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Manager, Large Corporates Unit  
Corporate and International Taxation Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Submission via email: [PRRT@treasury.gov.au](mailto:PRRT@treasury.gov.au)

Dear Secretariat

#### **PETROLEUM RESOURCE RENT TAX – CONSULTATION PAPER: DESIGN ISSUES**

This submission to the Petroleum Resource Rent Tax (PRRT) consultation paper process is made by INPEX Operations Australia Pty Ltd (hereafter referred to as INPEX) on behalf of all the INPEX group companies within Australia.

INPEX is a corporate citizen that takes its obligations in Australia seriously and is committed to working with Government on important matters such as the development of the fiscal policy settings. INPEX notes the intention of Treasury to split proposed changes into two parts, with major changes applying only to 'new projects' and administrative and integrity matters applying to all projects. This approach will not destabilise projects yet to produce or that have only recently commenced production after what is a capital intensive exploration and development phase.

This submission represents INPEX's third submission on PRRT matters. INPEX has previously provided Mr. Michael Callaghan a submission and a supplementary submission in relation to the PRRT review he chaired. INPEX appreciates this opportunity to submit on these matters in the PRRT Consultation Paper. The significance of any changes to the PRRT and the impact on investment decisions in Australia should not be underestimated.

To contextualise INPEX's role in Australia it is worth pointing out that as a multi-national corporation we are Japan's largest oil and gas company that has substantial petroleum interests in Australia. These interests include majority participation in the Ichthys LNG and Condensate Project (**Ichthys Project**) at 62.245%, and we are investors in a number of other projects including the Prelude Floating LNG Project (17.5%), Darwin LNG processing plant (11.4%) and the supplying Bayu-Undan gas and condensate field (11.4%); Ravensworth oil field (28.5%); Van Gogh/Coniston oil fields (45.46%) and holders of multiple exploration permits as both Operator and non-operator.

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<sup>1</sup> INPEX acknowledges that the Bayu-Undan field is expressly carved out of the PRRT by virtue of the Timor-Sea Treaty which makes it subject to additional Timor-Leste petroleum resource taxation

The Ichthys LNG Project represents the second largest resources project undertaken in Australia at US\$34b valued at the time of the Final Investment Decision (FID) in 2012. The investment by INPEX represents Japan's largest ever investment in Australia.

In order to finance the construction of the Ichthys LNG Project, INPEX and its Joint Venture Participants secured the largest ever syndicated Project Financing (PF) at US\$20b. The taxation arrangements, including PRRT, were crucial to the lenders who needed to determine the available after-tax cash flows to determine the borrowing capacity of Ichthys.

#### General Matters in the Consultation Paper

Through the government's approach of splitting the proposed amendments into two separate streams, INPEX believes the Australian Government aims to shield the very long-term investments that sponsors of LNG Projects are required to make. For example, INPEX acquired the WA-285-P exploration permit in 1998 and after two decades of continuous investment, the Ichthys Project is yet to commence production and earn revenue. Combining uncertain economic conditions (such as the continuing decline in oil price) which have impacted the value of assets, with taxation changes, both serve to impact returns and can modify managements choice regarding future expansions.

As a member of the Australian Petroleum Production and Explorations Association (APPEA) INPEX is aware of their submission and support the commentary and positions as reflective of the concerns as an industry as a whole.

Given the significance the PRRT regime can have on petroleum project economics, INPEX notes with concern that the consultation period was limited to 28 days from release of Treasury's paper on 30 June 2017. This consultation window coincides with compliance obligations for most companies in the oil and gas sector. The proposals in the consultation paper provide for multiple scenarios that require detailed modelling which cannot be given adequate coverage by all stakeholders.

INPEX suggests any legislation that may result from this consultation should ensure there is more realistic consultation period, as the downsides of not doing so will far outweigh the upsides of acting with expediency and could result in unintended outcomes for those FID sanctioned LNG projects. Given the intention is for the changes (if any) to mainly apply to new project's it remains unclear why an important review such as this must be closed by September 2017.

Treasury should also consider a point the consultation paper ignores, which is the very high rate of PRRT once a project becomes payable (40%). The implication is that the rate remains appropriate even if other changes to the regime should occur. Careful consideration by Treasury must be given to the interaction of the regime as against this rate, in particular ensuring the impact of making changes to new investments will have on funding considerations.

#### Specific Matters in the Consultation Paper

In direct response to the consultation paper questions and in addition to APPEA's submission INPEX provides, the following comments:

- The Gas Transfer Price (GTP) should be subject to separate review as this is a core variable in the PRRT framework. Consultation inside a 28 day period will not do justice to the complexity of the scenarios proposed. For instance, the following are some of the specific concerns as to why INPEX feel it is necessary that a separate review on the GTP section of the consultation paper should occur:

- The final bullet point on page 22 of the consultation paper suggests that a "greater proportion and distribution of rents *[should go]* to the upstream". This ignores the current commercial reality which is that with so much gas available globally<sup>2</sup>, the value for some oil and gas companies flows to those companies that can distribute the supplies at the lowest cost as opposed to those that hold a resource but have no access to markets;
- Identifying a satisfactory Comparable Uncontrolled Price (**CUP**) is unlikely to be achievable within the current offshore market. An artificial shadow price as a completely new concept should not be pursued. The likelihood of protracted disputes increases if a CUP or shadow price is to be applied over the RPM and is not representative of the actual cost to produce or revenue received. The RPM gives project investors certainty as it is a known regime that has been consistently modelled/applied since legislated. The fact that the consultation paper expressly references safeguards as being required to ensure the situation doesn't exist where a CUP/shadow price would exceed the actual proceeds of the LNG operation, highlights the issues with this approach;
- The notion that a new transfer pricing approach could be applied to determine the transfer price (under option 2), ignores the commercial reality that it is unlikely another method does exist that appropriately reflects the contribution of both the upstream and downstream portion of an integrated LNG operation;
- Moving the taxing point to the end of LNG production will result in taxing twice the infrastructure value-add (via company tax and PRRT), rather than determining the underlying value of the resource and imposing PRRT on the resource value. As noted in the consultation paper the impact on cash flows is likely to be considerable.

Material changes to cash flows such as this proposal will be extremely relevant when projects need to finance their development, as was needed by INPEX for Ichthys. It is of little relevance to Australia to have a tax that theoretically will capture significant returns, if the companies cannot secure funding from stakeholders to develop new projects as the PRRT erodes cash that could otherwise be available to pay down debt.

- The definition of new projects needs to be carefully thought through. Much of the near-term capital expenditure will be from expansions of existing facilities as projects attempt to extend the project life or increase through-put. The definition of new project will ultimately be relevant in determining the regime to which INPEX's future investment decisions will apply. INPEX note that if changes to the PRRT regime does occur, that option 2 in section 5 (on page 28), as proposed in the consultation paper, may have a detrimental impact on investment decisions as the proposal currently ignores the integrated nature of new projects.
- Regarding potential changes to augmentation rates, particularly the rate for exploration, INPEX notes that the changes proposed to reduce the rate of exploration seem to ignore the declining levels of exploration investment in Australia. Indeed this issue has been raised at an APPEA exploration committee meeting by the Offshore Resources Branch (**ORB**) from within the *Department of Industry, Innovation and Science* recently as an issue that ORB is seeking to address by streamlining the offshore exploration acreage release process. Therefore, it is surprising that changes to the tax system could arise that seek to further reduce the incentive to explore and therefore should be a consideration of this review.

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<sup>2</sup> INPEX notes Qatar's recent announcement that it intends on expanding its LNG output to overtake Australia as the world's largest LNG supplier

- INPEX also notes that the commentary in the consultation paper can be perceived as one sided, in that it oversimplifies the risks of exploration, and ignores entirely the GDP factor which applies under the current five year rule. Any discussion on augmentation decreases should also ensure that augmentation is considered in context to any other changes that may occur as part of this consultation process.
- Regarding the administrative matters in the consultation paper:
  - Recommendation 9 on substituted accounting periods would be beneficial to enable streamlined reporting to occur as records for accounting, income tax and PRRT would become aligned; and
  - Recommendation 10 on functional currency is required as the limitations in the PRRT Act on currency are significant in terms of administration for no benefit to either the Government or taxpayer. It is important to ensure that the currency regime is flexible enough to cater for the situation where there are PPRT entities that sit outside of any Multiple Entry Consolidated group to make the election. INPEX would be happy to provide further input to Treasury on this matter if requested.

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INPEX thanks Treasury for the opportunity to make this submission. If you would like further information please do not hesitate to contact [REDACTED]

Yours sincerely

A handwritten signature in black ink, appearing to read 'Seiya Ito', with a long horizontal flourish extending to the right.

**Seiya Ito**  
President Director, Australia