and that is a public policy decision which any political party may make—then it is all externalities that are internalised, not just one. At present the public policy debate is about internalising one.

Senator MURRAY—Not really. I am on the record about coal, for instance.

Mr Jones—The greater part of the public policy debate; I stand corrected. Yes, if we are going to internalise then it is everything, across the board. If the decision is that there should be some sort of resource use tax—which is the case, both for mining and petroleum—and if this resource tax is based on the grounds that these are public resources, community resources, being used by industry for a commercial reason and a public benefit, then I have two views: it should be a level playing field for everyone—and that does not exist, even within the fossil fuels sector—and it should cover everyone.

Senator MURRAY—You made those points earlier. My question to you was: are you asking this committee to recommend that this area be examined by the government as an outcome of this inquiry or were you just making a point?

Mr Jones—I want to make a third point. Even within the area of the petroleum resource rent tax, I do not believe the tax works properly. I do not believe that it in fact treats risk within the petroleum sector in a consistent way. So I do not even believe there is a level playing field within it. I do not believe it is within your terms of reference for you to do what you have suggested. I may be wrong; the chair will correct me.

Senator MURRAY—We can do what we want.

CHAIR—Senator Murray's question, as I understood it, was whether you wish to make a submission to this committee that, in the report we make to the Senate, we make a recommendation to government about further matters. That is a perfectly proper question and it is something that we could consider doing. But you are merely being asked whether you submit to us that we should consider doing so.

Mr Jones—In that case, yes, I would submit that, because I do believe that there is a public policy case to be argued.

CHAIR—For all of the aforementioned reasons, which you have canvassed in your discussions with Senator Watson and Senator Murray?

Mr Jones—I would argue a public policy case across the three points I have made to Senator Murray. If the committee saw their way free to recommend that, I would welcome it.

Senator MURRAY—I am obliged to the chair. Thank you.

Senator WATSON—Chair, you had to take great care with how you did that!

CHAIR—Mr Jones has simply accepted an invitation to make a recommendation, and we will consider it. Thank you.

[3.02 p.m.]

MAHER, Mr Simon, Director, Renewable Energy Generators of Australia Ltd

Evidence was taken via teleconference—

CHAIR—Good afternoon, Mr Maher. I invite you to make a brief opening statement and then any senators who have questions arising from your submission will put those questions to you. Would you like to make a statement?

Mr Maher—Yes. I am the Chief Executive of Southern Hydro Pty Ltd, which is a hydro generator, but I am here today acting on behalf of Renewable Energy Generators of Australia. I am a director of that organisation. It is an industry association that represents approximately 95 per cent of renewable generation capacity, which in Australia amounts to something in the order of 8,000 megawatts, $10 billion in assets and $700 million in annual revenue. We represent organisations such as Vestas Wind Systems and GE Hydro, which are suppliers in the renewable sector, and we also comprise a number of what you might call smaller innovative niche renewable businesses. One such example would be Solar Wind Systems. Its CEO is also a director of REGA.

I will move on to the topic at hand. Firstly, I would say that REGA is not here to grandstand. We have prided ourselves on taking a reasoned stance in the debate associated with Kyoto and renewable energy. To some extent we have differentiated ourselves from a number of other renewable energy organisations. We certainly promote a renewable agenda but we are open to arguments about the time frame over which such a move is achievable. We certainly recognise the critical role of the petroleum industry and believe that it continues to have a legitimate role for many years to come. We understand that the intent of the bill is to encourage greater Australian self-sufficiency in petroleum. Nonetheless, in this case and in other similar proposals where there is an intent to incentivise the fossil fuel sector, we do see it as necessary to point out the perhaps unintended consequence.

I will get to the nub of my argument now. The current provisions that relate to the resource rent tax might be onerous or they might be reasonable—we do not claim to know. Basically it is what it is. Any tinkering with it does, however, alter the incentives by which capital is allocated in Australia and would act in this case to make capital more likely to be allocated to the fossil fuel sector and away from other sectors. The impact, therefore, of providing a 150 per cent deduction in relation to exploration expenditure makes it more likely that capital will be allocated to the provision of a fossil fuel future for Australia and therefore less likely that capital will be available for renewable energy research and development. Essentially our argument is that, at the margin, the riskiness of petroleum exploration has been reduced, whilst for renewable energy the risk of researching and developing a new technology or permitting a preferred site has remained static. It is at the margin where economic decisions are made. The move being contemplated provides encouragement to fossil fuels but leaves a competing set of technologies behind.

As I said at the beginning, we are not opposed to petroleum. We judge it to be quite possible that this committee could conclude that, for a number of reasons, the legislation is sound and worth while. But we do urge the committee to contemplate the drafting of an independent bill that would act to provide a similar set of incentives for R&D in the renewable sector. Here we are talking about research being in the nature of such things as efficiency improvements in solar cells and development being in the nature of expenditure related to feasibility studies, site permitting and suchlike, which we view as equivalent to exploration in the petroleum sector. If this was achieved then at the margin the relative attractiveness of the two sectors would be maintained. That is essentially what we are seeking the committee to contemplate. Thank you.

CHAIR—Do you think that the renewable energy sector should pay the resource rent tax so that there is a level playing field between all forms of energy?

Mr Maher—My response to that would be that there is presently no level playing field out there. It depends what you contemplate as being the various issues of the relative sectors' impact on the economy. For example, the renewable sector certainly does not pay a resource rent tax. But on the other hand, the argument would be that it does not contribute to the same range of negative externalities that some other sectors of the economy do—in this case, fossil fuel. There is no level playing field, but I guess you take my point: certainly we accept that we do not get resource rent tax but neither do we provide detrimental impacts in certain aspects.

CHAIR—I will call Senator Murray, because he has to leave shortly.

Senator MURRAY—In these things I normally rank third as the minor party, Mr Maher. That is why I have been given special leave on this occasion. The chair has already picked on the nub of my question, which is this: across the energy sector there are two major concerns, in my view: one is how they should be taxed; and the second is what incentives or disincentives you provide. You would recognise that the disincentives part of that approach is of course addressing a full costing of what are known as 'externalities'.

But it seems to me that your submission has the same broad thrust as some of the comments that APPEA have made, and that is that the area of taxation and the area of incentives and disincentives need to be re-examined on a policy basis by government. So in that context, if the committee is unable to construct a bill—or if it feels unable to construct a bill as you have outlined—are you recommending to us that we ask the government to examine those two broad issues, tax and incentives?

Mr Maher—No, I cannot specifically say that I am asking for that. Our submission was specifically related to this individual piece of legislation, and that is the sum total of it. But as a general approach, we argue that any moves in adjusting the tax and incentives for one sector will have an impact on the shape of the economy of the future, in this case the energy economy. The particular request which I am authorised by my organisation to put before you is that we be examined in relation to a similar incentive if what you might call a competing energy form is to have its basis of incentivisation changed. That is the limit of what we are requesting. I am certainly not authorised to request any more.

Senator MURRAY—So you are effectively asking for competitive neutrality; if there are incentives available to one sector in the energy sector, you would wish them to be considered for your sector.

Mr Maher—We are arguing that there will be an impact of this to some extent. Clearly, at face value some of the renewable generation technology does not compete overwhelmingly with, say, liquid fuels, so we would accept that this is probably less of an area of significance to us than for perhaps an incentive that might be attached to something like coal, for example. But we do want to get across the principle that moving the incentives in the direction of fossil fuels ultimately at the margin has some form of impact and that that should be contemplated by the committee and in the drafting of legislation of this form.

Senator MURRAY—Would $17 million be a big incentive for your sector?

Mr Maher—I will say honestly no. It is not a significant incentive.

Senator MURRAY—Do you know that that is the total of the incentive for this bill?

Mr Maher—You are educating me on that particular matter and I am willing to accept that but, as I say, my argument is in the nature of principle here.

Senator WATSON—You talk about research and development. Are there any other areas in which you believe your industry should be benefiting from a tax point of view?

Mr Maher—I could certainly put out a wish list but the logic of my argument here is essentially one of neutrality in regard to tax measures that present a benefit to one sector in the energy economy. No representative organisation is going to turn back the opportunity for other benefits, and certainly the renewable sector would say that that is entirely justified. I will not go into the detail of that but it is essentially related to the externalities, which is a heavy debate.

That is essentially not the logic I am here to present. It is really to request a committee of parliament that is looking at legislation to contemplate that it will have some effect on other sectors, even if it is only at the margin, even if it is only a relatively small effect. That is the message that we intend endeavouring to get across for all such legislation. I would imagine the committee from time to time may take heed or from time to time may have a higher purpose and you will choose to go in a different direction, but we will continue to state our case in that area.

Senator WATSON—In a sense you are only attacking one side of the equation here. I am sure REGA would not like their respective corporations to be subject to a resource rent tax that this legislation is subjected to, because this is what the whole thing is all about. The two things are really interrelated: the resource rent tax on the one hand gives considerable revenues to the Commonwealth, and on the other hand the Commonwealth is giving up some of that revenue in the form of a particular incentive. What is taken away by the resource rent tax is much more significant than the 150 per cent tax incentive outlined in schedule 5. Your argument is just looking at one sector of the tax structure affecting the offshore petroleum industry, including gas.

Mr Maher—I think I said in my opening statement that the resource rent tax, for good or bad, is what it is, and one way or another right now it sets the rules by which petroleum companies look at the virtues of

exploration and sets the rules by which in some sense capital is allocated across the country between various sectors of the economy.

Senator WATSON—The only thing I am saying is that the incentive is minuscule relative to the amount of RRT, petroleum resource rent tax, that is payable by those companies, yet you are attacking that as creating an unlevel playing field. I am saying that surely the level playing field would be to eliminate the resource rent tax. Then maybe you would not need the 150 per cent tax incentive. You would have to do the arithmetic, but I would not think you would.

Mr Maher—I think our approach there would be that, if you look at the overall economy at any point in time, accept it is not a level playing field. It is what it is and there are various incentives and current tax effects. For one reason or another the petroleum industry has been chosen to be taxed by governments of various forms under the methodology that is there. But what is being proposed is a change to that and we are responding to that proposed change. We believe that will be a marginal change in incentives for capital to be allocated. It may be right or wrong. I think I said that we do not claim to know whether the RRT is right or wrong. It is what it is. But what the government is proposing is to change it and we are just drawing your attention to a possible effect of so doing.

CHAIR—As there are no further questions, thank you very much indeed, Mr Maher. You are excused.

Mr Maher—Thank you very much.

Senator WATSON—Mr Chair, I would like the Treasury officers appearing next to address some of the issues raised by Mr Jones.

CHAIR—Why don't you ask them that question, Senator Watson.

[3.20 p.m.]

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

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

LIVINGSTON, Mr Peter, Manager, Resources Taxation Section, Department of Industry, Tourism and Resources

CHAIR—Welcome. Do we not have anyone from the taxation office here?

Mr Colmer—We do not, but we have lined up someone whom we can phone if there are specific questions.

Senator STEPHENS—Gentlemen, you have listened to the evidence of the previous witnesses, and I hope that you will have some comments to make in relation to the issues raised by them. Can you begin by explaining the basis for the costing of the measure at $17 million?

Mr Anderson—Mr Jones went into some detail on that question. The factors he mentioned were taken into account in the costing. All the points in his submission were factors taken into account in costing this measure.

Mr Colmer—While I think Mr Jones is correct in his broad statement that there are some limiting factors and that it is likely that the costs outside the forward estimates will be more significant, that will depend, of course, on the uptake and what is found.

Senator STEPHENS—Can you advise the committee whether any consideration was given to exempting greenfield discoveries in designated areas from the PRRT to encourage exploration and development in the remote areas?

Mr Colmer—We have consulted with industry on this and we have provided advice to government. The policy we have is a government budget decision, and this is the proposal that we are implementing in the legislation. It is difficult for us to go into the issue of advice to government. I think it is a policy issue that we would steer away from, except to say that, as a general principle, we have consulted over a period of time on a variety of incentives.

Senator STEPHENS—Finally, could you respond to Renewable Energy Generators Australia's suggestion that exploration incentives offered to the petroleum industry should be matched by incentives for exploration of renewable energy resources intended for energy generation. Has any consideration being given to the development of those kinds of incentives?

Mr Colmer—Again, we are dealing with this bill, which is an amendment to the Petroleum Resource Rent Tax Act; it does not apply to the renewable energy sector. That is really a matter of policy. I make the observation, though, that some quite different opinions were put by APEA and the renewable energy generators. I also make the observation that the discussion has really only dealt with one aspect of energy taxation. The government made a major energy statement last year, the energy white paper, which dealt with a whole variety of issues across the entire energy sector. The issues we are dealing with today are essentially in the upstream part of the industry. As you would be aware, there are also a variety of issues around the downstream use of energy and, indeed, a variety of treatments of different sorts of fuels in different circumstances. Some of those treatments are for explicit policy reasons and some are historical. There are often competing interests, and they are very difficult issues. I guess my major observation is that the government's position has been set out generally, across the whole energy field, in the white paper from last year.

Mr Livingston—Renewable energy options are currently benefiting from targeted incentives through measures such as the mandatory renewable energy target and the other measures that were set out in the energy white paper. Those measures are not available for petroleum shelves.

Senator WATSON—I would like you to comment, if you can do so whilst avoiding policy issues, on the presentation by Mr Jones?

Mr Colmer—Are there any particular aspects that you would like me to comment on? It was fairly wide ranging.

CHAIR—Senator Watson, I think you should give the witnesses a bit more guidance as to the specific topic. I think I know what you have in mind, but would you mind directing them?

Senator WATSON—You might be able to elucidate it in a much more articulate way than I can!

Mr Colmer—Would you like me to comment on his performance? It was a good presentation.

Senator WATSON—Yes, it was—I found it most interesting.

CHAIR—I think there was a degree of interest in the level playing field issue and the uniformity of the application of resources rent taxation, for instance. Perhaps we could turn a blind eye to standing orders and Mr Colmer could whisper in Senator Watson's ear!

Mr Colmer—We are here because we have a specific proposal on the petroleum side of things. As I said just a few minutes ago, the whole issue of energy taxation across both the upstream and the downstream sectors is one where there are a variety of competing interests and views. The government has dealt with these, insofar as it is currently disposed to deal with them, in the energy white paper of last year. It is not up to me to go much further than that, I think.

CHAIR—I think that is fair enough.

Senator WATSON—What I am interested in, though, is whether any discussion or negotiations have taken place between, say, Treasury and state governments in relation to getting a greater harmony and realism into the state royalty system to enable greater onshore development of petroleum gas et cetera.

Mr Livingston—The Ministerial Council on Mineral and Petroleum Resources has recently requested a study into the fiscal competitiveness of the environment that the resources sector faces. That study will involve the examination of the fiscal regimes applying to energy resources across Australia and whether they are impediments to attracting investment. That study gets under way shortly. The committee has its first meeting next week and is due to report by September of this year.

Senator WATSON—Do you have the terms of reference?

Mr Livingston—I understand that terms of reference have been drafted. I know there is information about the ministerial council's decision on their web site. I can probably obtain a copy of the terms of reference and provide it to the committee.

Senator WATSON—When does that committee have to report?

Mr Livingston—It is due to report by September of this year.

CHAIR—To whom will it report? Will the report be a public document?

Mr Livingston—It reports to the ministerial council. I think it is a decision for council as to whether it is a public document.

CHAIR—To the best of your knowledge, will its consideration of the fiscal regime cover areas that the government's white paper did not cover?

Mr Livingston—Yes, it would. The white paper did not get into issues as to whether particular regimes are impediments to investment. It would look at more specific issues and seek to make recommendations to the council on improvements.

CHAIR—You followed the discussion with the other witnesses. Plainly one of the main themes of this afternoon's evidence has been the differential sectoral treatment within the industry from a tax point of view. That is the issue that this study is addressed to, is it?

Mr Livingston—Not specifically. It is an issue that the working group may look at. It has not met yet and it has not exactly agreed on what the study will address. The terms of reference are not that specific. It is more focusing on whether existing regimes are impediments to investment rather than the fact that you have differential regimes across particular resources.

CHAIR—Can any of the officers here—perhaps you, Mr Colmer—tell us when was the last time that a study, a report, a white paper or whatever published in this country that examined the fiscal efficiencies of the differential treatment of various parts of the resources sector?

Mr Colmer—I am not aware of one.

Mr Livingston—I am not aware of any recent studies, but I can take that question on notice.

CHAIR—Would you mind? Thank you, Mr Livingston.

Senator STEPHENS—I want to revisit Mr Jones's evidence on the nuts and bolts of the incentive and how it will operate. The bidding for the first round closes on 31 March 2005. Is that for the first six?
Mr Livingston—That is correct.

Senator STEPHENS—Have the areas for the next round been determined yet?

Mr Livingston—They would be in the process of determination. The minister, Minister Macfarlane, will announce those areas at the next APPEA conference in April. I am not aware that a decision has been made at this stage on which areas will be the designated frontier areas.

Senator STEPHENS—Is it a possibility that, as Mr Jones suggested, the technical detail required to prepare the submissions means that people will miss that first deadline of 31 March? Do you anticipate that people might not get their submissions into the first round and will look to go into the second round?

Mr Livingston—It is not something that we anticipate. I understand that applicants are likely to put in their bids for the first round of designated frontier areas on the expectation this incentive will get through. They might wish to consider their position if the legislation were to be rejected. Under the Petroleum (Submerged Lands) Act, which is the act under which the declaration permits are offered, the Commonwealth could assess the bids and make an offer to the successful applicants. The applicants can accept or refuse the offer of a permit. If the incentive was not passed, they could choose not to accept the offer of a permit.

Senator STEPHENS—When will the second round of bids close? Is that a full year?

Mr Livingston—Normally there are two closing periods. Within each round for a number of areas there may be a six-month period until the closing of bids and through other areas it might be a 12-month period. For the 2004 designated frontier areas, it was closer to a 12-month assessment period, and I would envisage a similar period for future designated frontier areas as well.

Senator STEPHENS—Could you provide a broad overview of how the consequential amendments are to work.

Mr Anderson—The consequential amendments ensure that the uplifted expenditure flows through the act in the correct way, so the uplifts that apply to exploration expenditure are captured. Exploration expenditure is uplifted by the long-term bond rate plus 15 per cent. So if you spend $100 in a designated frontier area, that becomes $150 and the uplift applies the $150 amount. That is how the consequentials work.

CHAIR—Thank you, Senator Stephens. Just finally, Senator Murray has had to leave, but he has left me with eight questions that he asks you to take on notice. I think for completeness I should just read them so that they appear as part of the *Hansard* record, but please do not answer them, even if you know the answer. This is just to make it tidy. Could you provide written responses to these questions, please.

Mr Colmer—Sure.

CHAIR—Firstly, if the government is going to provide incentives for petroleum exploration in frontier areas, does this legislation provide similar incentives for renewable energy sources such as by way of research and development or capital infrastructure? Secondly, if not, given the limited nature of fossil fuels, regardless of frontier exploration, should we consider extending the subsidy in order to provide more incentive for diverse energy source exploration and development rather than focus particularly on petroleum? Thirdly, giving 150 per cent tax rebates for petroleum exploration is akin to giving 150 per cent rebates for capital investment in biodiesel and ethanol production. Considering the potential for future expansion of these renewable fuels, is this being proposed? Fourthly, will these incentives for petroleum exploration also be extended to natural gas exploration? If so, does the proposed legislation cover this? Fifthly, considering that these subsidies are specifically targeted at exploration, how will the government guarantee a net positive return on taxpayer funds, especially in light of costs associated with petroleum impacts on air quality and greenhouse emissions? Is it possible that more predictable returns are available through subsidies for development and export of already existing and more future oriented technologies, such as ceramic fuel cells?

Sixthly, there are concerns that pursuing the fastest possible route to mining and export of our fossil fuel resources may be short-sighted. Regardless of the speed of expansion into frontier areas, how will this tax incentive progress timely energy market reform and diversification into different technologies? Seventhly, given that fossil fuel companies are already some of the most profitable private companies, and given the potential for large profits from petroleum finds, is it possible that the 150 per cent reap rate is inflated? Is it economically sensible to bloat an already vigorous market with such subsidies? Finally, if the government is going to provide these incentives, what tax incentives or public funds will be provided for research into containing petroleum spills? This may be particularly important in the area off the Great Barrier Reef frontier zone and in other frontier zones such as the Sydney basin, the area adjacent to Melbourne's Port Phillip Bay and off Western Australia's Shark Bay.

Mr Colmer, I will hand you those questions. In responding to them, you are of course at liberty to take any proper objections on the basis that they are related to policy or on any other proper ground. Having read them into the record does not constitute either an adoption of any of them by me or a ruling as to their admissibility.

Senator CHAPMAN—Spoken like a true barrister.

CHAIR—There being no further questions, these proceedings are closed. Thank you, gentlemen.

Committee adjourned at 3.38 p.m.