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Richard J Owen
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Manager, Large Corporates Unit
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The Treasury
Langton Crescent
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By email: prrt@treasury.gov.au

Dear Mr Francis

ExxonMobil Australia welcomes the opportunity to provide input to the *Options to address the design issues identified in the Petroleum Resource Rent Tax review – Consultation paper* (the 'Paper').

By way of background, the PRRT regime was first applied to the Gippsland Basin Joint Venture (whose participants are affiliates of ExxonMobil Australia and BHP respectively) in 1990. Since that time, in respect of its share of revenues from the joint venture, ExxonMobil Australia has submitted more than $12 billion in PRRT payments to the Federal Government. This equates to almost half a billion dollars from ExxonMobil Australia each and every year for almost a quarter of a century. This provides a significant return to the community, through direct PRRT payments, but also through the less tangible benefits such as employment, a reliable and domestic source of energy, and the associated industries spurred by oil and gas.

At the same time, the PRRT regime has operated effectively in that it has not obstructed ongoing investment in the Gippsland Basin Joint Venture, with two new generations of platforms coming online since the regime was introduced.

The *Petroleum Resource Rent Tax Review – Final Report* (the 'Review') notes that:

> *"…the petroleum industry faces considerable uncertainty in project planning and execution. Possible changes to oil prices, exchange rates, costs of production and production volume are among the many risks that need to be addressed. Also influencing investment decision is Australia's high cost structure. Given such influences, stable fiscal settings are important for companies planning long-term petroleum investments."*

Against this background the Government needs to be cautious about making significant changes to a regime that has been proven to be effective over the long-term, but is experiencing a short-term revenue reduction due to recent declines in resource prices and the lag between the start-up of projects and commencement of PRRT payments that is inherent in the design of PRRT.

Although the Paper details a range of issues for public comment, ExxonMobil Australia does not propose to respond to each one, but rather only to those that are of direct interest to our operations. ExxonMobil Australia also participated in the preparation of the Australian Petroleum Production and Exploration Association (APPEA) submission and supports its recommendations.

Gas Transfer Price

In ExxonMobil Australia's 9 March 2017 submission to the Review it cautioned against the Government making changes to the PRRT that could make Australia less favorable as an investment destination, as investment decisions are based not only on market dynamics and resource quality, but also the regulatory and fiscal regime.

The Residual Pricing Method (RPM) 'transfer price' mechanism is not overly complex, nor is it opaque. It is well understood by industry participants, and the Australian Taxation Office (ATO) – a body that actively enforces on behalf of the Australian community its power and capacity of oversight and adjustment.

The RPM is based on arm's length principles. It starts with the achieved sales price of gas for Liquefied Natural Gas (LNG) and makes adjustments to determine a notional sales price at the point of taxation for sales gas subject to the regulations. This mechanism provides a Comparable Uncontrolled Price (CUP) for the specific sales gas under examination.

In contrast, the proposed 'notional or proxy CUP' is not a CUP that accords with the arm's length principle. Furthermore, such a mechanism would introduce the risk of over-taxation of some taxpayers whilst under-taxing others with the associated fiscal uncertainty likely to further discourage investment in marginal or semi-marginal projects.

The Paper suggest that consideration could be given to 'compensating' adjustments for over-taxed taxpayers – but this of course does not compensate the community for under-taxed projects nor the economic loss (in the form of lost jobs, growth, and other taxes) for marginal or semi-marginal projects that may have otherwise gone ahead with a more certain and stable fiscal regime.

The existing 'transfer price' mechanism was development by Government after extensive consultation and provides a good proxy for 'market value' or a CUP at the point of taxation.

ExxonMobil Australia is concerned that the limited review being conducted by Treasury risks overturning a readily understood and workable system that contributes to fiscal stability in Australia, but without any clearly discernible benefits. This is contrary to the Review's recommendation that substantial changes should be the outcome of a considered, comprehensive and consultative process. On this basis ExxonMobil Australia recommends that Treasury extends the time for review to allow meaningful consultation on this important aspect of the PRRT settings.

Other PRRT Settings

The Paper states that the "*Review considered that the uplift rate should be changed for all deductible expenditure*". With respect, this overstates the recommendations of the Review which stated that changes should be "considered" without expressing a definitive view on the matter.

The PRRT is a tax on ‘economic rent’ with uplift rates on un-recouped carried forward losses part of the design mechanism to identify the ‘rent’. In economic theory, when the rate of uplift is set appropriately, Government can impose a high rate of taxation whilst still attracting investment in the relevant industry. The rate of uplift on un-recouped carried forward losses and the rate of PRRT are therefore linked by design. This has been recognised when setting the current uplift rates and rate of taxation.

What is relevant is whether or not the settings of the tax reveal the ‘economic rent’ of the petroleum project. If the settings render to PRRT the ‘normal’ return of investment, these settings will discourage investment and they will have failed in an important objective. The Long Term Bond Rate (LTBR) + 5% for the 2016 PRRT year was 7.61%. The Total Return for the S&P/ASX 200 for the 2016 year was 11.80% (11.81% for the five years to 2016). A before tax return of LTBR + 5% (or even LTBR + 7%) is a comparatively modest return for the risk undertaken by investors in petroleum projects and does not indicate a ‘super’ profit or ‘economic rent’.

Without anything additional, a reduction in augmentation rates below existing levels exposes more of the ‘normal’ profit of investing in Australian petroleum industry to a comparatively penal 58% effective tax rate and is likely to discourage investment in marginal and semi-marginal petroleum projects. If the Government reduces these settings, it should reduce the rate of PRRT to reflect the fact that it is no longer identifying and taxing the ‘economic rent’ (the excess returns necessary to attract investment into the petroleum industry) of projects. Failure to do so risks further discouraging future investment into the Australian petroleum industry.

Transferability of exploration expenditure was introduced in 1991 to overcome the distorting effect of ring-fenced deductibility for exploration. Transferability was predicated upon encouraging the broadening of the exploration effort to frontier areas. The quid pro quo for this change was a reduction in the uplift rate on general expenditure to LTBR + 5%. Changes to the PRRT settings to remove transferability or to reduce the uplift rate on transferred expenditure risks discouraging future investment in exploration at a time when exploration expenditure in Australia is at a low point.

The Review recommended that any major changes to the settings of the PRRT should only apply to new projects. ExxonMobil Australia has made, or has committed too, significant investments in existing exploration permits and retention leases that are intrinsically linked and likely to be combined with existing PRRT projects if they advance to production. This includes investments in both the Gippsland Basin and the greater Gorgon area.

Any decision by the Government to change PRRT settings for existing permits and leases (including by changing the rules for combination) may discourage further investment in these projects and risk the supply of oil and natural gas, and associated economic benefit, to Australia. It will also increase the regulatory burden on industry participants – particularly if they are unable to combine neighbouring permits that use the same downstream infrastructure.

As an alternative, if the Government does change any of the PRRT settings, it should follow the lead of the changes made in 1990 and distinguish new expenditure from old expenditure. However it should not change the settings for expenditure incurred under pre-existing obligations to Government in respect of an existing permit or lease (or extensions).

Final Report Part B Recommendations

We support the general direction of Recommendations 3, 4, 6, 7, 8, 9, 10, and 11, as detailed in the Review Final Report. However, care needs to be taken to ensure that law changes are properly designed without any unintended consequences. We are happy to work with you in developing these further.

Please contact Andrew Murphy, Public and Government Affairs Manager for ExxonMobil Australia on (03) 9261 0290, for any queries with respect to this submission.

Yours sincerely