



**Professionals
Australia**

Review of the Petroleum Resource Rent Tax

Professionals Australia Submission
February 2017

Executive summary

Professionals Australia represents technical professionals across Australia, including engineers performing design, scoping and project management roles across essential industries and services including IT, mining, construction, water, aviation, power, road and rail. Professionals Australia has an active membership in mining, oil and gas who have become increasingly concerned in recent years about the lack of dividend resulting from our finite natural resources.

In Australia, the Commonwealth and State and Territory governments generally own natural resources on behalf of the community, and impose charges to ensure that the community receives a benefit from their exploitation. However, our members are concerned that the current system is being abused, and fails to derive an adequate return to the community.

In order to repair the current system, Professionals Australia is advocating for a simpler system, narrowing the scope for exploitation, closing loopholes, and placing a greater emphasis on job creation and wider economic benefits. In particular, we are concerned that project proponents have not been providing fair opportunity to local engineering firms to bid for engineering works and have instead utilised international providers, thereby 'offshoring' the work and reducing the dividend that the community receives from our resources.

Summary of recommendations

1. Where possible, Federal and State Governments should utilise royalties levied on volumes as the preferred taxation method for resources, as these best recognise the depletion of finite state assets.
2. Where profit based taxes are employed, the Federal Government should ensure that companies are not able to shift their profit abroad to avoid taxation. More stringent requirements around local content would assist this process.
3. Federal and State Governments should seek commitments that the structure and size of future contracts do not directly or indirectly preclude the involvement of the local engineering market.
4. That all future projects and major service contracts must contain a requirement for a workforce skills development plan, which incorporates local actions that will be applicable to all subcontracting companies. These should have a focus on the development of high-wage, high-skills jobs for the State.
5. Federal and State Governments should ensure that all available government funding and assistance is clearly communicated to companies when they begin developing a skills development and training plan to ensure that training costs are minimised and local companies remain competitive.

6. Federal and State Governments should work with industry to provide financial assistance and tax incentives to help local engineering companies remain competitive in the context of a high Australian dollar and a fragile international economic climate.
7. Federal and State Governments should work with industry to simplify the regulatory and approval system through greater collaboration between Federal, State and Local government to remove duplications across different jurisdictions and improve efficiency.
8. Federal and State Governments should establish a streamlined approval process for engineering design work that has been completed locally by Australian registered engineers.
9. The Federal Government should establish a clear line of dialogue between the local engineering industry and the Treasury with quarterly meetings to discuss what measures can be taken to assist local industry in winning more work on oil and gas projects.
10. Project proponent wishing to operate in Australia must not exclude local engineering design firms from preferred tender lists. Local firms must be included in discussions surrounding prequalification and if the local market is unable to provide services due to a lack of capacity or capability then project proponents must provide detailed reasons outlining why this cannot be provided by the local market so that measures can be implemented to address shortfalls.
11. Both State and Federal Government should work together to encourage innovation and the development of key skills required for future demand in the oil and gas industry with a clear focus towards developing highly-technical skills and creating the jobs of the future.
12. Federal and State Governments should support the registration of engineers, to establish appropriate standards, encourage local employment and promote the high-skill level of the local workforce. To enable this, legislation should be drafted under which professionals working in these areas are identified as needing to register. In the absence of a national registration scheme, it is recommended that each individual state introduces a scheme that mirrors those of others states, including provisions for mutual recognition.
13. Government, Industry and Universities should become far more integrated in their long-term approaches to developing engineering capabilities in Australia. This already occurs to some degree in an ad-hoc manner, however greater linkages and a more detailed long term strategic plan must be developed.
14. The Federal and State Governments work together to establish Australia as an international example of engineering excellence, with high standards established and promoted through engineer registration.

Introduction

Australia's natural resources delivered the single greatest economic boom that the nation has seen, and helped shield the economy from a devastating recession that gripped most of the world. The mining boom provided jobs, investment and growth across the nation, and lifted our economy as new mines were built. However, as the construction phase has closed, the return on the exploitation of our natural resources has fallen dramatically, highlighting the failure of government policy to maximise community benefit.

While the mining construction boom has come to an end, export volumes remain high, and petroleum and gas exports have provided a major new avenue for growth. Australia is rapidly becoming one of the world's largest exporters of LNG. Indeed, Australia is expected to become the single largest exporter of LNG by 2020¹, highlighting the importance of sound policy.

The large-scale export of our natural resources provides a massive opportunity for the nation, and holds an unparalleled potential to deliver major community benefit. However, Governments must be broad in defining an "appropriate return to the community", as the narrow lens of taxation alone will not deliver the best result for Australians.

Government policy needs to address the wider economic benefits derived from our natural resources, as a holistic policy is required in order to capitalise on our natural wealth, ensure sustainability, and avoid abuse or avoidance. In forming such a policy, government should address all brackets of value added by the resources sector, namely, taxation revenue, employment, capital investment and profit.

¹ Department of Industry, Innovation & Science, Gas Market Report 2015, March 2016

Profit and taxation

Professionals Australia welcomes the Australian Government's review of the PRRT, the crude oil excise and relevant Commonwealth royalties. Taxation is one of the most visible ways in which Government can ensure an appropriate return on the use of natural resources, and good policy in this area is vital.

At present, the taxation environment fails to deliver an appropriate return to the community. Revenue in Australia's oil and gas extraction industry tends to fluctuate based on world prices, however IBISWorld figures place the current year's revenue at \$34 billion, expected to rise above \$50 billion over the next five years². The same report places industry profit margins at over 30%, suggesting profit levels of around \$11-17 billion per annum over the coming five years.

Massive profit margins also underline the inadequacy of the PRRT, which returns around \$0.9 billion on \$34 billion of current year revenue.³ The PRRT is equally ineffective in delivering a return to the community. According to the Western Australia Treasury, "giant new gas projects on the north-west shelf may pay no petroleum resources rent tax for 20 to 30 years."⁴

State royalties delivered considerably better returns as they are levied on wellhead value, and are not avoidable in the same manner as a profit-based tax. These figures alone highlight the inability of the current PRRT to effectively levy appropriate taxes on profit, as operators shift profits and avoid fair taxation.

The purpose of taxation on volumes is to provide a return to the community that reflects the fact that extraction companies are effectively selling non-replaceable community resources. Through the taxation system, extraction companies are able to effectively purchase these resources and sell them for profit. However, at present royalty levels in Australia are well below those of most other producing countries, and fail to reach a reasonable level of return.

When looking at the international management of oil and gas taxation, the average oil and gas royalties and similar taxes is 12.2% of revenue among all European producing countries⁵. In the USA, states such as Texas charge royalties as high as 25%, while the federal rate sits at 12.5% onshore and 18.75% for offshore projects.

In order to deliver an appropriate return to the community from Australia's natural resources, Professionals Australia supports a tax regime based primarily on royalties, which effectively sets a price at which companies can purchase natural resources. This system provides an even playing field for all players, and strong profit margins across the industry ensure that such a policy would be

² IBISWorld Industry Report B0700 Oil and Gas Extraction in Australia

³ Australian Government, Review of the Petroleum Resource Rent Tax: Issue note, 20 December 2016

⁴ ABC News, Oil and gas tax may raise no extra revenue for decades, October 2016

⁵ Deloitte, Observation on royalties and similar taxes – "an overview": oil and gas upstream Europe, January 2015

easily sustainable. Professionals Australia also supports increasing current royalty levels in light of current international equivalents⁶.

Case Study - Western Australia

Western Australia was one of the major winners from the mining boom. National resources provided the state with a once in a generation opportunity to secure its future. Sadly, Western Australia also represents a key case study in the failure of policy, with the resources boom having been replaced by skyrocketing debt and rising unemployment.

In 2009, during the mining boom, Western Australia's debt sat at only \$7.0 billion. Since then, the State recorded several years of record revenue, with employment figures strong and resource exports higher than ever. The foundations for major growth were present, with the boom providing the potential for record revenue, major workforce development, skills development and major infrastructure investment. Western Australia's debt currently sits at \$33.8 billion, and is forecast to rise to \$40.2 billion by 2020. Despite record revenue from mining, the Western Australian government wasted their opportunity by failing to derive an appropriate return through taxation, and by failing to utilise the boom to build the State's economy and workforce for the future.

Remarkably, Western Australia has now been presented by another opportunity in oil and natural gas. However, current policies risk yet another wasted opportunity, with debt continuing to rise as extraction companies record massive profits while importing skills and capital. A strong government policy is required at Federal and State levels that ensures the community receives an appropriate return on these highly-valued assets. These policies need to leverage resource projects for a lasting dividend and end the current system that gives away that nation's finite resources for little return.

Recommendations:

1. Where possible, Federal and State Governments should utilise royalties levied on volumes as the preferred taxation method for resources, as these best recognise the depletion of finite state assets.
2. Where profit based taxes are employed, the Federal Government should ensure that companies are not able to shift their profit abroad to avoid taxation. More stringent requirements around local content would assist this process.

⁶ Ernst & Young, Global oil and gas tax guide 2015, January 2015.

Employment and capital investment

While tax revenue provides an easily measurable return to the community, other returns such as employment and direct investment are arguably more important if managed appropriately. Professionals Australia believes that that nation's resources should be leveraged to build an innovation sector, and deliver high-skill, high-wage jobs across the country.

However, at present, our governments are failing to realise the full potential of our natural resources, and have been happy to derive tax revenue while ignoring other indirect benefits. With many projects occurring offshore, there is no major footprint on or connection with the Australian mainland. Under the current regulatory environment, onshore construction is either minimised or completely lacking, drastically affecting the level of content produced by the local Australian workforce. Not only is most of the design and procurement of many projects occurring overseas, but much of the construction phase as well.

According to IBISWorld data⁷ relating to oil and gas extraction in Australia, profit margins account for approximately 32.6% of the industry's revenue. Taxes on profit hope to return a portion of this gain to the community, however they are often ineffective and prone to profit shifting and avoidance. By comparison, capital investment and wage costs account for a collective 40.7% of the industry's revenue, providing a much greater opportunity to provide an appropriate return on Australia's finite resources. An improved local content framework has the potential to deliver much of this revenue directly to the community, through additional employment opportunities, greater capital investment in Australian businesses, and the downstream lift in related businesses and the transfer of knowledge.

Recommendations:

3. Federal and State Governments should seek commitments that the structure and size of future contracts do not directly or indirectly preclude the involvement of the local engineering market.
4. That all future projects and major service contracts must contain a requirement for a workforce skills development plan, which incorporates local actions that will be applicable to all subcontracting companies. These should have a focus on the development of high-wage, high-skills jobs for the State.
5. Federal and State Governments should ensure that all available government funding and assistance is clearly communicated to companies when they begin developing a skills development and training plan to ensure that training costs are minimised and local companies remain competitive.

⁷ IBISWorld Industry Report B0700 Oil and Gas Extraction in Australia

Engineering

Australia's engineering profession must target high-skill work if our wider economy is to remain internationally competitive. We are a high-skill, high-wage economy that is well positioned to compete for high-yield technical work. We need to make all efforts to ensure we maintain a competitive advantage against lower-cost markets in our region by providing the most innovative high quality engineering solutions. It should not be our aim to compete for less technical, cheaper work as it is both unachievable and undesirable, and would provide few long-term benefits.

Australia's resources sector provides a prime opportunity for operators to engage the local engineering workforce and allow them to gain knowledge and experience in how to design and maintain major projects. Once these projects are established they, continue to operate for 30-50 years, providing ongoing demand for engineering services. Australia must build its intellectual capital to provide the engineering capacity needed to support the growth in the sector over the coming years. A short term focus on delivery of projects does little to deliver a long-term dividend from these massive and lucrative projects.

It is important that current and future developments provide opportunities for future generations to gain valuable oil and gas experience. Local firms should not be ignored, there needs to be willingness from project proponents to involve local engineers and provide them with honest feedback that will allow them to improve their capabilities and become a more competitive option for future contracts, both locally and abroad. A lasting local dividend of a highly skilled workforce which can continue to drive a high-wage, high-growth economy must be a priority for any government.

Unfortunately, the opportunity to maximise the benefit Australia gains from its natural resources is already slipping. Figures released by the Department of Foreign Affairs and Trade show Australia imported \$1.3 billion of engineering services between in 2015⁸. At the same time, the Department of Employment's Internet Vacancy Index is also showing a collapse in the number of online vacancies for engineers of 70% since the peak of the mining boom⁹. We are now importing services at the expense of fostering local employment and industry opportunities.

Recommendations:

6. Federal and State Governments should work with industry to provide financial assistance and tax incentives to help local engineering companies remain competitive in the context of a high Australian dollar and a fragile international economic climate.
7. Federal and State Governments should work with industry to simplify the regulatory and approval system through greater collaboration between Federal, State and Local government to remove duplications across different jurisdictions and improve efficiency.

⁸ Department of Foreign Affairs and Trade. *Trade in Services Australia 2015*. <http://dfat.gov.au/about-us/publications/Documents/trade-in-services-australia-2015.pdf>. Last accessed 30 January 2017.

⁹ Department of Employment, Internet Vacancies Index, December 2016.

8. Federal and State Governments should establish a streamlined approval process for engineering design work that has been completed locally by Australian registered engineers.
9. The Federal Government should establish a clear line of dialogue between the local engineering industry and the Treasury with quarterly meetings to discuss what measures can be taken to assist local industry in winning more work on oil and gas projects.
10. Project proponent wishing to operate in Australia must not exclude local engineering design firms from preferred tender lists. Local firms must be included in discussions surrounding prequalification and if the local market is unable to provide services due to a lack of capacity or capability then project proponents must provide detailed reasons outlining why this cannot be provided by the local market so that measures can be implemented to address shortfalls.
11. Both State and Federal Government should work together to encourage innovation and the development of key skills required for future demand in the oil and gas industry with a clear focus towards developing highly-technical skills and creating the jobs of the future.

Registration

Engineers are fundamental to our national prosperity. Engineers design, build and maintain the infrastructure, devices and systems that are part of our everyday life, allowing our economy to function efficiently and most importantly, safely. Australia's resources sector provides a major opportunity to develop the world's leading engineering workforce, with the highly-technical nature of the work supporting the creation of a high-skill economy. However, these wider economic benefits will only be realised if government policy supports the engagement of the local workforce, rather than the importation of foreign engineering services.

While better engagement of local engineers is crucial in realising the full economic benefits stemming from our resources sector, we must ensure that Australia's engineers represent the highest standard of quality and safety. In many other jurisdictions around the world there are strict legislative requirements that must be met in order to provide engineering services. In Australia the only State where engineers must be registered to provide engineering services is Queensland, although registration is soon to be introduced in Victoria. Across Australia, most professional services may only be provided once strict educational and competency standards are met due to the responsibility that comes with their line of work. Doctors, lawyers and architects are but a few of the professions that must pass certain legislated criteria before they can legally offer those services.

Registration does not apply to the engineering profession throughout most of Australia, even though the consequences of poor engineering can be disastrous to our economy and fatal to human life. A

registration system for engineers should be implemented to ensure only sufficiently competent engineers are able to provide engineering services, whilst at the same time lifting the status of the profession to ensure it stands credibly alongside other professions which are subject to registration schemes.

The government should ensure any registration system is regulated independently of any one organisation and the system is straightforward and affordable to prevent an unfair cost and time burden being placed on people in the engineering profession, engineering organisations and the community.

Recommendations:

12. Federal and State Governments should support the registration of engineers, to establish appropriate standards, encourage local employment and promote the high-skill level of the local workforce. To enable this, legislation should be drafted under which professionals working in these areas are identified as needing to register. In the absence of a national registration scheme, it is recommended that each individual state introduces a scheme that mirrors those of others states, including provisions for mutual recognition.
13. Government, Industry and Universities should become far more integrated in their long-term approaches to developing engineering capabilities in Australia. This already occurs to some degree in an ad-hoc manner, however greater linkages and a more detailed long term strategic plan must be developed.
14. The Federal and State Governments work together to establish Australia as an international example of engineering excellence, with high standards established and promoted through engineer registration.

Conclusion

Professionals Australia is concerned that the current policy surrounding our resources sector fails to deliver the best outcomes for the community. At present, we operate a complicated mix of taxes that fail to generate an appropriate financial return, while largely ignoring the wider economic benefits – such as employment and skill development – that could be generated through smart policy that supports local content.

In this submission, we have provided a number of recommendations in support of a simpler tax system that discourages avoidance. We have also provided recommendations concerning wider economic benefits, and how Australia could leverage our resources sector to build a smarter, faster-growing economy.

We would welcome the opportunity to provide further detail to the content of this submission should the committee wish.