



SUBMISSION

Submission on options to address
the design issues identified in the
Petroleum Resource Rent Tax
Review

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The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

Executive summary

Introduction

The Business Council of Australia welcomes the opportunity to provide a submission to the consultation paper on options to address the design issues identified in the Petroleum Resource Rent Tax (PRRT) Review.

At the outset, we restate that the Business Council believes that the PRRT has worked appropriately to date and changes should not be pursued without a clear, demonstrable net benefit from doing so. The potential for policy reversals to jeopardise future investment and exploration remains a serious concern. In this respect, attention is drawn to the terms of reference for the PRRT Review which noted that any proposals should not be 'discouraging investment in exploration and development'.

Of course, the tax system must ensure the community receives an appropriate return for its resources. But we must not lose sight of the fact that appropriately compensating the owners also means not compromising efficiency and long-term revenue by discouraging investment. This is particularly the case when exploration is currently at a low ebb and as we look to unlock the next wave of industry exploration, investment and growth.

The Business Council is concerned that ad hoc changes to the tax system, particularly those not grounded by coherent and consistent policy principles, will increase risk and chill decisions to invest in Australia. Any proposals should be looked at holistically rather than in a piecemeal way, recognising the complexity and nature of the design of the PRRT. This is especially important as companies will not have the same PRRT profiles, even when they are participants in the same projects. This can be due to the type of projects invested in (e.g. oil or gas), the extent of exploration portfolios and the length of time these companies have been investing in Australia.

It is critical that changes to any tax settings look to improve the design and efficiency of the tax system. Changes that are ad hoc or arbitrary, that only seek to increase revenue, particularly in the short term, will damage Australia's competitiveness and reputation as an attractive destination for investment.

Stable fiscal settings are critical

The PRRT Review Final Report acknowledges 'that stable fiscal settings, and policy and regulatory certainty are country specific advantages that have contributed to Australia's LNG boom'. This stability and certainty of the existing regime helped unlock the \$200 billion of investment over the past few years. It has been critical because of the high risk and high cost of investment in Australia, as well as our reliance on foreign capital.

Investment and operational decisions, for both new and existing projects, will be distorted by ad hoc changes to the PRRT. Ad hoc changes will also increase fears of governments imposing additional and unexpected changes, and increase sovereign risk.

Individual policy decisions may be downplayed as a 'one-off', but taken together across all industries, such behaviours and interventions are having significant ramifications, increasing risk and chilling decisions to invest in Australia. Recent examples include the Commonwealth and South Australian major bank levies; mooted royalty changes in Western Australia; pressures on LNG exporters to restrict exports; state governments repudiating major infrastructure contracts and delaying major project approvals; and uncertainty around foreign investment assessment criteria resulting in late-in-the-day rejections of proposals.

Projects should be considered over their lifetimes

As the Business Council raised in its submission to the PRRT Review, the current outcomes around the PRRT are essentially a result of the deliberate design features of the tax. Revenues are reflective of project characteristics and lifecycles as well as broader market developments that influence global prices. The PRRT Review Final Report touched on these factors, including volatile and subdued prices, production declines in some older projects and the large amounts of investment that are now deductible. The petroleum sector continues to experience subdued oil prices and exploration expenditure is still subdued.

For this reason, the PRRT, and any proposals to change it, must be assessed over the life of projects. While PRRT receipts may be delayed for these reasons, the \$200 billion of investment in petroleum projects will continue to deliver a wide range of community benefits over many decades. These benefits include the creation of new jobs, tax revenues, contracts with local suppliers and investment in universities and research institutes (including impact assessment studies, monitoring programs, environmental baseline studies and peer review research papers).

How and why does PRRT work the way it does?

PRRT is levied on the taxable profits of petroleum projects at a rate of 40 per cent. It is calculated as assessable receipts, such as the sale of oil and gas products, minus deductible expenditure, such as project exploration, development and operating costs. Unused losses are carried forward to be used as a deduction in future years, and critically, the value of these losses is uplifted annually by a modest rate. This uplift rate attempts to preserve the real value of the project's PRRT losses and compensate investors for the risk of the activity. In effect this means that tax is not paid until a project makes a threshold rate of return.

It is a rent-based tax, which is less likely to distort investment and production decisions because it applies to the risk-adjusted rate of return. It was introduced because it was considered to be the most efficient way to deliver an appropriate share of the returns from developing resource projects to the community.

Proposed changes will have implications for energy policy

The PRRT is one of the means through which the Australian community, as owners of the rights to non-renewable resources, receives a return for the extraction of these resources. Proposed changes may deter marginal projects from proceeding, forgoing potential returns to the community.

There would also be implications for energy supply in Australia if investments do not proceed. Increasing gas supply is critical to industrial users of gas and for reducing the cost of generating electricity. Access to affordable and reliable energy sources is vital for protecting Australian jobs. Gas will also play an important role in delivering a secure and reliable energy system as we transition to a lower emission electricity sector. Any changes that discourage investment will impose another hurdle to energy producers accessing the fuel sources that are desperately needed in Australia's current energy system.

New versus existing projects

The Business Council is concerned separate tax systems for new and existing projects may produce a complex and incoherent set of outcomes. Separate systems also have the potential to affect investment in current projects, which may be early on in their life cycle. The exploration and pre-feasibility work already completed by these projects has been made under the existing PRRT regime, and would suddenly face increased risks and uncertainty if treated as 'new' investments. This could adversely affect the industry.

The Business Council supports Recommendation 5 of the PRRT Review Final Report, which proposes taxpayers lodge annual returns after they start holding an interest in an exploration permit, retention lease, or production lease, rather than when they receive assessable receipts. Consistent with this treatment of a project in the early stages of its life cycle, any projects that exist today but have not yet received assessable receipts would be considered existing projects.

The Business Council is concerned Recommendation 2 will chill onshore investments and exploration and create significant administrative complexity without addressing any real revenue risk. Implementing this recommendation would be retrospective in nature and contradict the policy intent when the PRRT was extended onshore. A clear, consistent and appropriate definition of what constitutes a new project, and that considers the integrated nature of onshore projects, is critical.

Uplift rates

The Business Council also notes continued discussion in the consultation paper on uplift rates. The Final Report argued the uplift rate should maintain the value of deductible expenditure and account for the risk that the project will not produce sufficient returns to use this deductible expenditure.

The Business Council reiterates the issues it raised in its submission to the PRRT Review. That is, identifying rents is the foundation on which the neutrality of rent taxes rests. But this is easier done in theory than in practice, and it is likely the PRRT as designed may also capture firm-specific or quasi rents. Given the challenge of measuring rents and maintaining neutrality, uplift rates should not be unduly punitive. This challenge is

compounded by the restrictions on transferability and refundability of losses. For these reasons, the rationale for lowering the current uplift rates is not strong, particularly when contrasted with the risk of distorting future project investment and production decisions.

Recommendations 3 to 12

The Business Council broadly supports Recommendations 3 to 12 of the PRRT Review's Final Report, subject to final details and consultation with industry. If implemented well, they should improve administration and compliance with PRRT. A more holistic consultation process will have the potential to address the concerns raised in the consultation paper.

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