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PRRT Review  
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### **Submission to the Petroleum Resource Rent Tax Review**

Dear PRRT Review Team,

Greenpeace Australia Pacific (GPAP) welcomes this inquiry into the operation of the Petroleum Resource Rent Tax (PRRT). More than ten thousand GPAP supporters signed a petition last year that called for a review of the PRRT. Our supporters are very concerned about the mounting evidence that the PRRT is not working and that Australians are not receiving a fair return from oil and gas projects. GPAP is also a member of the Tax Justice Network (TJN), which has advocated for an inquiry into the PRRT. On the whole, we support the submission made by Jason Ward on behalf of the TJN, although we would recommend that the Review Team consider a higher offshore royalty rate than that proposed (10%). We have also decided to make this separate submission to expand on some of the environmental issues raised in the TJN submission and to provide our perspective on the broader context that the Review Team should take into consideration when examining the PRRT.

Unfortunately, in doing so we must raise an objection to the terms of reference for the review. It is clear that under these terms, any proposed reform of the PRRT must be compatible with the Federal Government's desire to promote further investment in exploration for oil and gas reserves. To be clear, we support reforms that will result in more money from *existing* fossil fuel developments flowing back into the public purse. However, we fundamentally disagree with the notion that any further exploration activities conducted by fossil fuel companies should be facilitated or subsidised by the government. Aspects of the PRRT, including the uplift rates for exploration, constitute a clear subsidy. Australia, along with all other G20 countries, has committed to ending fossil fuel subsidies.

We would like to remind the Review Team, as it contemplates changes to the exploration incentives in the PRRT, of the very clear scientific evidence that most of

the world's known fossil fuel reserves must be left in the ground if climate change is to be kept below 2°C of warming above pre-industrial levels. Last year, an overwhelming majority of the world's governments, including the Australian Government, signed the Paris climate agreement, which aimed even more ambitiously to limit the temperature increase to 1.5°C. Furthermore, scientists have been joined by a growing chorus of financial experts who argue that the traditional assumptions that there will be ever-growing oil demand, oil scarcity and a need to increase bookable reserves are now untenable. The industry and the government need to accept that the fossil fuel era is coming to an end.

The reform of the PRRT must be considered within this broader frame. Accordingly, in this submission we recommend the elimination of the generous uplift rates and other incentives for exploration under the PRRT. This will generate increased government revenue, which in our view should be invested in the renewable energy sector to speed up the transition to a clean economy. Additionally, we argue that there should be much greater transparency and oversight of the reformed PRRT regime because oil and gas companies have proven their willingness and ability to aggressively avoid their tax obligations in Australia as well as in other jurisdictions around the world.

### **The Evolution of the PRRT in the Context of Industry Lobbying**

The PRRT is a profit-based tax at the rate of 40 per cent that was introduced by the Federal Government in 1987 (coming into effect in 1988). Under the PRRT, companies can reduce their taxable profits by deducting a wide range of expenditures, including those associated with exploration. When a company's deductions exceed assessable receipts, the balance is "uplifted" (carried over to the future with an increase in value).

In developing the PRRT, the Hawke Government faced determined opposition from the Australian Petroleum Production and Exploration Association and the two largest petroleum companies in Australia at the time: Esso and BHP.<sup>1</sup> Industry lobbyists were successful in pressuring the government to limit the PRRT to offshore projects and to exclude the Bass Strait and North-West Shelf. While these areas have since come under the ambit of the PRRT, other aspects of the regime have been changed that have eroded its effectiveness. Major oil and gas companies have successfully lobbied for the introduction of concessions such as: a widening of exploration cost deductibility from a project to a company wide basis, which allows exploration deductions to be transferred from one project to another (1991); and an uplift of 150 per cent on PRRT deductions for exploration expenditure incurred in offshore "frontier areas" (2004).

Concessions such as these make it possible for most companies to avoid paying any PRRT for long periods of time, if not indefinitely. In 2016, Fairfax Media revealed that just 5 per cent of 150 oil and gas ventures were paying any PRRT. It has also been pointed out in the media that the industry has built up a mountainous \$187 billion in exploration and development tax credits. These credits will continue to accumulate and “will be used to insulate the multinational petroleum companies from having to pay any resource rent tax for years to come”.<sup>2</sup>

The problems with the PRRT were highlighted in the 2010 Henry Tax Review and have even been acknowledged by Craig Emerson (a key architect of the original scheme).<sup>3</sup> Although we are heartened by the fact that both major parties now agree that the PRRT needs to be reviewed, we are concerned that a key lesson from history is that the federal government has consistently bowed to industry pressure when legislating in this area. While we hope that this review will prove to be the exception to the rule, we would like to take this opportunity to reiterate our view that fossil fuel companies should be banned from making political donations, given their disproportionate influence over our political system.

## Ending Fossil Fuel Subsidies

Independent assessments of Australia’s fossil fuel subsidies at the federal level range from \$4-\$40 billion dollars per year.<sup>4</sup> Estimates vary widely because the organisations making the calculations define fossil fuel subsidies differently.<sup>5</sup> Nevertheless, while there is continued debate about whether certain types of support that the industry receives should be captured by the definition, it is commonly accepted that forgone tax revenue is a form of subsidy. One of the most widely cited definitions (not confined to the fossil fuel sector) is found in the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (ACSM):

A subsidy shall be deemed to exist if:

- (a) ...
- (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits); ...
- (b) a benefit is thereby conferred.

The overly generous uplift rates under the PRRT for exploration expenses (Long Term Bond Rate (LTBR) +15 per cent) and general project expenses (LTBR +5 per cent) result in the generation of excessive PRRT credits and substantial reductions in future government revenue. These uplift rates should be considered fossil fuel subsidies.

According to one report, the PRRT expenditure uplift rate, gas transfer price regulations, and starting base and uplift rate for capital assets, each result in a subsidy of between \$10-\$100 million for a total subsidy of between \$30-\$300 million annually.<sup>6</sup> This is a clear case of the government providing the fossil fuel industry with special favours: other industries are entitled to carry forward losses for income tax purposes, but only the fossil fuel industry is provided with this kind of uplift.

Another subsidy that the industry has received under the PRRT, which has fortunately been phased out, is the 150 per cent uplift rate provided to exploration in “frontier areas”. Although this subsidy is no longer being offered to new projects, it applies to some of BP’s licences in the Great Australian Bight (GAB). BP has decided not to proceed with development in the GAB but it has been reported that the company will be able to transfer the PRRT credits generated from the 150 per cent uplift on drilling activities it has already conducted to other projects.<sup>7</sup> In a Senate Committee hearing, it was revealed that it could take more than twenty years for BP to use up the PRRT credits that the company has accumulated from its GAB exploration program.<sup>8</sup> The story of the GAB also provides other lessons on why the government should not be subsidising exploration activities, especially in “frontier” (read: risky) areas. Oil and gas operations in remote and challenging environments like the GAB are more likely to have catastrophic accidents. Oil spills pose a huge danger to unique marine ecosystems such as the one found in the GAB, which serves as a nursery for Australian sea lions and southern right whales and supports Australia’s most valuable fisheries.

Obviously, the uplift rates in the PRRT are not the only mechanism Australia uses to subsidise fossil fuel exploration. In addition to many other incentives and tax credits, the Government also engages directly in exploration activities through Geoscience Australia. Nevertheless, the reform of the PRRT to eliminate the uplift rates would be a positive outcome from this Review and would assist Australia in meeting its international commitment to end fossil fuel subsidies. In Pittsburgh in September 2009, G20 leaders agreed that:

Inefficient fossil fuel subsidies encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change. [...] eliminating fossil fuel subsidies by 2020 would reduce global greenhouse gas emissions in 2050 by ten per cent.

As noted in this short statement, there are a number of reasons to phase out fossil fuel subsidies:

- They hinder efforts to combat climate change (the IMF estimates that eliminating fossil fuel subsidies would reduce global carbon dioxide emissions by 13%)<sup>9</sup>;
- They create an uneven playing field for competing technologies like renewable energy (the Earth Policy Institute found that global fossil fuel subsidies were more than seven times higher than renewable energy subsidies in 2011)<sup>10</sup>;
- They can have negative economic consequences (depress investment in the energy sector, crowd out spending on public goods, diminish competitiveness, provide incentives for smuggling and make it harder to manage volatile international energy prices)<sup>11</sup>;
- They are regressive because they tend to benefit high energy users, with higher incomes - in other words they entrench poverty and reduce social equity<sup>12</sup>; and
- They represent a diversion of tax dollars from more productive uses like public services (education, health, etc.).<sup>13</sup>

*Recommendation 1: Any reform of the PRRT should eliminate the overly generous uplift rates as well as the ability of corporations to transfer PRRT credits between projects.*

## **The Paris Climate Agreement & Fossil Fuel Exploration**

The Paris climate agreement came into force on 4 November 2016. It was ratified by Australia on 9 November 2016. Under the agreement, governments commit to “holding the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels”. A 2°C rise in temperature has long been considered a threshold that should not be crossed given the potential for catastrophic consequences such as the melting of the Greenland ice-sheet, which would lead to a sea level rise of 7 metres with dire consequences for many of the world’s major cities.<sup>14</sup> As scientific knowledge has improved, it has become clear that very grave risks exist even if temperatures are kept below a 2°C increase, which is why the more ambitious 1.5°C limit is now widely advocated by climate scientists. Australia is already suffering severe impacts from climate change: from the bleaching occurring across the Great Barrier Reef, to record heatwaves and increasingly long and severe bush fire seasons.

To demonstrate how a 2°C or 1.5°C target can be accomplished across the world in an equitable manner, the notion of a “carbon budget” has been developed. By the most generous calculation, Australia’s share of the global carbon budget will be exhausted in six years if current levels of domestic greenhouse gas emissions are maintained.<sup>15</sup>

Furthermore, Australia's role as fossil fuel supplier to the world is incompatible with efforts to meet a 2°C or 1.5°C target, because fossil fuel use in other countries also needs to sharply decline. The bottom line is that globally, a 1.5°C or 2°C carbon budget is dramatically less than the carbon contained in the remaining fossil fuels. Researchers from the University College London have demonstrated that in order to have a reasonable chance of meeting even the 2°C limit, "globally, a third of oil reserves, half of gas reserves and over 80% of current coal reserves should remain unused from 2010 to 2050".<sup>16</sup> In other words, a substantial proportion of known fossil fuel deposits must be left in the ground and further exploration activities should not be undertaken. As Professor Will Steffen has noted, what this means in the Australian context is that "any exploratory drilling for oil or gas in the Great Australian Bight – or anywhere for that matter – should be immediately ruled out on the basis of the impact of their development on the climate system."<sup>17</sup>

All of this very clearly illustrates that government subsidies for fossil fuel exploration under the PRRT are incompatible with Australia's commitments under the Paris agreement. We therefore reiterate that they should be eliminated. We would additionally argue that revenues from any revised PRRT or new royalty scheme should be invested in renewable energy. This would help speed the transition away from fossil fuels as well as promoting innovation and creating jobs.

While we are convinced of the need to end fossil fuel exploration by the science alone, it is worth noting that many industry and finance experts have also argued that the industry should stop aiming for growth and proceed with an "orderly" liquidation.<sup>18</sup>

*Recommendation 2: Revenue from a reformed PRRT (or new royalty scheme) should be invested in renewable energy to help speed up the transition to a clean energy economy;*

## **Transparency & Oversight of the PRRT**

The willingness of multinational corporations to engage in aggressive tax avoidance is well documented and is the subject of a separate ongoing inquiry. In the fossil fuel sector, the tax practices of Chevron have been subject to particular scrutiny in Australia in recent years, with the company being taken to court by the ATO and required to pay \$300 million in back taxes. Chevron has also run into problems with its tax filings in the US, Nigeria, Angola, Saudi Arabia and Kazakhstan.<sup>19</sup> The other oil and gas majors (BP, Shell, and Exxon) have received less scrutiny but this does not mean

that they are above suspicion. Exxon (like Chevron) paid no corporate tax in Australia in 2013/14 or 2014/15.<sup>20</sup> And all the fossil fuel companies with “marketing hubs” in Singapore have been warned by the ATO about inappropriately shifting profits offshore.<sup>21</sup>

In this context, it seems inherently problematic for the PRRT to operate on the basis of voluntary compliance and self-reporting. The public should be able to see what project expenses companies are claiming deductions on and these should be thoroughly scrutinized by the government.

*Recommendation 3: A rigorous oversight mechanism for the PRRT should be adopted and information about any deductions claimed and credits received by a company should be publicly accessible.*

### **Summary of Recommendations:**

1. Any reform of the PRRT should eliminate overly generous uplift rates as well as the ability of corporations to transfer PRRT credits between projects;
2. Revenue from a reformed PRRT (or new royalty scheme) should be invested in renewable energy to help speed up the transition to a clean energy economy;
3. A rigorous oversight mechanism for the PRRT should be adopted and information about any deductions claimed and credits received by a company should be publicly accessible.

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<sup>1</sup> Diane Kraal (2016) "The Petroleum Resource Rent Tax: overview of primary documents and literature leading to the 1987 legislation", Tax and Transfer Policy Institute (ANU) Working Paper 9/2016, [https://taxpolicy.crawford.anu.edu.au/sites/default/files/publication/taxstudies\\_crawford\\_anu\\_edu\\_au/2016-10/d\\_kraal\\_wp\\_oct\\_2016\\_complete.pdf](https://taxpolicy.crawford.anu.edu.au/sites/default/files/publication/taxstudies_crawford_anu_edu_au/2016-10/d_kraal_wp_oct_2016_complete.pdf)

<sup>2</sup> Heath Aston "Oil and gas giants to face parliamentary inquiry into the tax and royalties they pay", *The Sydney Morning Herald*, 29 November 2016, <http://www.smh.com.au/federal-politics/political-news/oil-and-gas-giants-to-face-parliamentary-inquiry-into-the-tax-and-royalties-they-pay-20161129-gszyob.html>

<sup>3</sup> Joanne Mather, "Petroleum Resource Rent Tax architect says deductions could be 'too generous'", *Australian Financial Review*, 1 December, 2016.

<sup>4</sup> IMF Survey : Counting the Cost of Energy Subsidies, 17 July 2015, <http://www.imf.org/external/pubs/ft/survey/so/2015/NEW070215A.htm>; Sophie Borath, " Australian fossil fuel subsidies put at \$47bn, as RET wrestle continues", *REneweconomy*, 18 December 2014, <http://reneweconomy.com.au/australian-fossil-fuel-subsidies-put-at-47bn-as-ret-wrestle-continues-58572/>; The Australia Institute (2015) "Mining subsidies vs public services", <http://www.tai.org.au/sites/default/files/Brief%20-%20Mining%20subsidies%20vs%20public%20services.pdf>;

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<sup>6</sup> Market Forces (2017) "How your taxes subsidise fossil fuels" (last accessed 3 February 2017) <https://www.marketforces.org.au/ffs/tax/>

<sup>7</sup> Graham Lloyd, "BP could claim 150pc deepwater drilling cost in Bight", *The Australian*, 13 April 2016, <http://www.theaustralian.com.au/business/mining-energy/bp-could-claim-150pc-deepwater-drilling-cost-in-bight/news-story/2ff3f6446ec35d67966c21ff33923314>; Testimony of Mr Jeremy Hirschhorn, Deputy Commissioner, Public Groups , ATO (2016) Official Committee Hansard, Senate Economics Legislation Committee Estimates, 19 October, [http://parlinfo.aph.gov.au/parlInfo/download/committees/estimate/5e2b6867-b5c2-4cdd-bba7-375e1b75f4b5/toc\\_pdf/Economics%20Legislation%20Committee\\_2016\\_10\\_19\\_4516\\_Official.pdf;fileType=application%2Fpdf](http://parlinfo.aph.gov.au/parlInfo/download/committees/estimate/5e2b6867-b5c2-4cdd-bba7-375e1b75f4b5/toc_pdf/Economics%20Legislation%20Committee_2016_10_19_4516_Official.pdf;fileType=application%2Fpdf)

<sup>8</sup> Mike Slezack, "Oil companies skip main resources tax thanks to fossil fuel search incentives", *The Guardian*, 14 May 2016, <https://www.theguardian.com/australia-news/2016/may/14/oil-companies-skip-main-resources-tax-thanks-to-fossil-fuel-search-incentives>

<sup>9</sup> David Coady, Ian Parry, Louis Sears, and Baoping Shang (2015) "How Large Are Global Energy Subsidies?", IMF Working Paper WP/15/105, <http://www.imf.org/external/pubs/ft/survey/so/2015/NEW070215A.htm>

<sup>10</sup> Emily Adams, "The Energy Game is Rigged: Fossil Fuel Subsidies Topped \$620 Billion in 2011", 27 February 2013, [http://www.earth-policy.org/data\\_highlights/2013/highlights36](http://www.earth-policy.org/data_highlights/2013/highlights36)

<sup>11</sup> Chris Reidy, "Subsidies for unburnable carbon need to go up in smoke", *The Conversation*, 19 April 2013, <https://theconversation.com/subsidies-for-unburnable-carbon-need-to-go-up-in-smoke-13458>

<sup>12</sup> Ambrus Bányai and Dalia Grigonytė (2015) "Measuring Fossil Fuel Subsidies", European Commission Directorate for Economic and Financial Affairs, Economic Brief, Issue 40, [http://ec.europa.eu/economy\\_finance/publications/economic\\_briefs/2015/pdf/eb40\\_en.pdf](http://ec.europa.eu/economy_finance/publications/economic_briefs/2015/pdf/eb40_en.pdf)

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<sup>15</sup> Sivan Kartha (2016) Implications for Australia of a 1.5°C Future, Stockholm Environment Institute Working Paper 2016-09, <https://www.sei->



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<sup>17</sup> Will Steffen (2015) “Submission on the environmental impacts of the project, with reference to the impacts on climate change”, Senate Inquiry into the potential environmental, social and economic impacts of BP's planned exploratory oil drilling project, and any future oil or gas production in the Great Australian Bight, <http://www.aph.gov.au/DocumentStore.ashx?id=4e2772e1-481e-4bd0-b0b7-235d92cc0c5a&subId=412211>

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<sup>19</sup> Nassim Khadem, “Chevron tax filings challenged by US tax authorities, report says”, *The Sydney Morning Herald*, <http://www.smh.com.au/business/energy/chevron-tax-filings-challenged-by-us-tax-authorities-report-says-20150917-gjot8i.html>

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