Woodside submission

Review of the Petroleum Resource Rent Tax (PRRT)

February 2017

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY 3
1.1 Key Points 4
2. STRONG HISTORY OF COMPLIANCE 5
3. SIGNIFICANT CONTRIBUTION 6
3.1 Total tax paid 6
3.2 Broader contribution 6
4. PRRT AND CURRENT ENVIRONMENT 7
4.1 PRRT 7
4.2 Market Conditions 8
4.3 Investment Criteria 8
5. WOODSIDE'S INVESTMENT OUTLOOK 9
5.1 Browse 9
5.2 Sunrise 10
5.3 Scarborough 10
6. IMPACTS OF CHANGES TO FISCAL SETTINGS 11
7. NORTH WEST SHELF PROJECT 12
8. CONCLUSION 13

1. Executive Summary

Since Woodside first produced gas in 1984, the industry has created thousands of jobs and delivered billions of dollars in government revenue. This growth has been facilitated by a tax regime that recognises it can take some time for investors to recoup the high costs of developing projects in Australia.

Projects contribute corporate tax soon after operations commence. When costs are recovered, producers pay an extra layer of tax through the Petroleum Resources Rent Tax (PRRT). This system delivers a fair and equitable return to Australians for their resources.

This remains an effective tax regime and continues to benefit Australians, ensuring projects are developed despite high costs, jobs are created and taxes are paid.

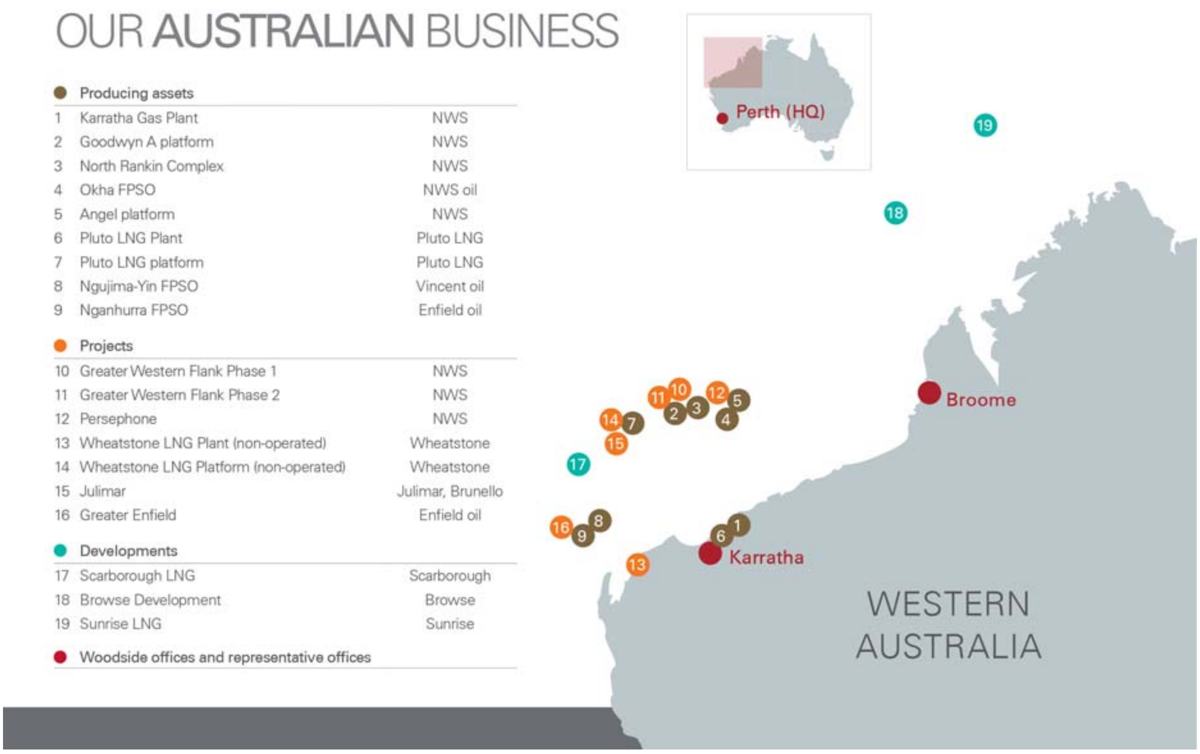
It is important to consider the total contribution a project makes to public finances over its lifecycle, rather than just in the early years or at a time of low oil and gas prices. Under the current regime, this contribution is substantial. As an investor, we carry all the burden of project risk, with governments receiving the largest benefit. For our large, economic gas projects in Australia, taxes account for typically 70% of the total value that the project generates.

We factor that into our investment decisions, but changing the fiscal regime now would jeopardise projects and undermine Australia's reputation as an attractive and stable investment destination. It is already challenging to establish commercially viable new projects in Australia, given high development costs. Changing the tax regime, particularly any retrospective changes, would be a backwards step and could deprive Australia of future jobs and tax revenues.

As a leading Australian company, we are proud of the contribution we make to the nation. This includes paying more than $6 billion in taxes over the past five years. Since 2001, Woodside has paid $2 billion in PRRT alone.

At Woodside, we are expanding our global portfolio but Australia is still our focus and our home. We want to continue investing and creating employment here, and we would urge the Government not to jeopardise that by placing further hurdles in our path.

Any changes to the tax regime that block new projects would be a loss for the Australian people.



1.1 Key Points

- The PRRT is operating as intended, delivering $200 billion worth of projects over the last decade.
- The PRRT was put in place as the previous fiscal framework was hindering exploration, project development and continuing production in existing projects.
- Material changes to the current fiscal regime run the risk of creating additional barriers to investment, significantly reducing the competitiveness of Australia and jeopardising Woodside's portfolio of Australian projects.
- This regime has supported the development of marginal projects, which under a more onerous fiscal setting, would likely not have been developed.
- As a profits-based tax, it is not unusual to have declining PRRT at a time of declining oil and gas prices and prior to these projects recouping their costs. The benefits from such projects must be measured over their full lifecycle and not adversely judged during periods of commodity price downturn.
- Any adjustment with retrospective impacts will undermine those good faith investments previously made for existing projects, reduce the ability to invest in the near term in any expansion plans, and significantly reduce confidence to manage future investments.
- As an Australian oil and gas company with approximately 3,500 employees, Woodside values the stability, fairness and competitiveness of Australia's tax regime.
- With more than 210,000 individual investors in Australia and 80% of our dividends being paid out in Australian dollars, the majority of wealth Woodside generates from our projects stays in Australia.
- Woodside has paid $2 billion in PRRT since 2001 across our portfolio.
- The Woodside operated North West Shelf (NWS) Project has carried a significant taxation burden since the project commenced, paying in excess of $26 billion through royalties and excise, strongly benefiting the Australian community. Any changes to the current fiscal settings that impact the NWS Project have the potential to negatively impact on the Australian economy and future regional jobs related to the project.

2. Strong history of compliance

Woodside takes pride in its contribution to the Australian community and recognises that the payment of taxes is an important part of this contribution.

Woodside does not support the use of artificial structures that have no commercial purpose except the avoidance or minimisation of tax. Our governance arrangements are robust and we are committed to transparency and compliance with the law.

Woodside has demonstrated this commitment by proactive and open engagement with the Australian Taxation Office (ATO) and other revenue authorities.

In 2013, Woodside voluntarily entered into an Annual Compliance Arrangement (ACA) with the ATO, covering both income tax and PRRT. Through the ACA framework the ATO and Woodside can discuss tax matters in an open and transparent manner. Woodside supports changes to Australian taxation laws that address specific instances of tax avoidance and increase transparency by taxpayers.

As part of our commitment to increased transparency, Woodside discloses its taxes each financial year and releases a Tax Transparency information sheet on our website for each income year.[1]

[1] Information Sheet: http://www.woodside.com.au/Working-Sustainably/Documents/Response%20-%20Woodside%20-%202014-15%20-%20The%20ATOs%20Tax%20Transparency%20Report.pdf

3. Significant contribution

3.1 Total tax paid

Woodside derives most of its income from the sale of petroleum products produced in Australia. We pay tax in Australia on the profits made in relation to these sales, and this represents more than 95% of taxes Woodside pays globally.

In considering the Australian tax contribution made by Woodside, it is important to recognise that hydrocarbon production in Australia is subject to a complex mix of taxes including income tax, PRRT, and Federal royalties and excise[2].

Woodside is a significant tax payer in Australia. We have paid in excess of $6 billion in taxes over the past five years.

Taxes and Royalties	SUBTOTAL	2015	2014	2013	2012	2011
Corporate Income Tax	3,608	1,050	608	931	555	464
PRRT	570	10	102	79	250	129
Federal Royalties (NWS)	1,400	209	313	317	288	273
Federal Excise (NWS)	766	81	143	178	185	179
Other Taxes[3]	379	68	118	85	58	50
Total	**6,723**	**1,418**	**1,284**	**1,590**	**1,336**	**1,095**

Since 2001, Woodside has paid $2 billion in PRRT alone.

It is also worth noting that in addition to the taxes and royalties outlined above, significant government revenue is generated through jobs created by the oil and gas industry. This includes PAYG tax, which is paid through the lifecycle of project, including during the capital intensive construction phase. Woodside paid wages that generated $1.4 billion in PAYG over the past 5 years.

3.2 Broader contribution

In addition to taxes paid, it is important to have a holistic understanding of Woodside's broader contribution to the economy and community.

Over the last eleven years, Woodside has invested over $29 billion in projects based in Western Australia through capital expenditure.

In 2016, Woodside as operator spent approximately $800 million in wages to our employees.

Woodside has spent $80 million on social investment initiatives over the last seven years. In 2016 alone, Woodside spent over $14.5 million on social contributions in Australia.

Since 2011, Woodside as operator of the NWS Project has spent over $329 million in the City of Karratha on local businesses and local content.

The continued delivery of this level of contribution will be at risk if material changes are made to the current fiscal settings.

[2] Federal royalties and excise applies to NWS, together with PRRT (since 1 July 2012)
[3] Includes Payroll Tax, Fringe Benefits Tax and Carbon Tax

4. PRRT and current environment

4.1 PRRT

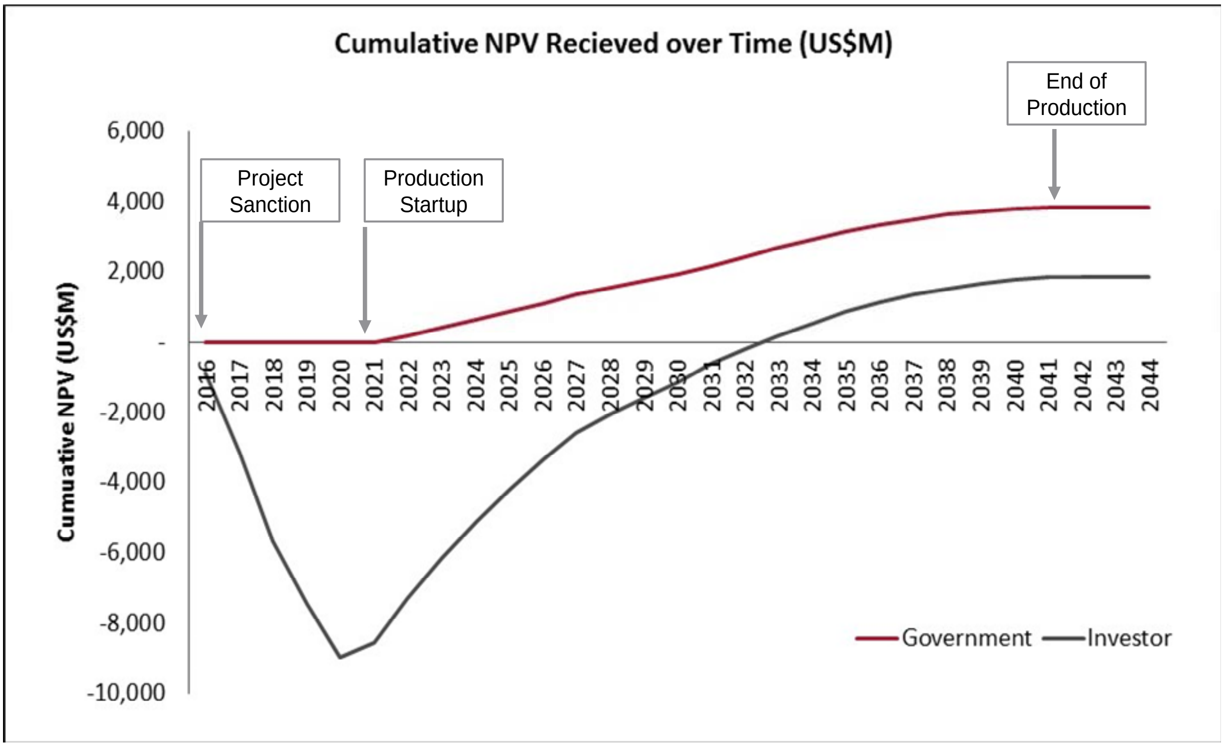
The PRRT has applied to offshore petroleum projects (except for the NWS Project and the Joint Petroleum Development Area in the Timor Sea) since 1987. From 1 July 2012, the PRRT regime was extended to apply to onshore petroleum projects and the NWS Project but not to the Joint Petroleum Development Area.

PRRT is a profits-based tax. The liability to pay PRRT arises when a project has recovered all eligible deductions plus a threshold rate of return. The rate of return feature of the PRRT is designed to allow the project to recover the cost of the capital put at risk. This is because funding costs such as interest are not deductable.

Payments depend on various factors, including market conditions, the magnitude and timing of capital expenditure and the natural lifecycle of petroleum projects. The fact that anticipated PRRT receipts decrease during a period of low prices for hydrocarbon products shows that PRRT is operating as intended, with PRRT logically reducing at times when macroeconomic factors are limiting industry rates of return.

LNG projects are characterised by extreme capital intensity, long development lead times and long production periods. These characteristics result in longer timeframes before economic returns are met. Once PRRT is triggered, the large scale and longevity of LNG projects leads to significant PRRT payments.

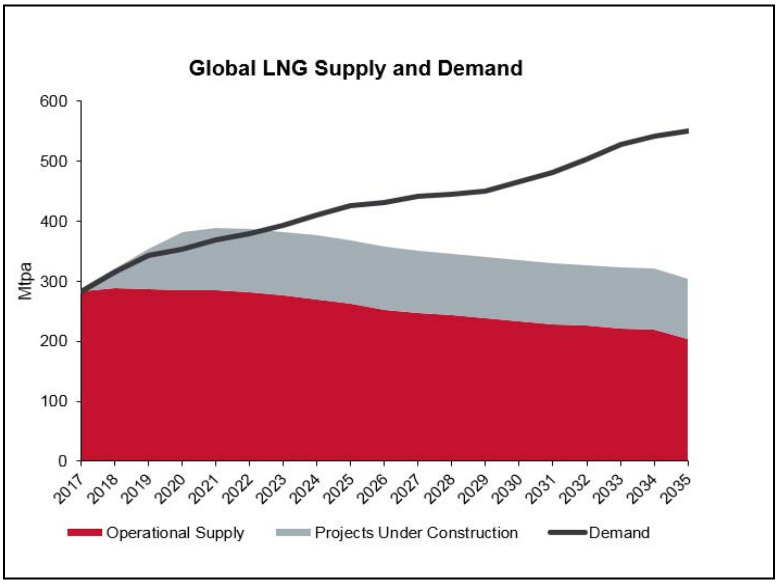
The graph below illustrates the cumulative value distribution progressively derived from a typical LNG project over time. The Australian tax regime enables the government to receive revenue from start-up and extract the majority of a project's value well before the investors have even met their cost of capital. This large capital burden and long lead time result in longer timeframes before economic returns are met. Once PRRT is triggered, the magnitude of LNG projects results in significant PRRT payments.



4.2 Market Conditions

Significant new production in Australia and the US means that the LNG market will be well supplied until the mid-2020s. New supply coupled with weaker demand and new cost-competitive technologies is placing downward pressure on LNG prices. This price reduction is amplified by significant reductions in oil prices, which directly impact LNG prices through contractual mechanisms. These pressures are expected to continue to impact the industry over the medium term. However, new investment in LNG capacity will be required before the end of the decade to avoid the expected shortages.

By ensuring the Australian tax system is set to encourage investment, there is an opportunity for Australia to establish infrastructure to supply into this anticipated shortfall.



Source: Wood MacKenzie

4.3 Investment Criteria

Investors expect Woodside to apply industry-standard processes to investment decisions. Net Present Value (NPV) analysis ensures investors' money is only invested when the project can achieve a market competitive rate of return. Woodside makes investment decisions based on a target of around 12% internal rate of return for LNG projects and around 15% internal rate of return for oil projects.

LNG projects are capital intensive and are very difficult to sanction. This is due to many factors related to significant project execution risk, price risk and reservoir risk. Woodside mitigates these material risks through long term take or pay contracts with premium customers and by linking LNG prices to the oil price. Woodside's focus for LNG projects is on downside protection; potential investments must be able to deliver zero NPV or better at low case assumptions. Woodside is also faced with a higher cost of capital than many of our multi-national competitors.

LNG projects require a great deal of risk to be taken on by the investor. For our large, economic projects in Australia, governments can expect to receive around 70% of total value (NPV). This represents a large amount of total project value, with no associated risk. This percentage of value is derived from a series of taxes including corporate income tax and PRRT.

Woodside and the broader oil and gas industry work within an environment of fluctuations in pricing and global supply and demand. As a business, we have to live with that level of uncertainty. However our investments in Australia have been traditionally supported by a stable fiscal regime. Potential changes to the fiscal regime because of the PRRT Review represent fiscal uncertainty and introduces a new element of sovereign risk to investments in Australia.

Australia's fiscal settings have facilitated significant industry investment during a period of economic uncertainty since the global financial crisis. Any material changes to these settings run the risk of creating additional barriers to continued investment in Australia and significantly reducing the competitiveness of Australia.

5. Woodside's Investment Outlook

As a major Australian listed company, Woodside has more than 210,000 individual investors in Australia, with 80% of our dividends being paid out in Australian dollars. This means that most of the wealth that Woodside generates from our projects stays in Australia. The dividends that Woodside pay are very important to these shareholders and changes to tax rules could result in a negative impact to Australian shareholders.

Woodside has significant investment options on the horizon. These include Browse, Sunrise and Scarborough, three projects that have the potential to deliver material benefits to Australia. Woodside is also pursuing lower capital intensity opportunities and investigating proposals which fully utilise existing infrastructure.

With these three major potential LNG projects in our portfolio, Woodside is materially exposed to any change in PRRT, perhaps more so than any other LNG project participant operating in Australia.

These projects are already challenging in the current economic climate and any adverse PRRT changes would only stifle continued progress. It is critically important that the PRRT Review Team recognise the significant sums from all taxes that these projects stand to deliver to the Government. Australia's fiscal regime should be conducive to Australian investors and encourage further investment.

Woodside wants to continue to invest in Australia and pursue opportunities that will bring significant benefits to the Government and the broader community, but risks driven by fiscal uncertainty and sovereign risk cannot be ignored.

At Woodside, we are expanding our global portfolio, including through development opportunities in Senegal, Myanmar and Canada. These opportunities compete alongside our Australian portfolio for an allocation of capital.

5.1 Browse

The Browse resources are in the Browse Basin, located offshore approximately 425 km north of Broome in Western Australia. The Browse Joint Venture (BJV) participants maintain seven petroleum retention leases under the Offshore Petroleum and Greenhouse Gas Storage Act 2006 (Cth) (OPGGSA), the Petroleum (Submerged Lands) Act 1982 (WA) and the Petroleum and Geothermal Energy Resources Act 1967 (WA).

In April 2013, Woodside announced that the proposed LNG development near James Price Point did not meet the company's commercial requirements.

In March 2016, the floating LNG development concept selected in June 2015 was not progressed due to the current economic and market environment.

The BJV participants are now preparing a new work program for assess and concept select phase activities. It is anticipated that a range of concept options will be considered.

Browse is a very challenging project. Any additional costs incurred, due to changes to current fiscal settings, would make proceeding with the project even more difficult.

5.2 Sunrise

The Greater Sunrise fields were discovered in 1974 and hold gross (100%) contingent resources (2C) of 5.13 Tcf of gas and 225.9 million barrels of condensate (net Woodside share of 1.7 Tcf of dry gas and 75.6 million barrels of condensate).

Woodside and the Sunrise Joint Venture remain committed to developing the Greater Sunrise fields, and consider it vital that both the Timor-Leste and Australian Governments agree the legal, regulatory and fiscal regime applicable to the resource. Once government alignment is established and fiscal stability achieved, the Sunrise Joint Venture believes there is an opportunity to proceed with a development that benefits all parties. The Sunrise Joint Venture continues a program of meaningful social investment via long-term partnerships with the communities of Timor-Leste.

5.3 Scarborough

In September 2016, Woodside acquired half of BHP Billiton's Scarborough area assets in the Carnarvon Basin, located offshore Western Australia.

Under the terms of the Sale and Purchase Agreements, Woodside has acquired a 25% interest in WA-1-R and a 50% interest in WA-61-R, WA-62-R and WA-63-R. Woodside will operate WA-61-R, WA-62-R and WA-63-R. ExxonMobil is the operator of WA-1-R.

The Scarborough area assets include the Scarborough, Thebe and Jupiter gas fields, which are estimated to contain gross 8.7 Tcf of dry gas resources at the 2C confidence level. On completion of the acquisition, Woodside's Best Estimate Contingent Resources (2C) increase by 462 MMboe.

6. Impacts of changes to fiscal settings

Fiscal stability is critical to Woodside's future investment in Australia. Change, and specifically retrospective change to the fiscal regime, particularly during the low price cycle, raises strong doubts about Australia's continued international competitiveness and questions about its level of sovereign risk. Australia has typically attracted investment, in part because of its stable and investment driven fiscal regime.

Woodside rejects so-called reform that applies retrospective changes that will undermine existing investments.

To make changes with retrospective effect will, in Woodside's view, negatively impact Australia's reputation and will support a risk rating closer to those of other resource-rich but capital importing countries. However, many such countries facilitate investment in the resources sector with instruments designed to provide a level of certainty to underpin decisions, such as production sharing contracts or resource development agreements. This allows investors the opportunity to both evaluate and, where appropriate, adopt mechanisms to manage such risk. Such mechanisms are not available in Australia.

Different operators have different exposure to PRRT and changes will not affect operators equally even within the same projects.

Hard lessons have already been learnt from other jurisdictions in which increases in government taxes were legislated. There is research linking the decline in economic activity and the loss of investor confidence in both Alaska and Alberta to adverse changes in taxes specific to the oil and gas industry. Indications from this research are that activity and re-investment decline drastically under repeated action to increase government revenue.[4]

The industry has invested substantially in capital intensive projects in good faith. These investment decisions factored a low risk of adverse retrospective changes to fiscal settings.

Adversely changing those settings after an investment has been committed is an unfair impact altering the risk/return equation for investors. In addition, suggesting PRRT is not working as intended, particularly at a time of low commodity prices, is flawed.

It should also be noted that as a capital importing country changes impacting Australia's competitiveness should be avoided.

Any recommendation for change to the current fiscal settings, particularly any with retrospective effect, will not be supported by Woodside.

[4] Agalliu, I. 2011. Comparative assessment of the federal oil and gas fiscal systems. U.S. Department of the Interior, Bureau of Ocean Energy Management Herndon. VA. OCS Study, BOEM 2011-xxx. 300 pp.

7. North West Shelf Project

The Woodside-operated North West Shelf (NWS) Project has carried a significant taxation burden since the project commenced, paying in excess of $26 billion of royalties and excise, strongly benefiting the Australian community.

Any changes to the current fiscal settings that impact the NWS Project have the potential to negatively impact the Australian economy and future regional jobs related to the project.

For broader commentary on the Woodside-operated NWS Project, Woodside directs the PRRT Review to the NWS Project submission.

8. Conclusion

Returns from the PRRT can only be delivered if resources are developed, so it is vital that the tax regime allows investment in project development, rather than blocking it.

The PRRT is designed to work as part of the overall tax system to facilitate the development of Australia's petroleum resources. It ensures that the Australian people, through the Government, receive significant benefits from income tax receipts from early on in a projects lifecycle, and a substantial share of economic rents earned after the significant capital costs of developing the project have been recovered.

The PRRT is a profits-based tax, so it is unsurprising that tax receipts are lower at a time of low oil and gas prices. It was never supposed to apply until the high costs of development had been recovered and is, therefore, not yet payable on some projects.

This should be viewed as a strength of the PRRT, rather than a weakness; these arrangements have made investment and development possible, with long-term benefits for Australians.

The global abundance of low-cost gas in recent years, most notably from the US, has made the economics of gas projects in Australia more challenging. But global demand is forecast to rise and further investment is needed.

Australia is a leading producer of LNG and should benefit from this projected rise in demand for gas as a safe and reliable energy source. But changing the tax regime now could impede this by blocking new projects and undermining existing investments.

As an Australian company, Woodside pays billions of dollars of taxes in Australia. The PRRT is just one part of our tax contribution but increasing it could put other tax revenues at risk by making future projects unviable.

Woodside has an ownership stake in three of Australia’s major undeveloped gas resources. As the leading Australian gas producer, we want to develop these resources and deliver significant benefits to the Australian people.

We urge the PRRT Review team to consider carefully the substantial impact of any changes to the current fiscal settings that could jeopardise existing and future investments.