

24 April 2013

Mr Gerry Antioch
General Manager
Tax System Division
The Treasury
Langton Crescent
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Dear Mr Antioch

Improving the Transparency of Australia's Business Tax System – Comments on April 2013 Discussion Paper

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body representing Australia's oil and gas exploration and production industry. APPEA has more than 80 member companies actively exploring for and/or producing Australia's oil and gas resources. These companies currently account for around 98 per cent of Australia's total oil and gas production and the vast majority of exploration. APPEA also represents over 250 service companies providing a range of goods and services to the industry. Further details about APPEA can be found at our website at www.appea.com.au.

APPEA welcomes the opportunity to provide comments on the Discussion Paper released in relation to improving the transparency of Australia's business tax system.

General Comments

APPEA and our member companies are broadly supportive of the principle of transparency around the tax compliance of companies in the industry. Many entities already publish tax payment information. However in its present form, the proposal will effectively create a dataset where very selective information will be reported for companies that are operating within a dynamic business environment.

Undertaking business activities in a global context is highly complex. This is particularly the case for oil and gas companies. The complexities of dealing in multiple cross-border jurisdictions necessitate complex business arrangements and structures. Statements that complex arrangements result in tax avoidance or that tax collected is less than a 'fair share' are oversimplifications and will possibly only further reduce public confidence in the corporate tax system.

Taxpayer Transparency

While the industry broadly supports processes to increase the awareness of the contribution made by the industry to the economy in terms of taxation payments and resource charges, the approach outlined in the Discussion Paper does not serve that objective. Its sole focus on direct taxation payments will provide little assistance in



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observers making informed judgements about the contribution and activities of individual taxpayers (see further comments below). In addition, the release of information from a number of companies in the industry that are effectively ‘single project entities’ will present commercial sensitivities due to identification of individual project metrics. As an extension of this concern, it will potentially create complexities within joint ventures, where the size of interests can vary within individual projects, and where some companies may be captured by an arbitrary threshold, while others may not.

Federal Budget

APPEA has been a long term advocate of the need for the community to be aware of the taxation contributions made by the industry. A key output of the annual survey of the financial performance of the petroleum industry undertaken by APPEA is an aggregation of the total payments made by the industry, broken into the categories of company tax, petroleum resource rent (PRRT) and other resource taxes (petroleum royalties, production excise and other resource taxes). The survey has been undertaken since 1987-88, with all results being publicly released.

Historically, the quantum of resource taxation payments made by the industry in the form of federal petroleum royalties, crude oil production excise and PRRT was published in the annual budget papers. However, federal petroleum royalties and crude oil production excise collections are effectively no longer disclosed in budget. In addition, and of more recent times, the quantum of PRRT payments has not been disclosed, instead being aggregated with mineral resource rent tax (MRRT) payments.

APPEA does not support the aggregation of MRRT and PRRT payments. We would rather see the aggregated disclosure of the total quantum of petroleum resource charges (PRRT, production excise and federal royalties) in the annual budget papers as a single line item to more accurately reflect the resource charge contribution made by the sector to the Federal Government.

Cost of Compliance

The comment that all information would be able to be obtained from tax returns and therefore there will be ‘no additional compliance costs are placed on taxpayers’ is misleading. Any anomalies from amounts reported or understanding of the genuine tax position of a company will need to be explained by taxpayers to the public or through any process of parliamentary scrutiny, which would by its very nature result in significant compliance costs.

Tax Expenditure Estimates

A related matter is the current process for the release of annual tax expenditure estimates by Treasury. There is a growing concern in relation to the lack of rigor and transparency of the processes associated with calculating tax expenditure estimates. For example, a number of estimates generated for key revenue items either fail to articulate any appropriate benchmarks that are used to ascertain an estimate (in the case of the immediate deductibility of exploration costs for income purposes) or use assumptions that seem at odds with real world practice (e.g., the use of the long term bond rate as the rate to reflect risk in investments in oil and gas operations for benchmarking the operation of the PRRT). APPEA recommends that a review (as a matter of priority) is commenced into processes for the calculation of tax expenditure estimates.

Perceptions about the Tax System

As a result of the above, the proposed reporting could potentially create negative community sentiment that the tax system is not fair (when it is fact operating as intended) and could therefore have the opposite impact of the intent of the broader proposal.

Specific Comments on the Discussion Paper

Reporting at the Australian Business Number (ABN) Level

For a number of commercial reasons, companies may choose or indeed may be required to undertake their project related activities using different ABN's. Any reporting should aggregate activities to the Group level for the relevant entity.

Taxpayer Threshold

The taxpayer threshold of \$100 million per annum in the oil and gas industry is considered too low. There are in excess of 20 companies with interests in oil and gas projects in Australia that would exceed this threshold, many of which are Australian based companies. We note the clear implication in the Assistant Treasurer's Media Release is for the application of the obligation for the reporting of tax paid to apply to large multinational companies:

“Large multinational companies that use complex arrangements and contrived corporate structures to avoid paying their fair share of tax should not be able to hide behind a veil of secrecy”;

In the context of the development of the details of the policy, an objective is:

“how the policy could best be designed to cover large and multinational businesses, including whether a threshold test would be appropriate;”

We therefore believe that a higher threshold that more realistically reflects the size of operations undertaken in the oil and gas sector would be more appropriate. This could be set at \$500 million per annum.

Furthermore, we note the following statement on page 8 of the Discussion Paper in regard to what constitutes “total income”:

“Although the concept of an entity’s ‘total income’ is not defined in the tax laws, it is envisaged that the Commissioner would use the information currently disclosed by corporate tax entities at question six of the company income tax return. This question aims to identify the entity’s total gross income for accounting purposes. As such, total income may include amounts of exempt income, non-assessable and non-exempt income and foreign source income. It may also include extraordinary amounts of revenue such as net domestic or foreign source gains arising from events outside the ordinary operations of the entity. This means that an entity’s total income is broader than the taxation concepts of ordinary income and statutory income, as referred to in section 6-1 of the Income Tax Assessment Act 1997. It is also broader than common notions of an entity’s turnover.”

If the objective of the policy is to ensure that large companies are paying their ‘fair share of tax’, then the inclusion in the definition of “total income”, of ‘income’ that is outside the scope of the ordinary meaning of income and statutory income seems at odds with this objective.

Context of Reportable Data

In large scale capital intensive industries, there is often a considerable time lag between projects expenditures/construction and the derivation of a project’s initial cash flows. This is further exacerbated where companies are required to undertake extensive exploration programs to prove-up reserves of oil and/or gas. The reporting of nil taxation payments where a taxpayer is utilising carry-forward tax losses is likely to lead to inaccurate perceptions of the effective tax rate of entities. This is because the disclosure proposals do not adequately address the impact of carry-forward tax losses.

This issue would also be exacerbated by the process of only reporting for years where an entity reports total income over the threshold. That is, the years where taxpayers generate operating losses (and therefore tax losses) would not be visible to the public. However, future years where income increases above the threshold would be reported, although it is possible that a lower taxable income will be reported due to the utilisation of tax losses incurred in prior periods. From the reporting by the Commissioner, it would simply look as though the entity has a low effective tax rate. The outcome is that the provision of such information is more misleading than being informative.

Furthermore, there could also be unintended confusion where corporate groups are comprised of multiple taxpayers, especially where headline profits from ASX or

other reporting are used as a comparison to the information disclosed by the Commissioner.

Reporting of PRRT Data

As indicated above, APPEA has significant concerns with the reporting of data that can effectively attribute the amount of tax paid to individual 'projects'. This can have significant commercial ramifications for entities involved in individual projects. Furthermore, the reporting of PRRT at the ABN level as proposed on page 9 of the Discussion Paper further exacerbates this concern where an entity is involved in a number of PRRT projects, but where those activities are undertaken through entities with separate ABN's. As indicated above, any reporting should be at a Group Entity level.

In addition, the payment of PRRT by one participant in a project can be very different to the payment by a separate entity in the same project due to a number of very valid reasons. For example, the exploration transferability provisions can see different PRRT liabilities being incurred by different project participants. Again, without the necessary context, the release of such information may be extremely misleading.

At an interpretive level, a number of additional aspects of the reporting of PRRT data need to be clarified. The Discussion Paper refers to the reporting requirements associated with entities that have PRRT 'payable' in a year. This needs further clarification - in particular, whether this means a project that has assessable income in a year; whether it relates to project with a PRRT liability prior to the deductibility of transferable expenditure; or whether it simply applies to companies that make an actual payment at the conclusion of the PRRT period.

Overall, while the industry is broadly supportive of increasing the transparency of the sectors contribution through taxes and resource charges, the current proposal contains a range of practical difficulties that would raise serious questions about the accuracy and meaningfulness of the material that would be published by the Commissioner.

Please contact Noel Mullen in the APPEA Secretariat (nmullen@appea.com.au) if you wish to discuss any matters raised above in further detail.

Yours sincerely



David Byers
CHIEF EXECUTIVE