CME

15 October 2012

Business Tax Working Group
The Treasury
Langton Crescent
PARKES ACT 2600

Email: BTWG@treasury.gov.au

Dear Sir/Madam

BUSINESS TAXATION WORKING GROUP: DISCUSSION PAPER - STATUTORY CAPPED EFFECTIVE LIFE

The Chamber of Minerals and Energy of Western Australia (CME) writes to provide additional information for the Business Taxation Working Group's (BTWG) consideration on options provided in the Discussion Paper on the 'statutory capped effective life' currently provided to depreciating assets used in the oil and gas extraction and petroleum industry.

In relation to providing comment on the full range of options included in the BTWG Discussion Paper, CME has endorsed the Submission provided by the Minerals Council of Australia.

CME AND THE WESTERN AUSTRALIAN RESOURCES INDUSTRY

CME is the peak resources sector representative body in Western Australia funded by its member companies who generate more than 95% of all mineral and energy production and employ 80% of the resource sector workforce in the State.

The Western Australian resources sector is diverse and complex covering exploration, processing, downstream value adding and refining of over 50 different types of mineral and energy resources.

In 2011, the value of Western Australia's mineral and petroleum production reached $107 billion, accounting for 92% of Western Australia's total merchandise exports and thus representing the majority of Western Australia's 46% contribution to Australian merchandise exports. Furthermore, royalty payments to the state government totalled $4.9 billion in 2011.

The prospects for future growth are strong, with $1.82 billion invested in minerals exploration in Western Australia in 2011, accounting for 51% of total national investment. This exploration is translating into significant further development, with the value of resource projects either committed or under construction at $166 billion.

STATUTORY CAPPED EFFECTIVE LIFE

The BTWG terms of reference stipulate that "in order to pursue the economic benefits associated with a reduction in the company tax rate, savings should be identified from within the business tax system". Against this background the BTWG discussion paper discusses the option to reduce or eliminate accelerated depreciation allowances in order to more closely align allowances with economic rates of depreciation.

The focus of this submission is on **BTWG Option B.3** which proposes the removal of statutory capped effective lives provided to depreciating assets used in the oil and gas extraction and petroleum industry. CME has concerns that adopting this measure will have a significant impact on the projects of its oil and gas members.

Specifically, CME submits that the statutory effective life caps for assets in the oil and gas industry should be retained on the basis that:

- They do not distort the corporate tax system as the industry is highly capital intensive compared with other industries such as retail, finance and services.
- There is unprecedented planned expenditure in relation to the expansion and development of projects. As a result, there is significant policy rationale to retain the existing statutory caps and to provide certainty for an industry which is risky and requires long lead times to construct, develop and operate projects. The removal of the statutory caps may jeopardise a number of large investments in the short term.
- Any change in the depreciation deductions will make Australia less competitive internationally and as such, investments in the oil and gas sector may move overseas in the long term at the expense of Australia.

Each of these submission points is discussed in further detail below.

1. Statutory caps for capital intensive industries do not distort the corporate tax system

The BTWG proposes that the removal of statutory effective life caps could be seen to eliminate a distortion in the corporate tax system. The BTWG argues that a more neutral system would foster a more efficient allocation of resources across the economy.

CME submits that the existing statutory caps do not distort investment given the highly capital intensive nature of the oil and gas industry. CME supports the views raised by APPEA in its submission to the BTWG dated 21 September 2012[1] that there is a natural bias in the current tax system towards industries that are less capital intensive, and which have a much higher proportion of costs that are able to be immediately deducted for tax purposes. CME also supports the views raised by APPEA that long lead time items (prevalent in the oil and gas industry) are disadvantaged given the sometimes long times between when the expenditure is incurred and when the asset is first able to be depreciated under the tax law.

Far from distorting investment, taking these factors into account, the statutory caps help restore neutrality between the oil and gas industry and other less capital intensive industries.

Given the highly capital intensive nature of the industry, including the long lead times and long lives of projects, removing the statutory effective life caps will significantly increase the NPV cost of capital investments into projects, particularly LNG developments. These negative impacts on project economics are real and will add pressure to the oil and gas industry at a time when it is already facing significant upward labour costs and capital constraints.

Importantly, in introducing the statutory caps as part of the 2002 Federal Budget, the then Federal Government recognised that:

> *"...the measure to cap statutory effective lives for certain depreciating assets is the* ***most efficient and transparent method*** *of achieving the desired policy outcome. The measure provides for the most appropriate 'balance of interest' between meeting the needs of the specific industries and maintaining the integrity of the Government's effective life capital allowance system".* [2] [emphasis added]

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[1] APPEA submission to the BTWG, 21 September 2012, pp. 36-38

[2] Explanatory Memorandum to *Tax Laws Amendment Bill (No.4) 2002,* para 4.79.

2. Unprecedented planned expenditure provides basis for retaining statutory caps

There is a considerable project pipeline for the oil and gas and petroleum sector, with planned investments in Australia based on the existing tax regime in which oil and gas assets have a statutory capped effective life. The magnitude of planned expenditure provides a significant policy rationale to retain the statutory caps for oil and gas assets. There are currently nine projects (7 of which are LNG projects) under construction or consideration, worth between A$14 billion and A$43 billion, the size and scale of which is unprecedented in Australia's history.

In introducing the statutory caps in 2002, the then Federal Government had regard to the $48 billion of planned investment in the oil and gas industry over the subsequent 10 years.

At that time, the Media Release issued by Senator Helen Coonan stated that the statutory cap legislation would be introduced to:

> *" ... **provide certainty for the industries concerned**, and provide an **appropriate balance** between meeting the needs of those industries as well as maintaining the integrity of the effective life depreciation system".* [3] [emphasis added]

The Explanatory Memorandum to *Tax Laws Amendment Bill (No.4) 2002* further considered that:

> *"If the Commissioner's likely effective life changes were implemented, it is likely that some of these planned investments would not proceed".* [4]

Given that the current capital expenditure planned far outweighs that contemplated in 2002, the potential impact on the economy is therefore much greater. In view of this, CME believes there is a clear basis for the retention of the statutory effective life caps for oil and gas assets based on current and unprecedented levels of investment in Australian oil and gas projects.

Further, as many oil and gas projects that have been approved will be outlaying significant amounts of capital over the next 5 years and beyond, the timing of the proposed change will inevitably impact existing investments which are facing significant pressures to deliver on time and on budget.

3. Importance of international competitiveness

The oil and gas industry is very much a part of the global economy, and Australia needs to remain competitive internationally to attract investment. However, as highlighted in APPEA's submission to the BTWG, Australian developers already face a challenging framework compared to their competitors.[5] Given the global mobility of capital, CME is of the view that there is a serious risk that investments in the oil and gas sector may move overseas if Australian effective tax rates are affected as a result of a less competitive tax depreciation regime. It should be noted that Australia's existing depreciation schedules for oil and gas projects are already far longer than other competing oil and gas economies.

In implementing the statutory caps in 2002, the Explanatory Memorandum recognised that the economy wide impacts of the changes would be difficult to measure as they would depend on the extent to which the investment projects would not have proceeded had the measures not been introduced. However, in adopting the measures, the Federal Government indicated it recognised the need to ensure that the relevant industries committed to their investments. The Explanatory Memorandum recognised that there would be benefits to the economy by implementing the statutory caps. Specifically, the Explanatory Memorandum stated that:

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[3] Senator Helen Coonan, Minister for Revenue and Assistant Treasurer (26 November 2001 to 17 July 2004), Media Release C44/02, 14 May 2002.

[4] Explanatory Memorandum to Tax Laws Amendment Bill (No.4) 2002, para 4.75.

[5] APPEA submission to the BTWG, 21 September 2012, pp. 39-40, Charts 3.6 and 3.7.

"To the extent that the recommended statutory caps on effective lives have a net positive impact on investment, there will be flow-on effects in the economy through employment and national production. Some of the investment will also impact on trade flows, particularly those projects that are export-orientated".[6]

In contrast to the approach taken in 2002, a change in the policy now would have an adverse consequence on Australia's economy given the industry's significant contribution to national Gross Domestic Product and productivity. These adverse consequences would be extrapolated through the economy as a result of the economic multiplier effect. Therefore CME submits that the continued investment by multinationals in the Australian oil and gas industry is fundamentally important to Australia's future prosperity.

CONCLUSION

CME submits that currently there is no basis to remove the statutory caps applicable to the oil and gas industry and that an "appropriate balance" between industry needs and the effective life depreciating system must be maintained to ensure Australia's fiscal competiveness in the global economy.

If you have any queries regarding our feedback, please contact Damian Callachor, Director, d.callachor@cmewa.com or (08) 9220 8518.

Yours Sincerely

Reg Howard-Smith
Chief Executive

[6] Explanatory Memorandum to Tax Laws Amendment Bill (No.4) 2002, para 4.76.