

ExxonMobil Australia Pty Ltd
ABN 48 091 561 198
12 Riverside Quay
Southbank, Victoria 3006
GPO Box 400
Melbourne, Victoria 3001
61 3 9270 3333 Telephone

Richard J Owen
Chairman



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Mr Michael Callaghan AM
Petroleum Resource Rent Tax Review
The Treasury
Langton Crescent
PARKES ACT 2600

By email: PRRTReview@treasury.gov.au

Dear Mr Callaghan

ExxonMobil Australia welcomes the opportunity to provide feedback to the *Review of Petroleum Resource Rent Tax – Issues Note* (the Paper) released by Australian Treasury on 20 December. Although the Paper details a range of issues for public comment, ExxonMobil Australia does not propose to respond to each one, but rather only to those that are of direct interest to our operations. ExxonMobil Australia also participated in the preparation of the Australian Petroleum Production and Exploration Association (APPEA) submission and supports its recommendations.

About ExxonMobil Australia

The ExxonMobil Australia Group of Companies (EMA Group) are subsidiaries of ExxonMobil Australia Pty Ltd (EMA) and operate under the brands of ExxonMobil Australia, Esso and Mobil.

The EMA Group has been operating in Australia since 1895. With a total investment of over \$20 billion, we are a substantial investor in the Australian economy and a major contributor to the wealth of the nation. Each year, we pipe thousands of millions of cubic feet of gas, extract and refine millions of barrels of oil and store and transport billions of litres of fuel to help meet the community's energy needs.

Esso Australia Resources Pty Ltd (Esso), part of the EMA Group, is the operator of the Gippsland Basin Joint Venture (GBJV, a 50/50 joint venture with BHP Billiton). With 23 offshore platforms and subsea installations connected to a network of 600 kilometres of underwater pipelines, these operations keep gas flowing to nearly 40 per cent the eastern Australian domestic market.

The EMA Group also has a 25 per cent interest in the Gorgon Project, operated by Chevron. This \$54 billion project located offshore Western Australia has recently started up and will lead to significant revenues for the Australian economy.

Esso also is the operator of the Scarborough gas field located offshore Western Australia, in a joint venture with BHP Billiton and Woodside. The field is one of the most remote of the Carnarvon Basin gas resources. This project is currently in concept select stage and a floating LNG concept is considered the best option for developing Scarborough at this stage. However, project challenges remain due to location, water depth, operating environment and resource characteristics.

Paying our fair share

The EMA Group makes a significant financial contribution across all levels of government in Australia, ranging from local council rates, through to profit based taxes such as corporate income tax and, the subject of the Paper, the Petroleum Resource Rent Tax (PRRT).

The PRRT regime was first applied to the GBJV's operations in 1990 and since that time Esso has made more than \$12 billion, in nominal terms, in PRRT payments to the Federal Government. This equates to almost half a billion dollars each and every year for almost a quarter of a century.

While payments have fluctuated over this period, the size of the payments made by ExxonMobil Australia show that PRRT effectively collects a significant share of project profits for the Federal Government. When production and/or commodity prices are high, PRRT payments are high. Conversely, when production and/or commodity prices are low, and in turn the return to the company is low, PRRT payments are low.

By way of example, in 2014 when commodity prices were at their peak, Esso paid almost \$550 million in PRRT. However, with the subsequent decline of the oil price in 2015, combined with industrial action impacting production levels, Esso paid a reduced amount of \$280 million in PRRT, reflecting the reduction in return to the company.

More than just taxation

Esso has made a significant tax contribution to the Federal Government through PRRT payments associated with the GBJV project. However, this project has delivered more than just taxation benefits to Australia as demonstrated by a recent [economic impact study](#) of the GBJV by ACIL Allen.

This report found that alongside the more than \$200 billion in royalty, PRRT and corporate income tax paid (2016 real terms) across the almost five decades of operation, it has also:

- Produced 54 per cent of all of Australia's crude oil and liquids, equivalent to enough fuel to fill every car currently on the road in Australia 500 times
- Produced over 40 per cent of all of Eastern Australia's natural gas, enough gas energy to power the MCG's lights for 3.3 million years
- Improved the real income of Australians by more than \$640 billion, that is \$780 per year for every person in this country
- Stimulated nearly 370,000 full time equivalent job years of employment throughout Australia

These benefits in turn deliver revenue to across all levels of government, as well as enhancing the welfare of all Australians.

Facilitating new investment

The EMA Group is a wholly owned subsidiary of Exxon Mobil Corporation which is incorporated in the United States of America. The global group controlled by Exxon Mobil Corporation is the world's largest publicly traded international oil and gas company. It has a presence through various affiliates in over 200 countries and territories throughout the world.

As a result, the EMA Group competes for capital for investments against each of these countries. However, under the current regime, Australia has remained a favourable investment destination, with billions of dollars invested over the past 25 years including:

- The construction and installation of the Bream B and West Tuna platforms, a \$1.1 billion investment which commenced production in 1996 and 1997 respectively
- The soon to be completed Kipper Tuna Turrum project, a \$5.5 billion project which will bring a much needed new source of natural gas into the east coast market
- The Chevron led Gorgon LNG project in West Australia, a \$54 billion project, which is the largest LNG project in the world, of which the EMA Group holds a 25 per cent interest

It is important that in the context of the current review any changes are considered in the context of potential impact on Australia's favourability as an investment destination.

The PRRT was enacted as a cradle-to-grave tax. Section 37, the cradle, provided for exploration, while section 38, life, provided for development and operation, and section 39, the grave, closing down. It was predicated upon providing a stable whole of life taxing regime that attracted investment capital into the petroleum industry in Australia whilst providing an equitable return to the community from the use of the community's resources.

The key elements of the tax were set to encourage investment in, and the continued operation of, marginal projects, by effectively freeing them from the economic burden of a secondary tax based on production if the projects did not earn a sufficiently high rate of return for the investor. However, the community still benefited from these projects from the income tax generated and the broader economic impact of the investment, while at the same time benefiting from the very high amounts of tax paid by the profitable projects that have generated the profits required to trigger payment of the tax.

PRRT – A well thought out and stable regime

The PRRT regime remains largely unchanged today since it was designed and implemented in the 1980's. This should be viewed as a success as it has been meeting its intended purpose. While it has been expanded to accommodate new projects the intent has remained constant: to achieve an appropriate share of large returns for the community, while not discouraging the exploration for and development of oil and gas resources.

The original design of the PRRT regime was subject to significant community and industry consultation over several years. The Federal Government released a paper in December 1983 entitled *Discussion Paper on Resources Rent Tax in the Petroleum Sector*. This paper stated:

*"The Replacement of the existing excise and royalty systems by an RRT [Resources Rent Tax] applicable to all petroleum mining activities is desirable on economic efficiency and equity grounds. An RRT along the lines proposed would not deter development of marginal fields; **only projects earning substantial profits would be liable to the tax.** Moreover, **a uniform, nationally applied RRT would provide an appropriate mechanism for***

achieving a more equitable sharing of the economic rents between the community (as represented by both the Commonwealth and State Governments) **and investors** in the petroleum sector. **It holds out better prospects for stability over time**, which is important in maintaining incentives to invest in exploration. This stability, together with appropriate treatment of exploration, can provide an environment conducive to maintaining acceptable levels of exploration.” (Emphasis Added)

A 27 June 1984 Joint Press Statement by the then Federal Treasurer and the then Federal Minister of Resources and Energy entitled, *Resources Rent Tax on ‘Greenfields’ Offshore Petroleum Projects*, sets out the principal policy elements of the RRT to apply to all projects:

“The Government believes that an RRT regime, which is related to achieved profits, is the most efficient mechanism for **deriving for the community an appropriate share of the large returns** that can be associated with the development of particularly rich mineral deposits. **Alternative secondary taxing regimes**, such as excise and royalties applying in the petroleum sector, are based on production and, as such, **can both discourage marginal projects from getting under way and bring about the early termination of projects.**”

and;

“In contrast to alternative production based secondary tax regimes, the **RRT will be payable only on those projects earning, before company tax, a minimum rate of return on the project outlays.**” (Emphasis Added)

These themes have been consistently repeated across consecutive governments, each time reaffirming the success of the scheme.

Design of PRRT – Is it working as intended?

The PRRT as originally enacted set the rate of tax at the high rate of 40% on taxable profits, before the application of the corporate income tax regime. It also set the augmentation or uplift rate on general project expenditure and exploration incurred within five years of the issue of a production licence at the Long Term Bond Rate (LTBR) plus 15%. Deductible expenditure incurred more than five years before the relevant production licence was issued was only to be augmented at the Gross Domestic Product deflator (GDP deflator). The augmentation or uplift rate is the assessment of the rate of return required on outlays in order for projects to achieve a high rate of return. Profits above the augmentation rate are the *rent* designed by the Government to be taxed by the PRRT.

In 1990 changes to PRRT included a reduction in the augmentation rate for general expenditure from LTBR plus 15% to LTBR plus 5%, while allowing for the wide transferability of exploration expenditure

These settings were deliberately put into place to strike a reasonable and equitable balance between the objectives of satisfying community rights to share in the benefits of profitable offshore petroleum projects, and providing investors with adequate returns for the risks they undertake in petroleum exploration and development.

The LTBR plus 15% uplift for exploration expenditure recognises the high risk associated with exploration. It is also should be noted that uplift can reduce to the much lower GDP deflator rate if the relevant project has not commenced within five years of the expenditure being incurred. Further, the way the ordering and transferability rules operate, the investor may find that exploration expenditure of an initial marginal project that is being uplifted at LTBR plus 15% is suddenly reduced to GDP deflator uplift when it is compulsorily transferred to a second, more profitable project. These, effectively means that in many cases the investor does not receive the benefit of the headline LTBR plus 15% uplift rate.

The uplift rate of LTBR plus 5% that applies to general expenditure provides the investor with a very modest pre-income tax return before it becomes subject to the significant impost of the 40% PRRT rate. In today's environment a pre-tax rate of return of 7.61% is not indicative of a 'super-profit'. A reduction in the uplift rate would seem to be contrary to the original intention of imposing the tax "only in respect of projects earning a high rate of return on outlays".

The outcome of these design features is:

- Profitable projects, such as the GBJV project, pay significant amounts of tax
- Projects in the early stage of production, such as the Gorgon LNG Project would not be expected to pay PRRT for many years
- Once oil and gas projects have recovered their augmented costs and have therefore become profitable they will, like the GBJV project, pay significant amounts of tax

The operation of the Gas Transfer Pricing Arrangements

The *Taxation Laws Amendment Act (No.6) 2001 (2001 Amending Act)* introduced minor changes to the PRRT to clarify the application of the PRRT to LNG projects. The changes in this Act reflected Joint Media Release 98/058 dated 23 December 1998, entitled *Government Response to Industry Petroleum Resources Rent Tax Concerns*. In the Media release, the then Treasurer and then Minister for Industry, Science and Resources stated:

*"The Government has decided to remove the taxation uncertainty for LNG projects by incorporating a formula determining a gas price for tax purposes. **The uncertainty arose because only the natural gas production phase was subject to the PRRT, while the subsequent refrigeration stage, which produces LNG was not.** As the whole LNG process is commonly developed as an integrated project under a single ownership structure, there was no negotiated "arm's length" price to value the gas for PRRT purposes."* (Emphasis Added)

The *2001 Amending Act* allowed for the introduction of Gas Transfer Pricing (GTP) mechanism for integrated gas to liquids projects including LNG projects. The Explanatory Memorandum (EM) to the Bill noted that:

"The current (pre-GTP) regime (through disputations and court actions), may produce a taxable value for the gas not dissimilar to a GTP calculated using a methodology. However, the proposed regime provides certainty on the manner in which a taxing value is to be determined." (Emphasis Added)

The EM to the *2001 Amending Act* recognised that the GTP was a proxy for market value – which was likely to produce a not dissimilar outcome as a market value calculation with a greater level of certainty for stake holders without the concomitant disputation. The actual GTP regulations were made in 2005 and again in 2015. The GTP calculations are rule driven and available for audit and challenge by the Commissioner of Taxation. Absent these rules, the parties would fall

back to the general PRRT provisions that require a taxpayer to return the market value of a Marketable Petroleum Commodity that becomes an excluded commodity without being sold at the point immediately before it becomes an excluded commodity. There would be no increased transparency from this – but likely, increased disputation and increased risk for project proponents for new LNG projects, with little, if any additional tax being paid.

Day to Day Operation of PRRT

This review of the PRRT regime also provides a useful opportunity to undertake some 'housekeeping' to reduce regulatory burden. For example:

- The PRRT regime has been expanded overtime to cover the NWS and various onshore projects, despite the fact that these project are subject to existing royalties regimes. As a result there is an increased regulatory burden on those projects, through requirements to lodge PRRT returns, even though, because of the federal and state royalty and excise they are paying there may never be a PRRT liability. For example, the EMA Group is a participant in a project subject to the Barrow Island royalty, a scheme that is largely the same as PRRT, including being applied at a rate of 40%. Because this project is already paying an equivalent royalty, the project is not expected to pay PRRT, but is required to complete annual PRRT returns. This regulatory cost is borne by the EMA Group and the ATO, without any apparent benefit to the community.
- The PRRT definition of exploration is significantly different to the income tax definition. ExxonMobil would encourage the Government to adopt the income tax definition in PRRT in order to encourage exploration and reduce the regulatory burden on the difference between the two regimes.
- The Paper quotes the Policy Transition Group (PTG) statement that the deductibility provisions of the PRRT could be amended to 'one of expenditures necessarily incurred'. The *necessarily incurred* tests is contained in the second positive limb of the income tax deduction provision – section 8-1 of the *Income Tax Assessment Act 1997*. It is considered expansive in nature and may be compared to the PRRT deduction provisions which are ill-defined and narrow in nature. This narrowness and lack of definition has led to increased compliance costs for taxpayers and long and significant litigation. ExxonMobil would encourage the Government to amend the law to adopt a 'necessarily incurred' test of deductibility but caution that sufficient care will need to be given to the design of this test and to its relationship to the excluded expenditure provisions.

Conclusion

This is an important opportunity for the Government to examine the PPRT regime and ensure it continues to provide a fair and equitable return to the community for the use of its finite oil and gas resources whilst supporting and promoting the petroleum industry in Australia. Indeed, the EMA Group has provided a significant return to the community, through direct PRRT payments of more than \$12 billion, but also through less tangible benefits such as employment, a reliable and domestic source of energy and the associated industries spurred by oil and gas. At the same time the PRRT has fostered ongoing investment in the Gippsland Basin, with two new generations of platforms coming online as a result of this regime.

Against this background the Government needs to be cautious about making significant changes to a regime that has been proven to be effective over the long-term, but is experiencing a short-term revenue reduction due to recent declines in resource prices and the lag between the start-up of projects and commencement of PRRT payments that is inherent in the design of PRRT. As the regime was designed as a cradle to the grave tax, any change that is retrospective could have serious negative implications for the many projects, such as the Gorgon LNG Project, where project decisions were made on the assumption that Australia had in place a stable, efficient and effective secondary tax regime for the petroleum sector.

Please contact Andrew Murphy, Public and Government Affairs Manager for ExxonMobil Australia on (03) 9270 3437, for any queries with respect to this submission.

Yours faithfully

A handwritten signature in blue ink, appearing to read "Richard ...".