QUEENSLAND resources COUNCIL

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Friday 3 February 2017

Mr Michael Callaghan AM
Review of Petroleum Resource Rent Tax
The Treasury
Langton Crescent
PARKES ACT 2600
via email: prrtreview@treasury.gov.au

Dear Mr Callaghan AM,

Thank you for the opportunity to provide a submission to the Review of the Petroleum Resource Rent Tax (PRRT).

The Queensland Resources Council (QRC) is the peak representative organisation of the Queensland minerals and energy sector. QRC's membership encompasses minerals and energy exploration, production, and processing companies and associated service companies. QRC works on behalf of members to ensure Queensland's resources are developed profitably and competitively, in a socially and environmentally sustainable way.

QRC's membership encompasses a number of companies operating in Queensland's onshore gas industry. While QRC's gas members are generally also members of the *national* peak body for the oil and gas sector, the Australian Petroleum Production and Exploration Association (APPEA), QRC's Queensland membership base is broader than APPEA and also encompasses many of the professional and technical service companies who contract to the onshore gas industry in Queensland.

QRC fully supports APPEA's comprehensive national submission and provides this submission to provide a particular focus on the issues relating to PRRT on Queensland resource operations.

The PRRT has been operating successfully since the mid-1980s and APPEA describe it as the global benchmark for a profits-based resources tax regime. As a profits-based tax, the PRRT was carefully designed so that the tax liability depends on a number of moving parts, including commodity prices, exchange rates and project costs. PRRT is designed to deliver the public with a fair return while still encouraging industry investment in the exploration and development that will grow the tax base over time.

Gas is well established as an integral part of the Queensland economy and underpins the regional economy of much of the Darling Downs and Central Queensland. QRC's unique economic contribution data shows that in 2015/16, Queensland's gas industry generated 4 per cent of the Queensland's gross regional product, or a direct injection of $12.8 billion dollars into the State economy. Queensland's gas industry indirectly provides 3 per cent of the state's employment, with wages of $745 million paid to 4,700 employees. Last financial year, the gas industry spent $5.3 billion on local goods and services with more than 3,200 businesses and provided contributions to close to 170 community organisations.

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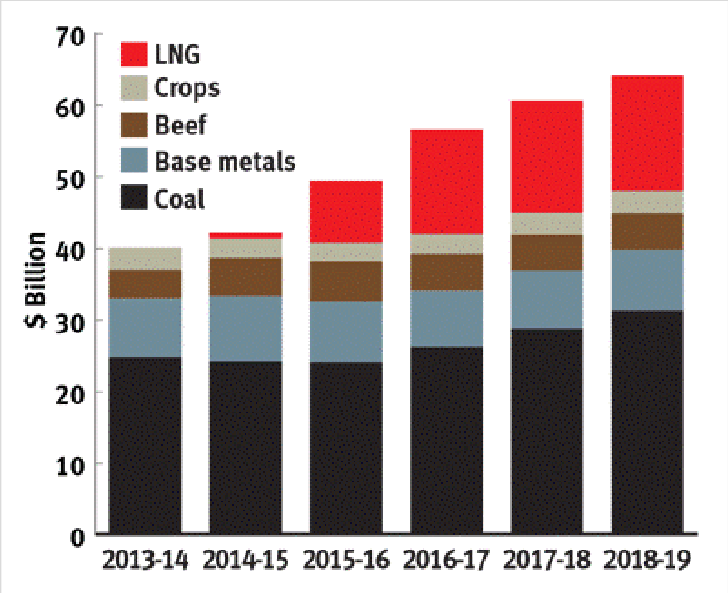
When the Queensland Treasury presents an overview (below) of the Queensland economy as part of the 2015-16 Budget documents, it is telling that the first graph they present has two key messages. First, the extent to which Queensland's export value depends on just five commodity groups and secondly the expected growth in the total value of these key exports (including gas exported as LNG). QRC suggests that both messages are highly relevant to the Review's consideration of any changes to Commonwealth resource taxation arrangements. For context in 2014-15, Queensland's total exports were $49.1 billion, so these five commodities represent more than 80 percent of the total value of Queensland exports.



QRC supports the strong view of the two peak national resource associations on the role of resource taxation. The peak *national* mining body, the Minerals Council of Australia (MCA) emphasises that the guiding objective of tax reform should be to increase Australia's growth potential through a more competitive tax system. The peak *national* petroleum body, the Australian Petroleum Production and Exploration Association (APPEA) advocate for a petroleum taxation system that encourages investment in oil and gas while also ensuring that the Australian community receives an appropriate return for the use of its resources. The existing PRRT regime has been carefully designed to deliver on all of these objectives.

Resource projects are highly capital intensive with considerable, high-risk exploration outlays, large upfront capital commitments, long-life assets, sophisticated technologies and long lead times to profitability. Securing the benefits of Australia's comparative advantage in resource endowment requires stable and globally competitive tax arrangements.

Company tax data from the Australian Taxation Office (ATO) confirms the resources industry (broadly defined to include oil and gas) is among the highest taxed industries in Australia. The MCA's analysis of ATO data shows mining paid $12.8 billion in company tax alone in 2013/14, or 19 per cent of all company tax in Australia. The net corporate tax rate on mining has been consistently above the average of total industries.

APPEA's financial surveys show that over the past decade, the petroleum and gas industry has typically paid tax at around 50% of pre-tax profit each year. In 2014/15, APPEA's figure show that the Australia's oil and gas industry operated at a net loss, but still paid more than $5.2 billion in taxes including $1.1 billion in PRRT.

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While the PRRT has been in operation since 1988, Queensland's onshore gas industry has only been subject to the PRRT since 2012. At the time the PRRT was applied onshore a starting base was provided to existing projects, to prevent the retrospective application of the tax and to shield the economics of those existing onshore projects.

The operational mechanics of how onshore gas is discovered and produced means that the Queensland gas industry's cost structures are very different to the off-shore petroleum industry, and so onshore gas industry would be expected to have less prospects of delivering the pure economic rent on which the PRRT is paid. This is particularly the case in the current economic climate. By contrast, offshore projects frequently have multiple revenue streams from their production of oil and/or condensate production in association with gas production, which generally helps to improve the project's underlying economics.

There are also operational complexities with imposing PRRT over the top of Queensland's long-standing system of petroleum royalties. While the payment of royalties to the Queensland government are recognised by the PRRT to avoid double taxation of the same gas production, a potential international investor can be expected to be wary of a jurisdiction where a gas project is required to account for two distinct project tax and royalty streams to two different layers of Government. This two-tier complexity can work to reduce the competitiveness of Australia's tax arrangements.

The prospect of any change in either of the two tax systems would raise the spectre of unintended consequences, particularly undermining investor certainty and the potential for new projects to be developed. Investor certainty is particularly important at a time when the Federal government is focussed on expanding the supply of gas on the east Coast of Australia. As such, QRC recommends maintaining the status-quo on PRRT. If the Review considers any changes to the PRRT, QRC would recommend that the Review adopt a thoroughly cautious approach to ensure that a stable and competitive fiscal regime exists and future investment is not discouraged.

Given the long history of the PRRT and its technical intricacies, the Review may identify prospective opportunities to fine tune the operations of PRRT; but any such opportunities need to be subjected to a rigorous cost benefit analysis, including full consultation with industry in order to avoid uncertainty and unintended consequences. Petroleum projects are capital intensive long-life projects, so even small changes in financial and fiscal parameters can have a large impact on the net present value of these projects, and the appetite for project proponents to bring new resources to market.

In this context, QRC notes that section 2.1 of the Review's issues note opted to present annual PRRT, excise and royalty revenues as a percentage of gross domestic product (GDP). As a ratio, the choice of GDP as denominator seems designed to make the industry's tax revenues seem insignificant and compress the expected volatility of revenues (which is expected as oil prices fluctuate and as production rates ebb from established fields). QRC was concerned that the Review's approach seemed to reflect the misleading aspects of the work of the Tax Justice Network who provide comparisons between countries without context or considering the different cost, project maturity and geological factors that exist between projects and countries.

QRC suggests that as PRRT is a profit-based tax, a more relevant ratio would as a percentage of industry profitability. APPEA's financial survey results show that over the past decade to 2014/15 that the industry has paid almost $16.5 billion dollars in PRRT (in actual dollar terms). It is important that any consideration of the PRRT is put in the correct context of industry profits, not measures of national output like GDP.

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Taxes and royalties are a critical aspect of regulatory certainty. The Queensland Government has recognised this with their iron-clad commitment to not introduce any new taxes or charges in this term of Government. While the resource industry has welcomed this ongoing commitment, the importance of regulatory certainty for the industry was emphasised in a recent survey of QRC member CEOs. The QRC's CEO Sentiment Index is a quarterly survey of QRC's producer and explorer members. When asked how favourable it was to do business in Queensland - just 13 percent backed Queensland over the other states - while one in five CEOs said their companies suffer a *cost disadvantage* in Queensland. Stable resource taxation arrangements, including at a Federal level, are essential to avoid the uncertainty that can make it difficult to attract and retain capital in resource projects.

The Queensland Government has underway a major project to develop the Gas Demand and Supply Action Plan by mid-2017. The development of the Plan has been informed by a number of consultancies and detailed analysis of Queensland's regulatory system for onshore gas. QRC understand that this analytical work shows that around a third of the cost of producing a molecule of gas in Queensland is regulatory or compliance cost. The analysis also points to substantial delays in the time taken to secure project approvals, and these delays involve holding and other direct costs for the projects.

One of the actions identified in the Queensland Government's gas plan discussion paper (page 24) was:

> *"In some cases, gas sector regulation tends to be overly prescriptive and sometimes disproportionate to risk, which creates an additional cost burden to government and industry."*

While the Queensland Government is now working towards a mid-2017 release for on the final gas plan, QRC's submission emphasised that regulatory uncertainty remains a live issue for the Queensland gas industry. The Review of the PRRT needs to be managed so it doesn't add to this uncertainty.

In summary, QRC fully supports APPEA's comprehensive national submission on the operation of the petroleum resource taxation system. QRC strongly recommends maintaining the existing operation of the PRRT. The Review should approach any proposals for reform to the PRRT with a sense of caution. Any proposals for change to PRRT should be the subject of detailed consultation with industry and then a forensic cost-benefit analysis so that the Government can be confident that they understand the ramifications of any prospective change. Before any changes are contemplated, the government needs to unequivocally demonstrate that the current PRRT provisions are not operating as intended.

If you have any questions, or would like any further information on this submission, the contact at QRC is Andrew Barger on 3316 2502 or andrewb@qrc.org.au Please note that QRC's submission is not confidential and the Review is welcome to publish this submission.

Yours sincerely

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