DRAFT EXPLANATORY STATEMENT

Issued by authority of the Treasurer

Petroleum Resource Rent Tax Assessment Act 1987

Petroleum Resource Rent Tax Regulations 2023

Section 114 of the *Petroleum Resource Rent Tax Assessment Act 1987* (the Act) provides that the Governor -General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed, for carrying out or giving effect to the Act.

Section 24 of the Act provides that assessable petroleum receipts arising from certain instances of sales gas becoming an excluded commodity in relation to a petroleum project are to be worked out according to the regulation.

The *Petroleum Resource Rent Tax Assessment Regulations 2023* (the 2023 Regulations) reforms the methodology used to calculate the price of sales gas that is processed into liquefied natural gas (LNG), including the advanced pricing arrangement (APA) rules, comparable uncontrolled price (CUP) rules and ensuring that tolling arrangements are expressly captured in the regulation. The *2023 Regulations: Tolling arrangements* insert deals only with reforms in relation to tolling arrangements outlined in Recommendation 8 of the Petroleum Resource Rent Tax: Review of Gas Transfer Pricing Arrangements.

On 2 November 2018, the former Government announced its final response to the Petroleum Resource Rent Tax Review conducted by Michael Callaghan AM PSM (Callaghan Review) in 2017. As part of its response to the Callaghan Review, the former Government asked Treasury to lead a review of the Gas Transfer Pricing (GTP) arrangements (Treasury Review), which determine the value of sales gas for Petroleum Resource Rent Tax (PRRT) purposes in LNG projects. These measures implement recommendations 3, 5, 6, 7, 8 and 11 of the Treasury Review.

The GTP rules are used to determine the arm's length price of sales gas in an LNG project, using one of three methods: APA, CUP or residual pricing method (RPM). Given that the PRRT is a resource rent tax, the pricing of sales gas under the GTP rules should result in the PRRT taxing those resource rents that are properly attributable to the associated petroleum resource. However, the Callaghan review concluded that the GTP rules are complex, opaque and raise issues as to whether the outcome ensures the Australian community is receiving an equitable share from the gas used in LNG projects.

The 2023 Regulations aim to mitigate these concerns by updating the CUP rules to be in line with the OECD guidelines, modifying the APA rules to include principles in agreeing to an APA, and including express rules for tolling arrangements in the RPM calculations. Further amendments to ensure the rent from projects is adequately captured include:

- requiring projects to make an irrevocable election to use the shorter or longer asset life formula;
- equalising the treatment of the notional upstream and downstream entities between loss situations and profit situations; and

- where an LNG facility enters the PRRT regime for the first time for backfill or tolling purposes, the value of the plant for use in PRRT calculations being set to the historical cost of the LNG facility, uplifted by the GDP deflator to the date of first production for PRRT purposes.

The Act does not specify any conditions that need to be satisfied before the power to make the Regulations may be exercised.

The 2023 Regulations are subject to sunsetting and disallowance.

The 2023 Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

The 2023 Regulations commenced on the day after registration.

Details of the 2023 Regulations are set out in Attachment A.

The Office of Impact Analysis has been (OIA) has been consulted and advised that the Gas Transfer Pricing Review has been certified as a process equivalent to an Impact Analysis. The measure has no impact on compliance costs.

<u>ATTACHMENT A</u>

<u>Details of the *Petroleum Resource Rent Tax Assessment Regulations 2023: Tolling Arrangements*</u>

This attachment sets out further details on the *Petroleum Resource Rent Tax Assessment Regulations 2023* (the 2023 Regulations). All references are to the 2023 Regulations unless otherwise stated. References to a 'corresponding provision' are to the corresponding provision in the *Petroleum Resources Rent Tax Assessment Regulation 2015* (the 2015 Regulation).

Changes in this Attachment are limited to provisions in the 2023 Regulations that amend the 2015 Regulation and that relate to tolling arrangements.

Previously, the RPM required a taxpayer to have complete cost information of the operation. If a taxpayer entered into a tolling arrangement in the position of a participant in a source project, which is the project from which petroleum is recovered, that taxpayer could only use the RPM if they had the cost information of the toller facility relevant to the phases covered by the tolling service.

Such cost information related to the historical costs of the construction of the facility that performed the tolling service. Practically, an exchange of such information was unlikely to occur, as source project participants and tollers were often competitors in the same market.

Under the 2023 Regulations, PRRT taxpayers of operations that utilise tolling arrangements that have commercial tolling fees will be able to apply those toll fees to phase costs, the phases of which are covered by the tolling service. In this way, it will not be necessary for taxpayers to have complete cost information in order to calculate assessable receipts in relation to sales gas under the RPM.

Toll fees substitute for costs from the tolling start point to the tolling end point. At the start point, the petroleum changes possession from the source project participants to the toller. At the end point, the petroleum is returned from the toller to the source project participants.

The application of the toll fee to the phases between the start point and end point allows a taxpayer, who pays a commercial tolling fee for another person to, for example, process their sales gas into LNG, to independently apply the RPM and determine their assessable receipts. This is the case even though they do not have complete historical cost information for all phases of the LNG operation.

<u>Part 1 – Preliminary</u>

<u>Division 2 – Definitions</u>

<u>Section 5 – Definitions (Items 1- 30)</u>

The following terms, relevant to tolling, are defined as new or amended terms in the 2023 Regulations:

- 'Commercial tolling fee' is defined in section 18A (see below) (Item 3)
- 'Commercial tolling phase' is defined in section 9A (see below) (Item 3).

- ‘Operating life’ is defined separately for a:
  - relevant GTL operation in subsection 6(8) (subject to subsection 6A(3) (Item 11);
  - relevant GTE operation in subsection 7(8) (subject to subsection 7A(2) (Item 11); and
- ‘Production year’ is defined separately for a:
  - relevant GTL operation in subsection 6(6) (subject to subsection 6A(2) (Item 17);
  - relevant GTE operation in subsection 7(6) (Item 17); and
- ‘Relevant GTE operation’ is defined in subsection 7(1) (see below) (Item 23)
- ‘Relevant GTL operation’ is defined in subsection 6(1) (see below) (Item 23)
- ‘Relevant operation’ means a relevant GTE operation or a relevant GTL operation (Item 23).
- ‘Source project’ means, in relation to a relevant operation, the petroleum project from which petroleum is or will be recovered in the relevant operation (Item 25).
- ‘Taxpayer’, in relation to a relevant operation, means a person:
  - who holds an interest in the operation that entitles the person, at the end of at least one phase to:
    - : petroleum product of the operation, other than petroleum product that is destroyed, used as fuel or otherwise consumed in the operation; or
    - : electricity produced in the operation; and
  - whose assessable petroleum receipts in relation to sales gas from the operation are to be worked out under the 2023 Regulations because of section 19 or 20 (Item 27).

Consequential amendments are made to the following definitions to reflect the change from integrated to relevant operation:

- ‘Actual mass of project natural gas’ (Item 1)
- ‘Actual volume of project natural gas’ (Item 2)
- ‘Downstream stage’ (Item 4)
- ‘Estimated average annual mass of project natural gas’ (Item 5)
- ‘Estimated annual average volume of project natural gas’ (Item 6)
- ‘Expected operating life’ (Item 7)

- ‘Mass coefficient’ (Item 9)
- ‘MPC production year’ (Item 10)
- ‘Operating life’ (Item 11)
- ‘Participant’ (Item 12)
- ‘Phase’ (Items 13-14)
- ‘Phase Cost’ (Item 15)
- ‘Production date’ (Item 16)
- ‘Project electricity’ (Item 18)
- ‘Project liquid’ (Item 19)
- ‘Project natural gas’ (Item 20)
- ‘Project product’ (Item 21)
- ‘Project sales gas’ (Item 22)
- ‘RPM price’ (Item 24)
- ‘Start date’ (Item 26)
- ‘Volume coefficient’ (Item 28)

<u>Sections 6, 7, 8-11, 13, 14-17, 19, 20, 22, 25-27, 29, 30-33, 35-38, 45, 46, 50 and 52 – When a relevant integrated operation exists (Items 29-31, 33-35, 37-42, 45, 47-51, 53-58, 60 -73, 75-79, 81-83, 85-86, 88-94,and 98-102)</u>

In various provisions, ‘integrated’, wherever occurring in the 2015 Regulation, is replaced by ‘relevant’ in the 2023 Regulations to accommodate tolling arrangements.

<u>Section 6A – Relevant GTL operation where there is a tolling arrangement without a commercial tolling fee (Item 32)</u>

Section 6A defines certain terms relating to a relevant GTL operation in which there is a tolling arrangement without a commercial tolling fee.

The production year for a relevant operation in which there is a tolling arrangement without a commercial tolling fee is the year of tax when sales gas of the source project is first processed into liquefied product, unless an election is made under section 50, in which case the production year is the 2012-23 year of tax.

The operating life of a relevant GTL operation in which there is a tolling arrangement without a commercial tolling fee begins with the production year. The end of the operating life of such an operation is the latest of:

- the end of the expected operating life of the operation

- if the toller is a participant of another relevant GTL operation and carries out an action in subsection 8(1) or (2) in that operation, the last year of tax for that person in relation to the other relevant GTL operation in which petroleum was, or is intended to be, processed into liquefied product.
- the last year of tax in which the tolling arrangement is in effect.

The definitions for production year and operating life continue to apply to the relevant GTL operation even if there is no longer a tolling arrangement without a commercial tolling fee.

<u>Section 7A – Relevant GTE operation in which there is a tolling arrangement agreed without a commercial tolling fee (Item 36)</u>

Section 7A defines certain terms relating to a relevant GTE operation in which there is a tolling arrangement without a commercial tolling fee.

The operating life of a relevant GTE operation in which there is a tolling arrangement without a commercial tolling fee begins with the production year. The end of the operating life of such an operation is the latest of:

- the end of the expected operating life of the operation
- if the toller is a participant of another relevant GTE operation and carries out an action in subsection 8(1) or (3) in that operation, the last year of tax for that person in relation to the other relevant GTE operation in which petroleum was, or is intended to be, consumed in the production of electricity.
- the last year of tax in which the tolling arrangement is in effect.

The definitions for production year and operating life continue to apply to the relevant GTE operation even if there is no longer a tolling arrangement without a commercial tolling fee.

<u>Section 9 - (Items 43-51)</u>

Amendments to this section introduce additional phase points for a relevant operation.

There is a phase point if there is a change in possession of the project product, from source project participants to toller and vice versa, at any point in the flow of the project product through the operation, and the change occurs for the purpose of carrying out one of the actions in section 8. Therefore, at the point where the project product moves from the possession of the participant to the toller, there is a phase point, and at the point where the project product is returned to the possession of the participant, there is a phase point.

Consequential changes are also made to this section to accommodate relevant operations.

<u>Section 9A – Commercial Tolling Phases (Item 523)</u>

Section 9A introduces commercial tolling phases.

For a relevant operation that has a tolling arrangement, there may be a phase point taken to occur between the start point (the change of possession of project product from source project participant to toller) and the end point (the return of project product from the possession of toller to source project participant), being the phase point between the upstream and downstream stages (the stream change point). There may, alternatively, be no phase point taken to occur between start point and end point if the tolling services occur entirely within either the upstream or downstream phases.

If there are no phase points between the start point and end point, then there is a single phase, called a commercial tolling phase. If there is a phase point between the start point and the end point, then there is a phase between the start point and stream change point, and between the stream change point and end point. These phases are called commercial tolling phases.

Section 18A – Commercial tolling fee (Item 59)

Section 18A defines a commercial tolling fee.

A commercial tolling fee must meet several criteria. The fee must be paid in consideration for the carrying out of one or more actions in section 8. The actions must be carried out in relation to petroleum of a source project of a relevant operation.

Additionally, the fee must be paid under a tolling arrangement. The parties to the tolling arrangement must be participants in the relevant operation and one or more people. The one or more people who are party to the tolling arrangement, in addition to the participants in the relevant operation, cannot be participants in the relevant operation or, if they are, must be parties to the arrangement both in their capacity as participants in the relevant operation and in another capacity. For example, they could be participants in their capacity of another relevant operation, the facilities of which are used to carry out the action or actions under the tolling arrangement.

Finally, the fee must be a reasonable arm's length price having regard to the entire commercial context of the tolling arrangement, including the following factors:

- functions performed by the parties
- assets used by the parties;
- risks borne by the parties;
- characteristics of the services provided;
- terms of any relevant contracts between the parties;
- economic circumstances;
- business strategies of the parties to the tolling arrangement.

The entire commercial context of the tolling arrangement is taken into consideration because the tolling fee may comprise a small part of the commercial transactions between the source project participants and toller.

It may be the case that the toll fee, in isolation, is not a commercial rate, and that the source project participants, for example, pay less than a commercial rate for the actions the toller performs. This may occur if, in other contracts between the parties, the price of the toll fee is offset with the price for other goods and services exchanged between the parties. Such a toll fee would not be a commercial tolling fee, and the source project participants would instead use cost information in the RPM to determine the value of their assessable receipts.

Part 4 – The residual pricing method

Division 1 – The residual pricing method

Section 29 (Items 73-74)

Section 29 is amended to incorporate tolling arrangements by specifying that the cost-plus, netback and RPM prices are calculated with either information about the direct costs of the operation or a commercial tolling fee.

These amendments allow the RPM to be used even if the taxpayer does not have all direct cost information associated with the relevant operation, if the taxpayer has entered into a tolling arrangement under which a commercial tolling fee is or will be paid. Where this is the case, the taxpayer must have access to the cost information up to the starting point, from the end point, and the amount of the commercial tolling fee.

Consequential amendments are made to this section to accommodate concepts of relevant operation and commercial tolling fee.

Division 2 – Identifying and classifying included costs

Section 31 (Items 77-82)

This section is amended to accommodate tolling arrangements.

These new provisions apply if

- a tolled cost is incurred in carrying out an action or actions in section 8 in relation to source project petroleum of the relevant operation; and
- a payment or allowance is paid by or on behalf of participants in the relevant operation in consideration for the action or actions; and
- information about the tolled cost is not available to the taxpayer.

If the payment or allowance is a commercial tolling fee, then the payment or allowance is a cost associated with the relevant operation, and the tolled costs are not costs associated with the relevant operation.

If the payment or allowance is not a commercial tolling fee, then the payment or allowance is not a cost associated with the relevant operation, and the tolled costs are treated as a cost of the relevant operation and incurred by the participants in the relevant operation.

Section 32 (Items 83-87)

This section is amended to add an exclusion from the costs of a relevant operation.

Subsection 32(2) clarifies that there cannot be double-counting of costs, even though infrastructure may be used in multiple operations. The value of each cost associated with a particular asset that is able to be applied does not change or increase because the asset is used in another relevant operation.

Division 4 – Accounting for multiple use of a phase

Section 43 (Items 95-97)

This section is amended so that the calculation of an energy coefficient does not apply to a phase cost of a commercial tolling phase.