APPENDIX 5

Policy Transition Group
List of Recommendations

MRRT RECOMMENDATIONS

SCOPE OF THE MRRT

Resources subject to the MRRT

Recommendation 1: The MRRT should apply to all mining operations resulting in the depletion of naturally occurring coal or iron ore. For the avoidance of doubt, the following activities should be covered by the MRRT rather than the PRRT:

• coal mining operations involving the extraction of gas derived from the underground conversion of coal; and

• coal mine methane extracted as a necessary and integral part of a coal mining operation.

Recommendation 2: Where there is incidental production of coal or iron ore as part of a mining project, the proceeds from the sale of the coal or iron ore should be assessable under the MRRT, with allowance for a reasonable apportionment of mining costs.

Recommendation 3: Where there is incidental production of other minerals or products as part of an coal or iron ore project, the proceeds from the sale of the other minerals or products should not be assessable under the MRRT and the reasonable apportionment of mining costs associated with those minerals or products should not be deductible under the MRRT.

Recommendation 4: The terms 'iron ore' and 'coal' should take their ordinary meanings in the legislation, rather than being defined terms.

3.2 Who is the taxpayer

Recommendation 5: An income tax consolidated group should be permitted to elect to be treated as a single entity for MRRT purposes. Only such a group should be permitted to combine mining interests held by more than one entity into the same project.

Recommendation 6: The head company of a consolidated group that makes that election should be responsible for paying the MRRT of the group, but each entity in the group should be jointly and severally liable for the group's unpaid MRRT.

4 DEFINITION OF A PROJECT

Defining a project

Recommendation 7: A project must consist of at least one production right. A project should commence when a production right is granted or acquired.

Recommendation 8: Where separate production rights that produce the same commodity exhibit a degree of integration in the extraction and processing operations, and other activities that occur prior to the taxing point, they should be considered a single project (a single mine).

Recommendation 9: The taxpayer should be allowed to elect to define a project as the aggregated interests in separate production rights that produce the same MRRT commodity and are managed as an integrated operation, demonstrated through the same downstream infrastructure being used or operated in an integrated manner in respect of production from the production rights. Where a taxpayer elects to aggregate production rights, the project must encompass the full extent provided by the criteria.

Recommendation 10: A project would need to be re defined to reflect changes in circumstances relating to the production rights in which the taxpayer holds an interest, such as where:

- an interest in a new production right is acquired, or an existing mining tenement in which the taxpayer has an interest becomes a production right, and is part of a project defined under Recommendations 8 or 9;
- an interest in a production right that is part of a project defined under Recommendations 8 or 9 is sold or relinquished; or
- the configuration of the taxpayer's mining operations change, such that one or more production rights satisfy, or no longer satisfy, the tests under Recommendations 8 or 9.

Applying the definition of a project

Recommendation 11: The taxpayer should be allowed to self-assess a project in accordance with the defining criteria. Decisions would be reviewable by the ATO and rulings available for those seeking certainty.

Recommendation 12: Entities that are consolidated for income tax purposes and elect to also be consolidated for MRRT purposes (see Recommendation 5) should apply Recommendations 8 and 9 to production rights held by members of the consolidated group under the single entity rule. In that case, the head company of the consolidated group will be the taxpayer for each aggregated project within the group.

Recommendation 13: Exploration for an MRRT commodity and pre-project expenditure relating to upstream activities, incurred on or after 1 July 2012, would be immediately deductible against assessable revenue generated by any project producing the same commodity held by a taxpayer who incurred the expenditure, in accordance with Recommendation 26.

Defining when a project ends

Recommendation 14: A project should be deemed to cease to exist when a production right is rescinded by or relinquished to the issuing authority, or 10 years after production of a commercial quantity of coal or iron ore from the mine ceases, or when the taxpayer elects to close the project, whichever occurs first.

Recommendation 15: Expenditure incurred in undertaking rehabilitation of a mine site after a project has ceased production should be deductible. To the extent that the rehabilitation costs cannot be offset against assessable revenue, or transferred to another project in the wholly-owned group, the taxpayer will be eligible for an immediate tax credit up to the amount of MRRT paid over the life of the project.

5 TAXING POINT

Recommendation 16: The taxing point is the point at which:

- the resource leaves the point at which it has been stockpiled after being extracted (the run of mine (ROM) stockpile) ready for the next unit of operation;

- where a ROM stockpile does not exist, or is by-passed, the point at which the resource is delivered to the first unit of operation after extractive mining activities have occurred (for example loading onto a conveyor belt to a processing unit or loading into an in-pit crusher); or

- a stand alone arm's length sale to a third party, where this occurs prior to the taxing point described in the points above.

Recommendation 17: The ATO should work with industry to develop acceptable administratively efficient approaches to allocating costs at the taxing point where existing accounting and administration systems are not aligned to that point.

6 TAXABLE REVENUE

6.1 Resource revenue

Recommendation 18: The value of the resource at the taxing point should be determined by:

- an arm’s length sale to a third party at the taxing point; or

- where there is not an arm’s length sale at the taxing point, the amount determined using the most appropriate and reliable arm’s length method.

Recommendation 19: The value of the resource should be determined at the time of supply of the resource, but no later than when the resource is loaded for export.

Recommendation 20: The explanatory memorandum should provide guidance as to the type of valuation methodologies that are suitable and be detailed enough to provide certainty to taxpayers and guidance to the ATO and the courts. In addition, draft ATO guidance on acceptable resource valuation methodologies and procedures should be developed, in parallel to the legislative process, to be available prior to the MRRT coming into effect.

Recommendation 21: A 'safe harbour' method to calculate the value of the resource at the taxing point where there is no arm's length supply to a third party at the taxing point should be available to:

- taxpayers with mining operations that, combined, produce fewer than 10 million tonnes per annum of saleable coal and iron ore in a tax year; and

- vertically integrated transformative operations in existence at 1 May 2010.

Recommendation 22: Taxpayers eligible to apply the 'safe harbour' method may calculate the value of the resource at the taxing point as the value derived from the first arm's length supply to a third party less:

- operating costs incurred between the taxing point and the point of sale;

- an allowance for capital employed between the taxing point and the point of supply, calculated as the depreciated optimal replacement cost of the capital employed multiplied by LTBR+7; and

- deductible and creditable amounts attributable to the use of the 'safe harbour' method should not be available to offset assessable receipts generated from other resource sales from the mining project or be transferable to other projects of the taxpayer.

6.2 Annual calculations

Recommendation 23: The MRRT should be assessed on an annual basis that includes MRRT deductions incurred throughout the year and all MRRT revenue receivable during the year.

Recommendation 24: The MRRT income should be deemed to be derived at the time of supply of the resource, but no later than when the resource is loaded for export.

Recommendation 25: The approach outlined in Recommendation 23 should apply from 1 July 2012, recognising that some resources supplied after that date will have been extracted prior to 1 July 2012.

6.3 Exploration and other pre-project expenditure

Recommendation 26: MRRT exploration and other pre-project upstream expenditure incurred in respect of mining tenements other than a production right should be:

- transferable to other projects producing the same MRRT commodity held by a taxpayer, subject to Recommendation 44; and
- transferable to projects producing the same MRRT commodity within an entity acquiring the tenement on which the expenditure is incurred, subject to Recommendation 47.

Recommendation 27: The uplift rate applying to eligible exploration and other pre-project expenditure incurred in respect of mining tenements other than a production right should reduce from the LTBR+7 to LTBR 10 years after the expenditure is incurred.

6.4 Other revenue and deductions

Recommendation 28: Project revenue and deductions should include other amounts relating to changes in the use of project assets and amounts previously assessed or deducted. These include:

- balancing adjustments when a project asset (whether in the starting base or acquired from 1 July 2012) leaves the project or the extent of its use in the project changes;
- compensation for the loss of an asset or an MRRT deductible expense (for example, an insurance payout);
- explicit or implicit reimbursements, reductions or subsidies of deductible expenditure; and
- amounts arising under a risk sharing arrangement embedded in a contract entered into by the taxpayer where the counterparty is the purchaser of the resource or supplier of a service or input to an upstream activity (for example, under a take or pay arrangement).

Recommendation 29: Amounts received from contract mining services which an MRRT entity provides to a third party, such as extraction services, should not be MRRT assessable receipts to the entity and the costs of providing those services should not be MRRT deductible to the entity.

7 DEDUCTIBLE EXPENSES

Recommendation 30: Payments of a revenue or capital nature should be deductible for MRRT purposes to the extent they are necessarily incurred by an entity in carrying on mining operations upstream of the taxing point, subject to the exclusions listed in Recommendation 31.

Recommendation 31: The following payments should be excluded for the purposes of Recommendation 30:

- Payments of interest or principal on a loan, and other borrowing costs, with hire purchase and finance lease arrangements treated as a debt financed asset purchase;

- Payments of dividends, the cost of issuing shares, and repayments of equity capital.

- Payments of resource royalties levied under State or Territory legislation;

- Payments to acquire, or to acquire an interest in, an exploration permit, retention lease, production licence, pipeline licence or access authority, otherwise than in respect of the grant of the right, or project profits, receipts or expenditures;

- Payments of private override royalties, other than those subject to Recommendation 33, noting that the market value starting base should be determined as if unencumbered by such royalties;

- Payments to the extent they represent hedging or foreign exchange losses relating to the resource, other than those arising under an agreement to sell the resource or acquire any service or input to an upstream activity;

- Payments of rehabilitation bonds or to a rehabilitation fund;

- Payments that represent a provision, reserve, sinking fund, insurance fund, or similar;

- Payments of a capital nature in respect of land or buildings for use in connection with administrative or accounting activities (for example, a head office), not being land or buildings located at, or adjacent to, mining operations upstream of the taxing point; and

- Payments of income tax or GST.

Recommendation 32: The Implementation Group should investigate the treatment of expenses associated with plant and equipment included in head office expenditure.

Recommendation 33: Private royalties payable in respect of a period after 30 June 2012 to a State or Territory body under an agreement entered into prior to 2 May 2010 should be deductible but otherwise treated in an equivalent manner to State and Territory royalties. Recommendation 31 would not apply in respect of such royalties.

Recommendation 34: The legislation should ensure that native title payments made pursuant to an agreement under the Native Title Act 1993 or a similar Act in settlement of an indigenous land use agreement, should be deductible to the extent they relate to upstream operations.

Recommendation 35: The definition of exploration under the MRRT should be aligned with that used for income tax.

Recommendation 36: The time of recognition of an expense should be aligned with that under income taxation.

8 TREATMENT OF DEDUCTIONS

8.1 Starting base losses and royalties

Recommendation 37: Losses arising from unused depreciation of the starting base (starting base losses) should not be transferable to other projects.

Recommendation 38: Starting base losses should be uplifted in the following manner:

- market value starting base – by the consumer price index to retain their real value; and
- book value starting base – by the MRRT uplift rate consistent with the design announced on 2 May 2010.

Recommendation 39: State and Territory mineral and gas royalties (including those raised on behalf of private land owners holding mineral rights) should be:

- creditable against MRRT liabilities;
- non-transferable and non-refundable; and
- carried forward and uplifted where they are unable to be used.

Recommendation 40: It is important to ensure that the taxation of Australia's resources preserves our international competitiveness and ensures Australians receive a greater benefit from mineral resources and that this is reflected in the treatment of royalties under the MRRT. The MRRT should not be used as a mechanism to enable States and Territories to increase inefficient royalties on MRRT taxable commodities. All current and future State and Territory royalties on coal and iron ore should, therefore, be credited and it is imperative that the Australian, State and Territory Governments put in place arrangements to ensure that the States and Territories do not have an incentive to increase royalties.

Recommendation 41: Private royalties imposed by the States and Territories on behalf of private land owners should be treated in the same manner as State and Territory royalties and therefore be creditable and uplifted but not transferable.

8.2 Deduction ordering rules

Recommendation 42: MRRT revenue should be reduced by deductions, losses and royalty credits in the following order:

1. Project deductions.

2. Royalty credits (current year and carried forward).

3. Carried forward losses of the project.

4. Starting base depreciation deductions and starting base losses.

5. Transferable exploration expenditure.

6. Transferred-in project losses.

9 TRANSFERS OF MRRT LOSSES

Recommendation 43: Losses should only be transferable between projects producing the same MRRT commodity.

Recommendation 44: Losses that can be transferred should be transferred at the appropriate point under the ordering rules, to the extent that they can be used.

Recommendation 45: Project losses should only be transferable if the transferring and transferee projects were owned by the same entity (or group) from when the losses were generated until they are transferred. Historical losses should otherwise be quarantined to the project from which they originated.

Recommendation 46: Notwithstanding Recommendation 45, the Implementation Group should consider whether there are administrative and/or alternative legislative approaches to loss transferability that could apply in situations where the holder of an interest in a joint venture acquires a further interest in that joint venture. (The Implementation Group is identified in Recommendation 61.)

Recommendation 47: MRRT exploration and pre-project losses acquired with a mining tenement should be transferable to projects with MRRT profits, whether or not any ownership condition is satisfied. To avoid the possibility that this free transfer of exploration losses leads to trading in exploration deductions that have a greater economic value than the underlying tenement:

- the unused exploration losses attributable to a tenement should go with the tenement when it is transferred; and

- the part of an exploration loss that an entity acquiring a mining tenement can use should be limited by reference to the amount paid for the tenement (or an equivalent amount where the entity that owns the tenement is acquired).

Recommendation 48: If the relevant tests are otherwise satisfied, losses should be transferable to projects owned by other entities within the same consolidatable group regardless of whether the group has chosen to consolidate.

10 STARTING BASE

Starting base

Recommendation 49: A starting base should be available for all interests in mining tenements in existence at 1 May 2010.

Starting base election

Recommendation 50: An entity must make an irrevocable election to use market value or book value as the method for determining a starting base for each interest the entity holds in a project or other mining tenement in existence at 1 May 2010, by the due date for the filing of the first MRRT tax return. Where an election is not made by the required date, the project or mining tenement should be taken to have a book value starting base. Where an appropriate book value does not exist or cannot be reliably reproduced, there should be no starting base.

Determining the market value starting base

Recommendation 51: An entity should determine a market value starting base comprising the market value of mining assets upstream of the taxing point as at 1 May 2010 on the basis of accepted market valuation principles.

- In determining how market valuation principles should be applied, the taxpayer should take into consideration their particular circumstances and the stage of development of the project or mining tenement.

- The derivation of the market value starting base should have regard to market expectations of future iron ore and coal prices, exchange rates, interest rates, inflation and other industry reference benchmarks as at 1 May 2010, and recognised methodologies for market valuation in the mining sector. The Treasury, ATO and RET should consult industry and professionals to identify suitable reference benchmarks to reduce compliance costs and provide greater certainty to taxpayers. The existence of such benchmarks would not constrain a taxpayer's choice of valuation methods or their ability to use alternative estimates.

- Guidance as to the application of valuation methodologies should be provided through examples within the explanatory memorandum. In addition, the ATO should provide early guidance to industry regarding the practical application of this aspect of the legislation.

- The approach used in deriving the starting base should be consistent with that used to value the resource at the taxing point.

- The starting base should include all tangible assets including improvements to land and mining rights (as defined by income tax – that is, mining, quarrying and prospecting), as well as relevant intangible assets such as mining information.

- Where a private override royalty existed in relation to the project or tenement at 2 May 2010, the starting base should be determined as if it were unencumbered by the private override royalty liability (Recommendation 31).

- As a proxy for the market value of tenements other than a production right, an entity could elect to use the sum of their expenditure over the previous 10 years.

Applying the market value starting base

Recommendation 52: The market value starting base of a mining project or other mining tenement should not start to be depreciated until an MRRT commodity is first produced from the tenement to which the starting base relates. Where a resource does not come into production by 30 June 2037 (25 years from the commencement of the MRRT), the starting base should be immediately deductible in the year production commences.

- Depreciation of the market value starting base should be on a straight-line basis.

- The mining right and mining information should be treated as one asset and depreciated over the lesser of the life of the mine or the period to 30 June 2037.

- Other assets should be written off over the lesser of their effective life, the life of the mine or the remainder of the period to 30 June 2037.

- The market value starting base should not be uplifted. Starting base deductions that have not been used within a project should be uplifted by the consumer price index to retain their real value (Recommendation 38).

- Any undepreciated starting base amounts attributable to an interest in a project or mining tenement are to be transferred to the new owner upon sale of the interest.

- The starting base is not to be reduced to reflect any depletion in the resource between 2 May 2010 and 30 June 2012. However, where starting base assets are disposed of between 2 May 2010 and 30 June 2012, the starting base should be reduced by the market value ascribed to the asset at 1 May 2010.

- Capital and mine development expenditure incurred between 2 May 2010 and 30 June 2012 should be added to the starting base.

Determining the book value starting base

Recommendation 53: A book value starting base should be the accounting book value of existing project assets (excluding the value of the resource) as at the most recent audited accounts available on 1 May 2010. Such accounts are to have been prepared in line with Australian Accounting Standards.

- Capital and mine development expenditure incurred after the date at which the audited accounts were prepared and before 1 July 2012 should be added to the starting base.

- The book value starting base should be uplifted at the MRRT uplift rate from the date at which the audited accounts were prepared until fully offset against project revenues.

- Further guidance as to the application of the book value starting base should be provided through examples within the explanatory memorandum.

Applying the book value starting base

Recommendation 54: The book value starting base of a mining project or other mining tenement should start to be depreciated from the later of the commencement of the MRRT (1 July 2012) and the date an MRRT commodity is first produced from the tenement to which the starting base relates.

- The starting base should be depreciated over five years with the following profile: 36 per cent, 24 per cent, 15 per cent, 15 per cent and 10 per cent.

- Undeducted book value starting base amounts should be uplifted and carried forward to be available as an offset against future project revenue.

- Any undepreciated starting base amounts should be transferred to a new owner if an interest in a project or mining tenement is sold.

- Where starting base assets are disposed of between the date at which the audited accounts were prepared and 30 June 2012, the starting base should be reduced by the book value ascribed to the asset at 1 May 2010.

11 COSTS OF COMPLIANCE FOR SMALL MINERS

11.1 $50 Million threshold offset

Recommendation 55: The $50 million threshold offset is intended to relieve a taxpayer of any MRRT liability arising in respect of an income year when their MRRT profit is below $50 million. The offset should have the following features:

- the profit threshold should apply annually to a taxpayer's MRRT profit (revenue less expenses);

- the profit threshold should apply at an aggregate taxpayer level, defined by the small business test in Subdivision 328-C of the Income Tax Assessment Act 1997;

- the offset should be phased-down between $50 million and $100 million, such that the maximum possible tax concession provided by the threshold ($11.25 million at $50 million), is reduced by $0.225 for every $1 of MRRT profit above $50 million; and

- the actual offset available to a taxpayer with an MRRT profit of between $50 million and $100 million should be the lesser of:

  - o the maximum offset reduced by creditable royalties paid and the credit equivalent of other deductible amounts (carry-forward losses and starting base deductions); and

  - o MRRT otherwise payable.

11.2 Simplified MRRT obligations

Recommendation 56: Taxpayers subject to MRRT, who are unlikely to have an MRRT liability for an extended period for example, due to their lack of MRRT profits or the relativity between gross MRRT profit and creditable royalty payment, should be provided the option to elect to comply with simplified MRRT obligations to reduce their compliance burden.

Recommendation 57: The Treasury and ATO should work with industry to develop and implement one or more tests that allow a taxpayer to evidence they will not be liable for MRRT for an extended period. The test, or tests, should be designed to work with readily available data and be applied at an aggregate taxpayer level, defined by the small business test in Subdivision 328-C of the Income Tax Assessment Act 1997.

The PTG observes that the following tests could achieve the required outcome:

- Earnings Before Interest and Tax (EBIT) on iron ore and coal extraction plus creditable royalties less than $50 million.

- EBIT on iron ore and coal extraction plus creditable royalties less than $250 million AND creditable royalties exceed 25 per cent of such earnings plus creditable royalties.

Recommendation 58: Where a taxpayer meets the relevant test, or tests, an annual election to opt into the simplified MRRT obligations should be available.

Recommendation 59: Where an entity no longer satisfies at least one of the relevant tests, or opts to withdraw from the simplified MRRT obligations, it would need to comply with the full MRRT obligations for that year. Such taxpayers should be treated as new MRRT taxpayers and only receive a deduction for expenditure incurred in the year they fail the tests or move to the full MRRT.

12 MRRT ADMINISTRATION

12.1 Transitional administration

Recommendation 60: The Treasury should engage with overseas jurisdictions as soon as possible, regarding the crediting of MRRT in their jurisdictions.

Recommendation 61: The Treasury and ATO should continue to engage with industry to progress the administrative design and implementation of the MRRT, including:

- establishing an Implementation Group involving industry representatives and relevant advisors and officials from RET, the Treasury and ATO;
- providing practical early guidance on the MRRT and taxpayer obligations; and
- establishing capability in both the ATO and key intermediaries to support industry in complying with the law.

Recommendation 62: The Government should ensure the ATO is appropriately funded to provide interpretive and administrative support to industry in their transition to the MRRT.

Recommendation 63: To ensure the MRRT achieves its intended purpose efficiently and equitably, with minimal compliance and administration costs, the Board of Tax should review the operation of the MRRT within five years of its implementation.

Recommendation 64: The ATO should provide guidance on circumstances that may warrant a remission of penalties by the ATO in cases of inadvertent errors, particularly in the first two years of the MRRT.

12.2 Ongoing administration

Recommendation 65: The MRRT legislation should provide for:

- the MRRT to be designed and implemented as a self-assessed tax;
- a July−June accounting period, with substituted accounting periods in place for taxpayers who use them for income taxation;
- an instalments regime that is responsive to the potential for significant within-year variability in mining profits and a final reconciliation period that fits within entities' tax calendars;
- acceptance of functional currencies where the company meets the criteria and uses them in accounting for income taxation; and
- the ability of the ATO to obtain MRRT relevant information from third parties such as project vendors or joint venture operators.

Recommendation 66: Division 25 of the Income Tax Assessment Act 1997 should be updated to specifically include expenditure related to management of MRRT tax affairs as an income tax deduction.

Recommendation 67: The administrative design of the MRRT should provide workable certainty to taxpayers and minimise the costs of complying with and administering the MRRT. These practices should include:

- providing for annual MRRT returns, including the option to lodge returns prior to the receipt of MRRT income to support the provision of certainty regarding historic expenditure; and

- guidelines for joint venture participants and operators, and the ATO, in relation to joint venture accounts and substantiation of expenditure.

PRRT RECOMMENDATIONS

14 DEFINITION OF THE PROJECT

Recommendation 68: The definition of a project transitioning into the PRRT should be based on the granting of a production licence and the definition of a production licence within the PRRT legislation should be extended to cover production licences granted under relevant State and Territory legislation.

Recommendation 69: The existing criteria for combining offshore projects should be applied to the combining of onshore projects. However, the criteria that the Minister has regard to should be expanded to include:

- the aggregated interests in separate production rights that exhibit a degree of integration in extraction and processing operations, and other activities that occur prior to the taxing point; and

- the aggregated interests in separate production rights that are managed as an integrated operation because the same downstream infrastructure is used or operated in an integrated manner in respect of production from the production rights.

Recommendation 70: Given the need to provide certainty to the North West Shelf (NWS) project, it should be specified in the legislation that the licence areas associated with the project can be considered one project, as was the case when the Bass Strait project transitioned to the PRRT.

Recommendation 71: The Minister for Resources and Energy should continue to issue combination certificates under Section 20 of the PRRT Assessment Act 1987 for both onshore and offshore projects.

15 RESOURCES SUBJECT TO THE EXTENSION

Recommendation 72: The PRRT should apply from 1 July 2012 to all Australian onshore and offshore oil and gas extraction projects, including coal seam methane and oil shale projects. It should not apply to:

- projects within the Joint Petroleum Development Area in the Timor Sea;

- coal mining operations involving the extraction of coal or gas derived from the underground combustion of coal; and

- the extraction of coal mine methane where it is a necessary and integral part of a coal mining operation.

16 TAXING POINT

Recommendation 73: The existing PRRT provisions determining the point at which petroleum, or products produced from petroleum, become taxable (the taxing point) are sufficient to accommodate all types of petroleum projects, onshore and offshore, conventional and unconventional, and should therefore be retained.

17 TAXABLE REVENUE

Recommendation 74: The existing PRRT provisions for valuing the resource at the taxing point should be applied to projects transitioning into the PRRT, subject to the following considerations:

- where a State or Commonwealth royalty determination that sets the value of the resource at the taxing point is in place the taxpayer should be able to seek a determination from the Minister for Resources and Energy to allow the taxpayer to elect that value in determining their PRRT receipts;

- taxpayers developing onshore gas resources within an integrated gas to liquids project, such as liquefied natural gas, should have the option of using the existing RPM as a default methodology for calculating the value of the resource at the taxing point;

- taxpayers with existing integrated gas to liquids projects, such as liquefied natural gas, at 1 May 2010 that are to transition to the PRRT should have access to a simplified RPM as a default methodology. This should provide a single agreed phase point and capital base determined by an agreed valuation methodology for existing assets; and

- existing RPM provisions within the PRRT should be amended to provide for integrated gas to electricity projects. Industry should be consulted in relation to the amendments required to ensure appropriate functionality of the methodology.

18 DEDUCTION ORDERING AND DEDUCTIBLE EXPENDITURE

18.1 Deduction ordering rules

Recommendation 75: The existing PRRT deductibility rules should apply to transitioning projects with amendments to accommodate starting base amounts and government resource tax credits.

18.2 Transition deductible expenditure

Recommendation 76: The legislation should ensure that native title payments made pursuant to an agreement under the Native Title Act 1993 or a similar Act in settlement of an indigenous land use agreement should be deductible to the extent they relate to upstream operations.

Recommendation 77: The costs of water treatment processes and associated facilities integral to the production of coal seam methane should be treated as deductible expenditure.

Recommendation 78: The existing PRRT treatment of private override royalties as non-deductible/non-assessable amounts should be extended to projects transitioning into the PRRT. Where such royalties exist, the market value starting base should be determined as if unencumbered by the royalty.

18.3 Exploration for unconventional gas

Recommendation 79: The PTG recommends existing treatment of exploration expenditure under PRRT be extended to unconventional gas projects.

18.4 Deductible expenditure issues

Advice to Government 1: While it is not within the PTG's terms of reference to make recommendations in respect of the design of the PRRT, other than in relation to transitioning projects, the PTG advises that the test for deductibility could be amended to one of expenditure necessarily incurred in carrying on activities in relation to a petroleum project (upstream of the taxing point) from 1 July 2012.

18.5 Exploration deductions

Advice to Government 2: While it is not within the PTG's terms of reference to make recommendations in respect of the design of the PRRT, other than in relation to transitioning projects, the PTG advises aligning the definition of exploration under the PRRT to that under income tax.

19 STARTING BASE

Starting base election

Recommendation 80: An entity must make an irrevocable election to use either market value, book value or the look-back method for determining a starting base for each interest the entity holds in a project or other petroleum tenement in existence at 1 May 2010, by the due date for the filing of the first PRRT tax return. Where an election is not made by the required date, the project or petroleum tenement should be taken to have a look-back starting base. Where an appropriate look-back does not exist or cannot be reliably reproduced, there should be no starting base.

Determining the market value starting base

Recommendation 81: An entity should determine a market value starting base comprising the market value of petroleum assets upstream of the taxing point as at 1 May 2010 on the basis of accepted market valuation principles.

- In determining how market valuation principles should be applied, the taxpayer should take into consideration their particular circumstances and the stage of development of the project or petroleum tenement.

- The derivation of the market value starting base should have regard to market expectations of future petroleum prices, exchange rates, interest rates, inflation and other industry reference benchmarks as at 1 May 2010, and recognised methodologies for market valuation in the petroleum sector. The Treasury, ATO and RET should consult industry and professionals to identify suitable reference benchmarks to reduce compliance costs and provide greater certainty to taxpayers. The existence of such benchmarks would not constrain a taxpayer's choice of valuation methods or their ability to use alternative estimates.

- Guidance as to the application of valuation methodologies should be provided through examples within the explanatory memorandum. In addition, the ATO should provide early guidance to industry regarding the practical application of this aspect of the legislation.

- The approach used in deriving the starting base should be consistent with that used to value the resource at the taxing point.

- The starting base should include all tangible assets including improvements to land and mining rights (as defined by income tax – that is, mining, quarrying and prospecting), as well as relevant intangible assets such as petroleum information.

- Where a private override royalty existed in relation to the project or tenement at 2 May 2010, the starting base should be determined as if it were unencumbered by the private override royalty liability (Recommendation 78).

- The starting base is not to be reduced to reflect any depletion in the resource between 2 May 2010 and 30 June 2012. However, where starting base assets are disposed of between 2 May 2010 and 30 June 2012, the starting base should be reduced by the market value ascribed to the asset at 1 May 2010.

- Capital expenditure incurred between 2 May 2010 and 30 June 2012 should be added to the starting base.

Recommendation 82: A default methodology should be considered for taxpayers that acquired or disposed of a portion of an interest in a project or petroleum right with an identified coal seam methane resource in the 3 years to 1 May 2010. The default should determine a proxy for the market value starting base, based on known reserves as at 1 May 2010 and a value derived from a recent comparable market transaction or transactions.

Applying the market value starting base

Recommendation 83: The market value starting base should be immediately deductible for projects transitioning to the PRRT. For other petroleum tenements the starting base should be immediately deductible upon becoming part of a project.

- The market value starting base should be uplifted in line with the provisions provided for general project expenditure, with the expenditure deemed to be incurred on the 1 July 2012.

- Where eligible expenditure is incurred between 1 May 2010 and 1 July 2012, it will be added to the starting base.

- The starting base and losses generated from the starting base should not be transferable between projects.

- Any undeducted starting base amounts attributable to an interest in a project or petroleum tenement are to be transferred to the new owner upon acquisition of the interest.

Determining the book value starting base

Recommendation 84: A book value starting base should be the accounting book value of existing project assets (excluding the value of the resource) as at the most recent audited accounts available on 1 May 2010. Such accounts are to have been prepared in line with Australian Accounting Standards.

- Capital expenditure incurred after the date at which the audited accounts were prepared and before 1 July 2012 should be added to the starting base.

- Where starting base assets are disposed of between 2 May 2010 and 30 June 2012, the starting base should be reduced by the book value ascribed to the asset at 1 May 2010.

Applying the book value starting base

Recommendation 85: The starting base should be immediately deductible for projects transitioning to the PRRT. For other petroleum tenements the starting base should be immediately deductible upon becoming part of a project.

- The book value starting base should be uplifted in line with the provisions provided for general project expenditure, with the expenditure deemed to be incurred on the valuation date of 1 May 2010 or, where eligible expenditure is incurred between 1 May 2010 and 1 July 2012, the date when the expenditure is incurred.

- The starting base and losses generated from the starting base should not be transferable between projects.

- Any undeducted starting base amounts attributable to an interest in a project or petroleum tenement are to be transferred to the new owner upon acquisition of the interest.

- Further guidance as to the application of the book value starting base should be provided through examples within the Explanatory Memorandum.

Determining the look-back starting base

Recommendation 86: A look-back starting base should be available based on deductible expenditure incurred in the exploration and development of a project or other petroleum tenement between 1 July 2002 and 2 May 2010.

- Capital and exploration expenditure incurred after 1 May 2010 and prior to the commencement of the extension of the PRRT on 1 July 2012 should be added to the starting base.

- Where starting base assets are disposed of between the date at which the audited accounts were prepared and 30 June 2012, the starting base should be reduced by the book value ascribed to the asset at 1 May 2010.

Applying the look-back starting base

Recommendation 87: The starting base should be immediately deductible for projects transitioning to the PRRT. For other petroleum tenements the starting base should be immediately deductible upon becoming part of a project.

- The book value starting base should be uplifted in line with the provisions provided for general project expenditure, with the expenditure deemed to be incurred on the date at which the audited accounts were prepared or, where eligible expenditure is incurred between the date at which the audited accounts were prepared and 1 July 2012, the date when the expenditure is incurred.

- The starting base and losses generated from the starting base should not be transferable between projects.

- Consideration should be given to allowing the inclusion of relevant acquisition costs as they relate to project assets upstream of the taxing point. If acquisition costs are included:

  - they should be allocated to the existing PRRT expenditure categories, with appropriate methods to apportion the starting base to be developed in consultation with industry; and

  - the period of uplift at LTBR+15 on the portion allocated to exploration expenditure should be limited to 5 years.

- Further guidance as to the application of the look back value starting base should be provided through examples within the explanatory memorandum.

20 TREATMENT OF THE STARTING BASE AND CREDITS FOR GOVERNMENT RESOURCE TAXES

Recommendation 88: Starting base amounts should be treated in the same manner as general project expenditure, being immediately deductible, non-transferable and non-refundable, with undeducted amounts uplifted in accordance with the existing augmentation provisions. An exception would be the exploration expenditure component of a look back starting base, which should be treated in accordance with the existing provisions relating to exploration expenditure.

Recommendation 89: Government resource taxes should be creditable against PRRT liabilities and treated in the same manner as general project expenditure, being immediately creditable, non transferable and non-refundable, with unused amounts uplifted in accordance with the existing augmentation provisions.

Recommendation 90: It is important to ensure that the taxation of Australia's petroleum resources preserves our international competitiveness and ensures Australians receive a greater benefit from these resources and that this is reflected in the treatment of royalties under the PRRT. The extension of the PRRT should not be used as a mechanism to enable States and Territories to increase inefficient royalties on petroleum activities. All current and future resource taxes on petroleum should, therefore, be credited and it is imperative that the Australian, State and Territory Governments put in place arrangements to ensure that the States and Territories do not have an incentive to increase royalties.

21 PRRT ADMINISTRATION

21.1 Transitional administration

Recommendation 91: The Treasury and ATO continue to engage with industry to progress the administrative design and implementation of the extension of the PRRT to all petroleum projects, including:

- establishing an Implementation Group involving industry representatives, relevant advisors and officials from RET, the Treasury and ATO;
- providing practical early guidance on the extension of PRRT and taxpayer obligations; and
- establishing capability in both the ATO and key intermediaries to support industry in complying with the law.

Recommendation 92: That Government should ensure the ATO is appropriately funded to provide interpretive and administrative support to industry in their transition to the extended PRRT.

Recommendation 93: To ensure the extension of the PRRT achieves its intended purpose efficiently and equitably with minimal compliance and administration costs, the Board of Tax should review the operation of the extended PRRT within five years of its implementation.

Recommendation 94: The ATO should provide guidance on circumstances that may warrant a remission of penalties by the ATO in cases of inadvertent errors, particularly in the first two years of the extended PRRT.

21.2 Ongoing administration

Advice to Government 3: As part of extending the PRRT, the Australian Government could consider amending the PRRT legislation to provide for:

- substituted accounting periods for taxpayers who use them for income taxation;

- an instalments regime that is responsive to the potential for significant within-year variability in petroleum profits and a final reconciliation period that fits within entities' tax calendars;

- the ability of ATO to obtain PRRT relevant information from third parties such as project vendors or joint venture operators.

Advice to Government 4: The ATO could consider adapting the administrative design of the PRRT, to provide workable certainty to taxpayers and minimise the costs of complying with and administering the extended PRRT. These practices should include:

- providing for annual PRRT returns, including the option to lodge returns prior to the receipt of PRRT income, to support the provision of certainty regarding historic expenditure; and

- guidelines for joint venture partners and operators, and the ATO in relation to joint venture accounts and substantiation of expenditure.