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Dear Sir / Madam

DESIGN ISSUES – PETROLEUM RESOURCE RENT TAX (PRRT) CONSULTATION PAPER

Mitsui E&P Australia Pty Ltd (MEPAU) welcomes the opportunity to provide comments as part of the PRRT design issues consultation announced by Treasury on 30 June 2017.

BACKGROUND

MEPAU, as a wholly owned subsidiary of Mitsui & Co. Ltd (Mitsui), has been a significant investor in Australia's oil and gas sector since its initial investment in the Enfield oil project in 2004. MEPAU is currently Australia's seventh largest oil producer with interests in five producing oil and gas projects, as well as holding interests in a number of oil and gas exploration projects.

In total MEPAU has invested approximately \$5 billion on the acquisition and development of its interests in Australian oil and gas projects. Since first becoming liable to pay PRRT in 2010, MEPAU has made total PRRT payments of \$700 million, largely in connection with its Enfield and Vincent oil projects.

Over the past year MEPAU has made investment decisions to acquire further energy assets. In March 2016 MEPAU acquired a 35% non-operator stake in the Kipper Gas Field in the Gippsland Basin at a cost of \$520 million and commenced production in March of this year. In June 2016 MEPAU, in conjunction with its joint venture partner Woodside, committed to developing its 40% interest in the Greater Enfield oil project off Exmouth WA at a cost of USD 800 million (MEPAU share) to be incurred over a three year period.

GENERAL COMMENTS

Australia must retain its attractiveness as a place of investment for MEPAU to meet global corporate goals as it competes for capital in the global market within the Mitsui group of companies.

MEPAU agrees with many of the findings of the recent PRRT review for Treasury, which concluded amongst other things that the PRRT regime as currently constituted was not discouraging investment and that many external uncontrollable factors, such as oil price and foreign exchange rates – which continue to influence MEPAU's operations, directly impact the amount of PRRT revenue raised.

MEPAU believes a holistic approach needs to be adopted with PRRT, the tax being only a part of a bigger picture. Any changes to PRRT should be viewed in the context of the needs of Australia to invest in energy both domestically and for export, as well consider flow on investments that occur in relation to employment and infrastructure development.

Any proposed changes to PRRT should also take into consideration the integrated nature of PRRT; that not any one change can be considered in isolation. Full consideration must be given to maintaining the international competitiveness of the Australian oil and gas sector to continue to attract investment.

CONSULTATION MATTERS

Uplift Rates

MEPAU believes the current uplift rates are appropriate and does not believe any of the proposed options to adjust uplift rates fully reflect an adequate return required for the risks assumed.

In its experience, MEPAU has not in its offshore projects had many multiples of years in which undeducted carry forward expenditure is compounded, particularly with respect to exploration. Wider deductibility provisions require (it is not a choice) the transfer of exploration expenditure where other profitable group projects exist. How this occurs will be different and specific to each taxpayer's profile.

Lead times between initial exploration activities and development can go beyond the five year pre-production licence window that would allow access to the higher augmentation rate; thereby only being uplifted by the GDP deflator rate, which for the last three out of five years has been negative.

For example, MEPAU with one of its joint venture partners is currently developing the Laverda field, discovered in the year 2000. The production licence was issued in 2016 meaning, if developed on a standalone basis, eleven of the preceding years' undeducted project exploration expenditure could only receive GDP uplift. Because it already has existing PRRT payable projects, related eligible exploration expenditure was required to be transferred immediately receiving no augmentation.

MEPAU must also compete internally for capital on a global stage. The rates of internal return expected often exceed that offered by the current augmentation rates and any reductions could potentially result in less investment domestically by Mitsui.

Changes to the Order of Deductions and Transferability of Exploration

MEPAU does not believe additional changes to the order of deductions are necessary. Any changes, especially the introduction of additional tiers or a dual stream, would bring further complexity and added compliance risk. Further, as noted in the consultation paper, changes to augmentation rates would impact the ordering of deductions and no one change can be considered in isolation.

MEPAU agrees with the policy principles outlined by the Treasurer at the time amendments to PRRT were introduced in 1991, with respect to the ordering of deductions. Namely, that project specific expenditure be deducted first to protect against the risk it could not be utilised in the case of unsuccessful or marginal projects.¹

The wider deductibility made available by these amendments to allow for the transferability of exploration expenditure encourages MEPAU in its pursuit of further investment and development opportunities. It also provides a degree of incentive so that such expenditure is not wasted, in a PRRT context, when an exploration venture proves to be unsuccessful. Changes adversely affecting the application of these provisions could negatively affect MEPAU's future investment decisions.

¹ Petroleum Resource Rent Legislation Amendment Bill 1991, Second Reading Speech

Gas Transfer Pricing

MEPAU does not hold any direct investment in LNG projects and does not specifically comment on related proposals put forward in the paper.

New Projects

Changes to the definition of what is a project for PRRT purposes could also have an unfavourable impact on MEPAU's investments. It would be undesirable if any unfavourable changes impacted prospective near field developments, which may already be marginal and in the absence of being able to be combined with an existing project, be rendered uneconomic. This would leave certain resources undeveloped and have consequences beyond the tax revenue.

Allowances should be made for future developments of discoveries in licences, permits, leases or project combination certificates in existence or applied for as at the date of the announcement of such a change and meet the existing project combination certificate criteria be allowed to combine with a project in future without any adverse impact.

INTEGRITY, EFFICIENCY AND ADMINISTRATION IMPROVEMENTS

In relation to recommendations for improving the integrity, efficiency and administration of PRRT, MEPAU in principle agrees with most of the recommendations made where they will add to the effective administration of the tax and relieve some of the administrative burden on both the revenue authority and the taxpayer. However, any changes should not inadvertently disadvantage taxpayers for the sake of administrative efficiency alone.

With respect to Recommendation 2, MEPAU does not agree with the proposal to prevent new onshore projects combining with existing projects that have a starting base. For MEPAU, this proposal could limit the viability of new adjacent and near field developments of its onshore prospects that may otherwise be marginal and at risk of not being developed.

The proposal of Recommendation 5 to require the lodgement of annual returns for all types of petroleum permits (exploration permit, retention lease, or production licence) would be acceptable only if doing so would provide a degree of certainty for both revenue authority and taxpayer. Given a significant lead time can exist between initial exploration and utilisation, MEPAU sees this would add a taxpayer administration burden unless such a measure also had a definitive window in which both the revenue authority and taxpayer could amend. Therefore MEPAU would suggest any such measure if introduced have returns subject to the existing period of review limitations.

For Recommendation 11, where an exemption to PRRT obligations was put in place, MEPAU would want protections established to preserve the prospective deductions in the event that circumstances change (e.g. increase in prices) such that the project does become PRRT liable.

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Please contact our Tax Manager, Bryan Skipworth, for any questions regarding this submission.

Yours faithfully



Hiroyuki Matsuyama

DIRECTOR & GENERAL MANAGER – ACCOUNTING & FINANCE