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Mr Michael Callaghan
PRRT Review
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Michael

Review of the Petroleum Resource Rent Tax (PRRT)

Eni welcomes this opportunity to provide its contribution on the Review of the Petroleum Resource Rent Tax Issues Note circulated by Treasury for stakeholder comment.

PRRT has been an integral part of the Australian taxation landscape for oil and gas companies since its introduction in the mid-1980s. Eni recognises the importance of PRRT to national revenues and believes that in order for this contribution to be maintained, the existing balance between PRRT revenue generation, and the promotion of continued investment in order to sustain such revenues for the long term, should also be maintained.

Background to Eni in Australia

The Eni Group is a major integrated energy company, involved in the exploration, production, transportation and marketing of oil and gas products. The Eni Group operates in 69 countries and employs approximately 33,000 people worldwide.

Eni has been operating in Australia since 2000, through its wholly owned subsidiary Eni Australia Limited and six additional entities. Eni's principal activity in Australia is the exploration, development and production of oil and gas resources. In recent years, in addition to a portfolio of exploration interests, Eni has operated two production projects within the PRRT regime: (i) Woollybutt, an oil asset (WBT), and (ii) Blacktip, a gas asset.

Since inception, Eni has invested over US$2 billion in Australia through its exploration activities and the development of WBT and Blacktip.

PRRT Regime Analysis

Since the introduction of PRRT by the Hawke Government in the mid-1980s, Eni believes it has operated as intended: it has encouraged investment in exploration and production of petroleum resources while providing an equitable return to the Australian Treasury (amounting to more than $1 billion per year in additional revenues since introduction[1]).

[1] Australian Taxation Office statistics – 2002-03 = $1.2 billion; 2003-04 = $1.5 billion; 2004-05 = $2.0 billion; 2005-06 = $1.8 billion; 2006-07 = $1.9 billion and 2007-08 = $ 1.6 billion.

PRRT's effectiveness is attributable to 2 characteristics which were highlighted in the 2010 Henry Tax Review[2]:

- economic efficiency; and
- the size, variability and timing of the return received by the Government.

Each of these elements is addressed below in further detail, including their application in the Eni context.

Economic efficiency

A deliberate design feature of the PRRT regime was to differentiate itself from royalty and excise arrangements. PRRT is profit-based, rather than being based on production. PRRT is levied at a rate of 40 per cent, but only after a company has recouped its investment in the relevant project.

Oil and gas projects typically involve substantial upfront investment. This includes exploration expenditures which by definition offer no guaranteed return, and may in themselves amount to hundreds of millions of dollars. Even in success cases where exploration activity leads to subsequent development and production, pay back of the initial investment may take many years.

In taking the decision to carry out exploration activity (the "first steps" of the investment cycle), investors will consider an average period of 10 years between successful exploration and the start-up of production. The exploration investment decision is made based on market assumptions for development in case of exploration success. These known variables include oil price and cost escalations which are out of the company's control. However, without fiscal stability, economics cannot be run with confidence. Eni has carried out exploration projects in Australia over the last 5 years which have depended on an assumption that the existing fiscal regime will apply if hydrocarbons are discovered and developed. A negative change to the fiscal regime now not only calls into question the economics supporting those exploration decisions, it also substantially increases the risk premium for Australia in future investment evaluations.

The current PRRT regime fits the high risk profile of the industry. It is levied only where initial investment has been recovered and the project is generating returns above a reasonable margin (reflected in the rates of augmentation for PRRT credits). Investors know that assets with poor rates of return will not be further penalised by an additional tax/royalty burden - base returns are preserved, and this reduces risk and is a powerful incentive for investment. Conversely in the case of a project with robust returns it is understood that the state will incrementally benefit from the economic upside. I referred to balance in my introduction and this is one of the indicators of a balanced - and economically efficient - system.

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[2] Henry Final Report Detailed Analysis Chapter C: Land and resources taxes C1. Charging for non-renewable resources C1–1. The community's return from the exploitation of its resources.

The size, variability and timing of the return

Oil and gas project revenues, and the taxable income they drive, are of course highly susceptible to fluctuations in commodity prices. The variability of the PRRT regime means the Government shares in price upside, and the investor is partially protected from price downside. Without this variability, oil and gas operators have greater exposure to downside price risk and thus a greater risk of discontinuing production for marginal assets when prices are low. PRRT reduces volatility in project returns by helping to smooth the peaks and troughs of commodity prices. This supports business continuity and encourages future investment.

The size, variability and timing of the return can be compared and contrasted between Eni's two PRRT projects in Australia. The WBT project as discussed above has paid a significant amount of PRRT due to the economic profile of the project: a short development timeframe and quick payback, supported by a period of high oil prices.

PRRT Regime compared to other key tax jurisdictions around the world

The oil and gas industry operates on a global playing field. Competition for new investment is now more intense than ever and recent market volatility drives an increasingly selective investment strategy from industry players, including Eni.

This situation is in turn prompting a response from governments keen to ensure their country's presence in the industry remains relevant, competitive and sustainable. For example, two of Australia's closest neighbours are either progressing the introduction of more favourable fiscal terms for new oil and gas investment (Indonesia) or are openly expressing their intention to do so (Timor-Leste). This is not an isolated response. In 2015 the UK reduced its Petroleum Revenue Tax rate (equivalent to PRRT) from 50% to 35%, before abolishing the tax altogether from 1 January 2016.

As can be seen in the table below, Australia is already one of the highest taxing jurisdictions in the industry. Any tightening of Australia's fiscal policy towards oil and gas goes against prevailing trends and will inevitably drive new investment elsewhere.

Table 1: comparison of taxation rates applicable to oil and gas[3]

Country	PRRT tax rate	Company tax rate	Royalties/Resource Tax
Australia	40%	30%	0%
Brazil	0%	34%	5% to 15%
China	0%	25%	0% to 12.5% and resource tax of 6% of sales price
Indonesia	0%[4]	25%	0%
Mozambique	0%	32%	10% for oil and 6% for gas
Norway	53%	25%	0%
Timor-Leste	0%	30%[5]	32.14%[6] of accumulated net receipts
United Kingdom	0%[7]	30%	10%
United States of America	0%	35%	12.5% to 30% for onshore and 12.50% to 18.75% for offshore
Vietnam	0%	32% to 50%	Resource tax of 7% to 29% for crude oil and 1% to 10% for natural gas

Summary

An increased PRRT tax burden on the oil and gas industry in Australia will significantly reduce the number of future approvals and development of new projects. In a competitive global market, higher rates of taxation will not generate long term revenue growth – investors will vote with their feet and the ultimate result will be lower investment, lower revenues, and fewer jobs.

In addition, and whilst we believe the PRRT is delivering the results intended in its design, there are aspects of the PRRT regime which can be improved to reduce the complexity and costs associated with compliance. This includes the inability to align PRRT tax years with a company's income tax year, where the latter does not run from 1 July to 30 June (as is the case with Eni). Eni would therefore welcome the inclusion of the PRRT reporting and compliance process within the scope of your Review.

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[3] Rates per EY's Global oil and gas tax guide 2016

[4] 8.8% investment credit net after tax on the capital investment costs directly required for developing production facilities out of new oilfields.

[5] The 30% company tax rate is for the Timor-Leste exclusive area.

[6] Supplemental Petroleum Tax

[7] From 1 January 2016

I am grateful for the opportunity to provide Eni's views on this matter, and would be happy to further discuss with you any of the points raised above.

Yours sincerely

Ernie Delfos
Managing Director
Eni Australia Limited