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Consultation Paper: Options to address the design issues identified in the Petroleum Resource Rent Tax Review

Australia Pacific LNG Pty Ltd ('APLNG') welcomes the opportunity to provide comments to Treasury on the 30 June 2017 Consultation Paper ('the Paper'), which canvasses issues associated with the design of the Petroleum Resource Rent Tax ('PRRT') as described in a report by Michael Callaghan AM PSM on 28 April 2017 ('Callaghan Review'). In relation to resource taxation policy, APLNG supports a stable, fair and transparent fiscal regime that takes into account both the high costs of developing Australia's remote resources and the long-term benefits which arise from their development.

The Treasury Paper seeks feedback on 35 questions, covering a wide range of issues arising from 12 recommendations made in the Callaghan Review. These questions have been addressed in some detail in a submission on the Paper by industry body Australian Petroleum Production & Exploration Association ('APPEA'), and APLNG supports and endorses that submission. In addition to its support for APPEA's submission, APLNG asks that Treasury consider specific concerns it has with two of the recommendations in the Callaghan review, which will be particularly problematic if implemented without proper consideration.

Recommendation 1: An updated PRRT regime should be developed and applied to new projects (as defined in the PRRT legislation).

A PRRT project is defined in the PRRT Act as a Production Licence ('PL'), which means that, under Recommendation 1, any PL granted after a certain date may be considered a "new project" and subject to a new PRRT regime. Question 29 in the Paper asks "whether there are any unintended consequences arising from having the new regime apply only to projects that have their production licence come into force after any amendments to the PRRT regime commence". The short answer is yes, there are significant unintended consequences for producers with existing projects, where the investment in those existing projects was made in anticipation of a stable fiscal regime that would also apply to new PLs deriving from existing acreage that would otherwise be incorporated into a larger combined project.

Consider, for example, that at 31 December 2016 APLNG had applications for 18 PLs underway, as well as applications for a range of retention leases (from which an application for additional PLs will be made at some point in the future). Under the current PRRT regime, each of these future PLs will meet the criteria for combination with APLNG's existing PRRT projects, and will be combined for PRRT and managed as part of a pre-existing single commercial enterprise. To be clear, these new PLs are not new projects from a commercial perspective. Each PL will be directly derived from acreage (eg an Authority to Prospect, being exploration tenure) that has been held for many years by APLNG, and exploitation of the reserves has already been factored into the development planning and management of APLNG's operations. The fact that a large number of future PLs are expected and will be being incorporated into an existing project, is a very common occurrence in onshore petroleum developments and, particularly, in the CSG industry.

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APLNG's shareholders made significant investments in APLNG prior to the extension of PRRT onshore from 1 July 2012, and these investments were protected against the extension of PRRT by way of a starting base amount that would be deducted before any PRRT is paid. On page 28 of the Paper, Option 1 and 2 canvass circumstances where "new" projects should either be prevented from combining with existing projects, or combination allowed only if the new PRRT regime is to apply to the entire combined project. With respect, these options would force APLNG to either leave new PLs stranded and not combined with APLNG's existing PRRT projects (i.e. and those new PLs would receive no benefit from the starting base in the primary PRRT project), or to surrender the fiscal regime provided to existing projects when the PRRT was extended onshore on 1 July 2012. This choice represents a significant retrospective change to the fiscal regime that currently applies to APLNG's operations, and significant sovereign risk impact for APLNG's shareholders who made commercial investments even prior to 1 May 2010, when the changes to the PRRT were first announced.

In summary, it would be inappropriate to treat these newly issued PLs as separate projects (with potentially no PRRT starting base protection), as the reserves contained in these PLs were factored into investment decisions made prior to the extension of PRRT onshore, and a stable fiscal regime is required in order to generate a return to cover those up front investments.

On Recommendation 1, APLNG supports APPEA's proposal that PLs which have already been applied for, or which meet the existing criteria for combination with existing PRRT projects, should not be considered new PRRT projects.

Recommendation 2: Integrity measures should be introduced and apply to all PRRT projects, to prevent the combination for PRRT purposes, of new PLs that do not have a PRRT starting base, with those that do.

The Callaghan Review considers that some project proponents are avoiding PRRT liabilities by combining new PLs that have no PRRT starting base with others that do have a PRRT starting base. The proposed solution is to restrict the combination of projects that do not have a PRRT starting base, with those that do have a starting base. Question 33 in the Paper asks whether there are any unforeseen consequences of implementing recommendations 2 through 12. The answer in relation to Recommendation 2 is yes, as APLNG considers that this Recommendation 2 has significant adverse consequences for existing project proponents.

At issue here is that 100% of the PRRT starting base will attach to the first PL granted from a permit, and any subsequent permits granted from that same permit will have no PRRT starting base. The proposed restriction in Recommendation 2 would mean that no subsequent PL can be grouped with the first PL from a tenement, even where all the PLs are operated as a single commercial enterprise. For example, it is common onshore in the coal seam gas industry for multiple PLs to be granted out of a single exploration permit, but the feedstock from all the PLs is incorporated into one large commercial enterprise.

Restriction on the combination of these subsequent PLs where they are operated as part of one large commercial enterprise, would be a retrospective change in the operation of the PRRT regime. Subsequent PLs would be stranded without the benefit of any PRRT starting base shield, which was never intended when the PRRT was extended onshore. The starting base was provided to existing project proponents to shield those existing investments from the impact of PRRT, and not to shield only the first PL granted from each tenement. This integrity measure has the potential to materially impact the economics of any subsequent PL granted from a permit, and may limit future investment and the ability of producers to bring new resources to market.

A second issue of concern is that when onshore producers transitioned acreage into the PRRT regime on 1 July 2012, three methods were provided to producers as options for calculating a shield against the PRRT, being (a) the look back method, (b) market value method and (c) the book value method. Under the PRRT, the market value method will produce a PRRT starting base amount, but the look back method is not technically considered to be a "starting base" for PRRT purposes (although similarly to the starting base, this method also provides a shield for the producer against the PRRT). APLNG elected to use the market value method to determine its PRRT starting base, and submits that Recommendation 2 would discriminate between producers such as APLNG who elected to use the market value method, and those who did not. For example, producers with

existing acreage at 1 July 2012 who elected to use the look back method for determining their PRRT tax shield, would never be prevented under Recommendation 2 from combining new acreage for PRRT purposes. This outcome arises on the basis that to the extent those producers used the look back method, neither their existing acreage, nor any new acreage, would contain any PRRT starting base.

We suggest that if there is a concern regarding some project proponents avoiding PRRT liabilities through particular actions, then this concern is best addressed through the anti-avoidance measures that are contemplated in Recommendation 12. Recommendation 2 is a specific integrity measure, and as such is really a subset of the broader range of anti-avoidance measures contemplated in Recommendation 12. APLNG supports Recommendation 12, and does not see any need for an additional integrity measure such as that outlined in Recommendation 2, which as we have described above has the potential for unintended outcomes and discriminatory impact between producers.

General comments in relation to a new PRRT regime for new projects.

APLNG supports APPEA's submission that the design of the PRRT is a complete package and changes to its components should not be made in isolation. Consideration should also be given, in the design of any resource taxation regime, to the fact that onshore projects are already subject to substantial state and territory royalty regimes, which work to offset and limit the impact of federal taxes such as PRRT.

One key change being considered in relation to new PRRT projects, is the method of calculating the gas transfer price in a vertically integrated gas to liquids project. On this issue APLNG supports APPEA's suggestion that the measures are complex and the timeframe allowed for considering any amendments is inappropriate. The use of a comparable uncontrolled price ('CUP') is preferable to value LNG feedstock, but CUPs are notoriously difficult to identify, particularly with very large projects where the availability of genuinely comparable circumstances and prices are few, if any. In relation to advance pricing agreements ('APAs'), in APLNG's experience it is not always possible to obtain an APA, as the process requires the sustained commitment of resources by both the producer and the ATO. In a vertically integrated project, in the absence of a CUP or an APA, the PRRT Regulations ('RPM') can be used to determine the price of LNG feedstock. The Paper provides a discussion of several aspects of the RPM calculation, and on this point, in particular, APLNG considers that the timeframe for consultation on such a complex issue is far too short. APLNG notes that the design of the RPM and in particular its application to the onshore industry has been reviewed and reconsidered in recent times as part of the extension of PRRT to the North West Shelf and onshore projects. In consultation with the petroleum industry at the time, the Government introduced, on 28 June 2013, a revised set of rules in relation to the RPM that we consider are still appropriate for the industry today.

The purpose of the revised RPM introduced in 2013 was to adapt and extend the existing framework (introduced in 2005) to ensure it took into account differences in the structure and operations of onshore integrated operations. It was also considered at the time that taxpayers should have an election to apply the RPM as a default method in order to provide certainty regarding the application of the PRRT Act to such operations, particularly for transitioning projects. In our view, circumstances have not significantly altered since this time that would warrant fundamental changes to this regime. However, APLNG would like to draw Treasury's attention to one aspect of the RPM that is discussed in the Paper, being the 50/50 profit split.

APLNG supports the statement in APPEA's submission, that events surrounding the development of the Coal Seam Gas to LNG industry on the east coast of Australia, support a 50/50 split of project profit as being appropriate for even the most recent LNG project developments. The circumstances are that the entities which discovered and initially developed the CSG reserves, were unable to bring those reserves to market without the assistance of large multinational companies with an established LNG liquefaction and marketing capability.

The difficulty faced by the upstream producers is that there was no domestic market for the large volume of gas identified, and it was not until international partners arrived with downstream liquefaction expertise and the experience and reputation required to engage in LNG marketing, that those CSG reserves became marketable as exported LNG. It is a reasonable conclusion that the upstream and downstream parties each needed the skills and resources of the other to bring the

reserves to market, and this symbiotic relationship would be reflected in an equal 50/50 sharing of the risks and rewards of the joint venture as a whole.

Other administrative issues to be addressed – 90 day time limit for PRRT combination applications

We have discussed above the fact that onshore projects will often have a range of additional PLs that will be granted over time and incorporated into a project. The administrative difficulty is the constant vigilance required in relation to the 90 day time limit that is allowed for an application to be made for a PRRT combination certificate. If the time limit is missed, then the consequences can be dire with that additional PL becoming stranded for PRRT purposes. APLNG suggests that the need for a 90 day time limit for PRRT combination certificate applications is dubious, and that this requirement should either be extended or, preferably, removed in its entirety.

We are happy to discuss any of the above matters in more detail, I would be grateful if you would please contact, in the first instance, Mr Dan Clancy, Group Manager Indirect Tax on (02) 8345 5380.

Yours sincerely,

Mark McCabe
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