

Professor Richard Eccleston and Mr Lachlan Johnson
Institute for the Study of Social Change
University of Tasmania



27th June 2019

Dear Secretary,

As researchers who have published widely on international tax issues we are pleased to make this submission to the Treasury's review of gas transfer pricing arrangements under the Petroleum Resource Rent Tax (PRRT). The views expressed in this submission are ours alone and don't reflect the views of the University of Tasmania.

We concur with the Callaghan Review's finding that the current regulations may be undervaluing gas from vertically-integrated LNG or electricity generation operations. Much-needed reform of current transfer pricing rules has the potential to generate a significant increase in PRRT revenue and boost public confidence in the probity and effectiveness of the system without compromising the sector's competitiveness or investor confidence.

Moreover, a fair and transparent mechanism for allocating profits between upstream and downstream activities within integrated LNG projects would mitigate risk and uncertainty for industry players while simplifying compliance and consolidating public accountability.

The Callaghan Review's finding that reforming the present gas transfer pricing mechanisms could net an additional \$89 billion in PRRT revenue speaks to the magnitude of the existing problem and the potential windfall available to Australian essential service provision. For this reason, this submission enthusiastically supports the proposals set forth by the Tax Justice Network – Australia (TJN-Aus) that the existing method for valuing gas in transfer pricing calculations be replaced by a netback only method as the default approach for current and future LNG projects.

There are a number of reasons why this reform is essential.

First of all, the inability of PRRT revenue to reflect Australia's emergence as one of the world's most important LNG exporters is a significant policy failure. The volume of revenue forgone by the Australian government represents poor value to taxpayers and an unfair return on the exploitation of a commonly-owned resource. This is not true only for PRRT revenue either: unacceptably low corporate income tax receipts from offshore oil and gas projects reflect a similarly compromised value proposition for taxpayers. Furthermore, a transparent gas pricing regime may increase the incentives of LNG multinationals to provide adequate supply to the Australian market.

Second, a lack of transparency undermines the public's ability to judge for itself the probity and value of transfer pricing arrangements. Many of the firms involved in offshore gas exploration and extraction in Australia has a long track record of using transfer mispricing – as well as other aggressive tax planning strategies including thin capitalisation and dubious debt structuring arrangements – to reduce their corporate income tax liabilities in Australia.

The lack of transparency provided by the current GTP regime allows firms the opportunity to employ equally troubling transfer pricing practices for upstream and downstream components of vertically-integrated gas production, with very low visibility to regulators and the public. As is the case with many other multinational tax reporting initiatives such as the Extractive Industries Transparency Initiative, multi-country automatic tax information exchange agreements, and country-by-country reporting, recapturing forgone revenue and restoring public confidence must proceed hand-in-hand with increased transparency.

Finally, we believe, considering the volume of revenue that could potentially be captured by the recommended reforms (some \$3.3 billion annually), that amendment of the mechanisms used to price gas under the PRRT should be relatively easy to implement. We concur with TJN-Aus' submission that adopting a netback-only approach as a default GTP methodology would be consistent with the PRRT's original design principles and is largely a matter of adjusting the existing regulations. As a profit-based alternative to more traditional royalty regimes, the PRRT is especially vulnerable to profit shifting and transfer mispricing by integrated LNG operators and, for this reason, a fair, rigorous and transparent profit allocation mechanism for transfer pricing calculations is essential.

We commend this submission to the committee, and support TJN-Aus' netback only GTP model as a laudable way forward to ensure that taxpayer value in offshore gas projects is maximised and transparency increased.

Once again, we appreciate the opportunity to offer comment on this matter and would be happy to discuss this submission with members of the Committee should they require any additional information.

Yours sincerely,

Professor Richard Eccleston

Lachlan Johnson