

8 June 2010

The Secretary
Select Committee on Fuel and Energy
The Senate
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Parliament House
Canberra ACT 2600

Email: fueleenergy.sen@aph.gov.au

Dear Committee Secretary

Inquiry into Fuel and Energy: Government Response to Australia's Future Tax System Review

The Australian Petroleum Production & Exploration Association Ltd (APPEA) is the peak national body representing the collective interests of companies engaged in petroleum exploration, development and production in Australia. The Association's membership comprises companies that account for an estimated 98 per cent of Australia's petroleum production and the vast majority of exploration. APPEA is pleased to provide the comments below in relation to the potential impact of the Federal Government's proposed response to the Future Tax System Review.

Background

The petroleum exploration and production industry has made a substantial contribution to Australia's economic growth and prosperity for a continuous period spanning more than 40 years. Taxation payments alone have totalled hundreds of billions of dollars, while the industry has provided a springboard for regional growth, employment and the provision of reliable and competitively priced energy supplies to Australian householders and industry.

From a fiscal perspective, the Australian taxation framework has provided a stable basis for companies to make large scale investment commitments. The industry recognises that governments can change fiscal settings, however reforms must take account of the impact on both current and future investments. For example, the debate and discussions surrounding the introduction of the petroleum resource rent tax in the mid 1980's, while robust in nature, has provided the Government and industry with a stable and balanced fiscal regime that has lasted more than two decades.



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YEARS

Taxation and the Petroleum Exploration and Production Industry

The release of the Federal Government's proposed reforms to the resource taxation system on 2 May was accompanied by a series of comments and data sets that sought to demonstrate the fiscal payments made by the resources sector over the last decade. The case for reform to the taxation of resource extraction activities was in part justified by the Government on the basis of an estimated decline in the contribution made by the sector since 2000. APPEA does not agree with the basis of this claim.

Attachment 1 contains both a chart presented by the Government (based on Treasury estimates) and a graphical representation of data collected by APPEA as part of the industry's annual financial survey that is conducted across the upstream oil and gas sector in Australia. The divergent results highlight two important factors. The first is that the level of resource tax paid represents one aspect of the fiscal contribution by the sector, while the second is that separating oil and gas from the remainder of the resources sector demonstrates different results. Overall, what is clear is that the petroleum industry's total taxation contribution to governments (resource taxes plus company tax) has approximately (and consistently) equated to the industry's net profit for the entire decade. It is APPEA's contention that this dispels any suggestion that the industry 'has not paid its way'.

Announced Tax Reforms

The reforms announced by the Federal Government on 2 May have the potential to significantly influence the future growth of the petroleum exploration and production industry in Australia. The specific measures that will have a direct impact are:

- a new *resource exploration rebate* applying to expenditures incurred after 1 July 2011 that will provide for a refundable tax offset for eligible exploration expenditure;
- the *resource super profits tax* (RSPT) that will be introduced with effect from 1 July 2012 that will apply to all existing and future projects, other than those projects subject to the provisions of the Petroleum Resource Rent Tax (PRRT); and
- a modification to the *company tax rate* that will be reduced to 29 per cent in 2013-14 and 28 per cent in 2014-15.

Assessing the Impact of Tax Reform – Design Principles

In terms of assessing the impact of the proposed RSPT on companies with operations in the petroleum exploration and production industry, APPEA is applying the following broad criteria to inform our comments to the Government.

1. In general, it is more efficient to tax profits rather than output.
2. The taxation system must reward success, not failure. The industry does not support the introduction of a risk sharing provision (via a rebate or refund at the end of a project life). Rather, a higher priority should be placed on the application of appropriate uplift rates to reflect the risks associated with exploration and development decisions in the industry.
3. Existing projects and those nearing a stage of final investment decision must not be disadvantaged. This includes CSG to LNG projects, domestic gas and conventional onshore and offshore projects. Any fundamental shift in the investment framework must be very carefully considered and managed, with projects transitioning into the new regime not being adversely impacted. In addition, value adding activities post the taxing point should not be taxed via the RSPT. Changes should only be introduced on a prospective basis, while retrospective impacts must be avoided, or the impacted parties should be fully compensated.
4. Any new taxation provisions must not place investments in Australia at a competitive disadvantage compared with similar activities in other countries.
5. The fiscal regime is an important factor that influences exploration decisions. An appropriately structured taxation regime for oil and gas exploration and development activities will provide the best basis for encouraging exploration in Australia.
6. Competitive neutrality must underpin the design of any new system. Gas must be able to compete with alternative energy sources on a 'level playing field'. For example, natural gas should not be disadvantaged relative to competing fuels, such as coal. In addition, taxation neutrality is essential for commodities competing for the same market.

Consultation Processes

As part of the 2 May announcement, the Federal Government advised of its intention to consult in relation to key transitional and design elements of the RSPT. An initial round of targeted discussions with the Consultation Panel commenced shortly after 2 May, while public consultations in a number of state capital cities (with departmental staff) commenced on 24 May. APPEA and our member companies have participated in both processes.

At this stage, the scope and detail of the outcomes arising from these consultations remains unknown, however what is clear is that there are numerous issues that will need to be addressed through direct dialogue between Government and industry. In addition to design details, the administration and compliance aspects of the proposed RSPT regime are likely to present a series of complexities and costs burdens for entities – these will need to be accorded a high priority in the consultation process.

The considerable experience that the petroleum industry has had with the PRRT regime suggests that time and effort will need to be spent on providing clear and unambiguous policy guidance to avoid the uncertainties that have arisen as a result of the Australian Taxation Office's administration and audit practices associated with that system.

Responses to Committee Questions

As the consultation process with the Government is at a relatively early stage and many member companies are still assessing the impact of the reforms on investment decisions and project economics, the comments outlined below represent APPEA's preliminary views on the possible incidence of the RSPT and the Resource Exploration Rebate. What is clear is that if the key design features of the regime are not structured in a manner that reflect the commercial and technical risks associated with petroleum operations, the proposed reforms could negatively impact on both current and future activities in the industry.

1. What is your assessment of the impact of the proposed 'Resource Super Profits Tax' on your field?

At this stage, the impact of the RSPT remains uncertain. Advice from APPEA member companies suggests the impact will potentially be twofold. Firstly, it may influence incremental investment decisions on existing projects and secondly, it will be important in determining final investment decisions for future projects and activities. Until such time as the final details are determined (including the critical transitional details), the medium to long term impacts will remain uncertain.

2. Specifically, what is your assessment of the impact of the 'Resource Super Profits Tax' on fuel and energy security in your field?

Factors critical to Australia's fuel and energy security are the commercialisation of discovered resources and the exploration for new petroleum deposits. The RSPT can be expected to impact on both exploration and development decisions. Again, the final details and provisions will be critical to assessing the overall impact on energy security.

3. Specifically, what is your assessment of the impact of the 'Resource Super Profits Tax' on jobs in your field?

The final impact on jobs and employment will hinge on the way the new regime influences project economics, particularly those in the process of making final investment decisions. Australia has the potential to see significant growth associated with the development of the nation's gas resources, with upside potential of more than \$200 billion in capital investment and the creation of around 50,000 jobs. Many of the proposed developments in the industry require significant capital and human resourcing in regional areas. Poorly structured fiscal settings may see many of these opportunities lost.

4. How do you foresee the proposed resource exploration rebate impacting on your field?

APPEA has consistently advocated the benefits that would arise from an appropriately structured and targeted flow through share regime. The advantage of such a system is that it will assist companies in raising capital from equity markets. The exploration credit measure announced by the Government targets the existing tax distortion that prevents companies without assessable income from gaining the full after company tax value of exploration expenditure. While the rebate will address this distortion, the advice from member companies at this stage is that it may not address the challenges of raising equity capital. This is because the benefit accrues at the company, not the subscriber level.

5. Do you have any other issues you wish to raise with the committee about the recommendations set out in the Henry Tax Review and/or the government's response to those recommendations?

At this stage, APPEA's focus has been directed towards assessing the potential impact and discussing the critical design details of the RSPT through the consultation process. We note that the report prepared by Dr Henry's Review Panel to the Government raises numerous issues that would, if implemented, have varying degrees of impact on the efficient operations of the industry. It is APPEA's intention to more fully review these issues and provide comments to the Government following the finalisation of discussions surrounding the consideration of the RSPT.

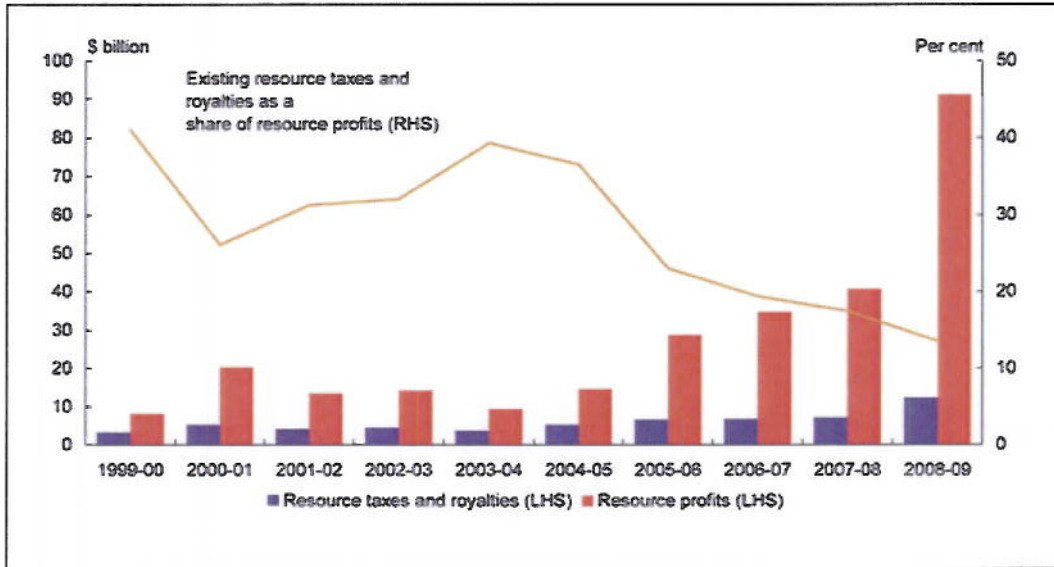
Contact in APPEA if you require any further information on the issues raised above is Noel Mullen

Yours faithfully

Belinda Robinson
CHIEF EXECUTIVE

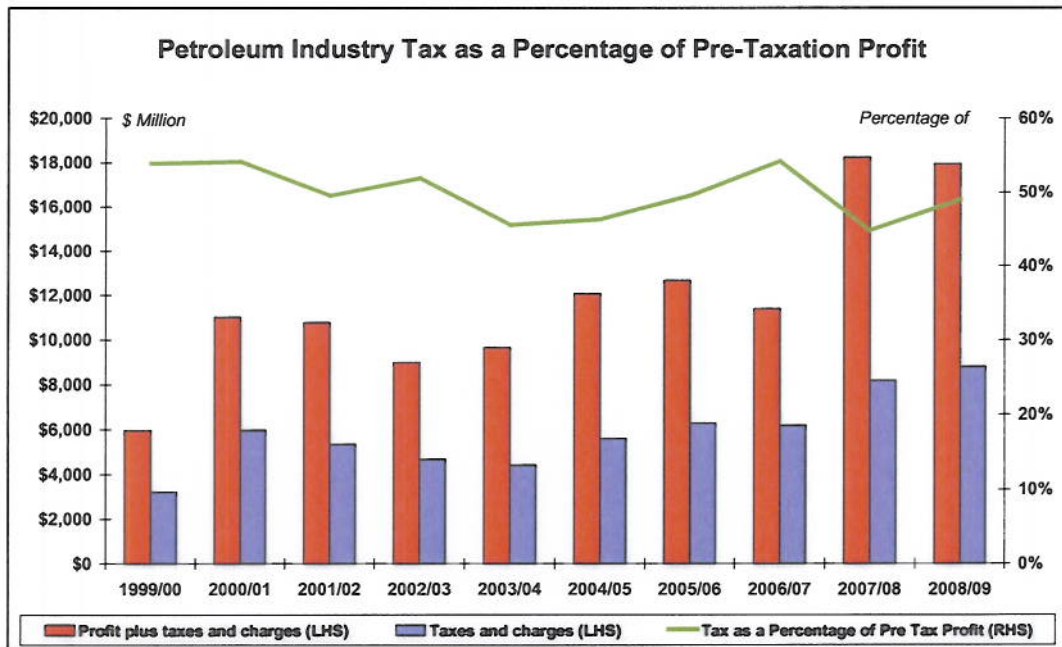
Attachment 1

Resource Tax and Royalties as a Share of Resource Profits



Source: *The Resource Super Profits Tax* (p.10) – Australian Government Publication

Total Petroleum Industry Tax Contribution



Source: *APPEA Annual Financial Survey*