

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

28 July 2017

Dear Committee,

RE: SUBMISSION TO OPTIONS TO ADDRESS THE DESIGN ISSUES IDENTIFIED IN THE PETROLEUM RESOURCE RENT TAX (PRRT) REVIEW

This submission is informed by research that I, Kevin Morrison, have undertaken into resource taxation in Australia since 2013. It forms part of the Master of Sustainable Futures (Research) degree that I am soon to complete at the UTS Institute for Sustainable Futures, where Professor Damien Giurco is my supervisor. The focus of my research is on resource rent taxes in Australia.

The submission also follows the one I submitted in February 2017 to the Petroleum Resource Rent Tax Review and the subsequent conversation I had with the PRRT review team in Canberra.

In response to Part A of this phase of the PRRT Review, my answers relate to my study in that the PRRT was to tax the economic rent generated from resource extraction. Since the PRRT was legislated in 1988 there have been several amendments to the legislation, which the Review has identified in the June 2017 consultation and the share of gas for LNG production has gone from almost non-existent in 1988 to dominating Australian hydrocarbon production in 2017 and this is why the gas price transfer methodology is an important issue, as it was not addressed in the original design.

There are four relevant aspects of the PRRT under Part A to consider, the first being *uplift rates*. The rate should reflect the average borrowing cost for corporate Australia. There is of course risk associated with oil and gas projects, but much of that risk is managed through the engineering work done before a project is approved. Through this work, the project partners have a strong understanding of the hydrocarbons in the field and technical challenges that there may be in extracting it. Advances in technology have also reduced the cost of production for many oil and gas fields.

The original uplift rates were set in a period when interest rates were, on average, higher than what they have been over the past seven to eight years. This has led to a lower cost of borrowing for corporate Australia in more recent times. The uplift rate should be updated to reflect this change.

From the options for the uplift rate being considered in the 30 June 2017 Consultation Paper,

- > Option 1: Reduce uplift rates to better reflect the risk of losing deductions
- > Option 2: Limit the number of years for which a high uplift rate applies
- > Option 3: Provide an investment allowance (a deduction in excess of 100 per cent) for the initial expenditure, with a low uplift applied thereafter,

a combination of Option 1 and 2 should be seriously considered. In Option 1 the uplift rate should be reduced to better reflect the risk of losing deductions. This should be done in

conjunction with a time limit as some of the LNG projects in operation in Australia have a working life of up to 40 years. Deductions should not be allowed to be carried over the life of the project with an uplift rate as it will lead to a lower tax take even when the project is making its desired return on investment.

The second aspect for consideration in Part A is *classes of expenditure*. The order of deductions under the PRRT I did not spend much of my research focussing on. I did look at the issue of thin capitalisation and profit shifting and the issue of excessive interest payments on inter-company loans, which results in reduced tax liabilities for companies and has been the subject of the latest phase of the Senate Inquiry into Tax Avoidance.

Regarding the issue of *transferability*, the third aspect for consideration in Part A, I did not study this in any great depth in my Master's research.

The fourth aspect, *Gas Transfer Pricing* under consideration in Part A is one that I studied and conclude that under the current pricing methodology, the PRRT receives less revenue from gas on a per barrel of oil equivalent than from a barrel of oil. This was highlighted in the table I provided in my February 2017 submission to this review and is reattached to this submission. The gas pricing methodology may not be the only contribution to this, as global LNG contract prices are linked to oil prices, there are increasing amounts of LNG cargoes sold on a spot basis whereby the linkage to oil prices is not as strong as with contract pricing.

Given the dominance of gas produced for LNG exports, which is likely to remain for the foreseeable future as Australian crude oil production extends its decline in output, a serious consideration of Option 3 of the gas transfer pricing in the June 2017 consultation paper, namely to move the taxing point to the end of the LNG production, should be taken as the PRRT is to represent the taxation of economic rent from the extraction Australia's hydrocarbon reserves and by extending the taxing point to the end of the LNG processing chain the PRRT will capture all of the economic rent in the process.

If these changes only apply to new projects, it is unlikely to make any material difference as it is unlikely that there will be any repeat of the number of new LNG projects that have been sanctioned since 2009 due to increased competition from other gas basins such as onshore US and east Africa as well as traditional basins in the Middle East and Russia. The new LNG projects in Australia are likely to be linked to backfill gas to replace existing gas fields that are expected to deplete over the next 10 years. There should a discussion on how these measures could be included in existing LNG projects through a phased introduction of the changes.

Yours faithfully,

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Year	Oil production b/d	Condensate b/d	LPG b/d	LNG exports bce/d	LNG exports kt	Oil, condensate, LPG LNG combined output boe/d	PRRT revenue A\$m	Oil price (USD)	Oil price (A\$)	NWSS grants	WA petroleum royalty	Old Petroleum royalty	Total royalty & PRRT revenue A\$	Fuel excise A\$
1983-84	462,272.77					462,272.77					18,141,972.00		18,141,972.00	2,137,000,000
1984-85	531,402.26					531,402.26					17,555,803.00		17,555,803.00	2,387,000,000
1985-86	548,807.96					548,807.96					34,022,904.00		34,022,904.00	3,087,000,000
1986-87	542,844.84					542,844.84		18.720			27,409,626.00		27,409,626.00	3,217,000,000
1987-88	538,709.40					538,709.40		17.200			30,044,164.00		30,044,164.00	3,420,000,000
1988-89	496,861.38					486,861.38		16.052			20,579,607.00		20,579,607.00	5,828,000,000
1989-90	551,288.02				49,396	2,010,000	600,684.46	42,000,000	17.9	22.82	51,777,319.00		51,777,319.00	6,416,000,000
1990-91	550,516.01	55,146.34	61,035.86		83,556	3,490,000	750,354.38	293,000,000	23.52	30.25	92,427,105.00		92,427,105.00	6,642,000,000
1991-92	539,484.79	58,717.22	61,728.33		114,521	4,660,000	774,451.44	876,000,000	19.14	25.38	86,520,781.00		86,520,781.00	7,093,000,000
1992-93	529,077.28	61,167.28	64,507.21		122,484	4,894,000	777,236.27	1,389,000,000	18.77	26.00	79,728,050.00		79,728,050.00	7,200,000,000
1993-94	499,750.75	63,440.03	66,104.81		145,238	6,032,000	776,654.06	1,072,000,000	15.34	22.17	72,086,313.00		72,086,313.00	8,459,000,000
1994-95	537,434.31	77,380.53	76,109.20		172,470	7,018,000	863,292.79	805,000,000	17.21	23.31	112,736,987.00		112,736,987.00	9,408,000,000
1995-96	521,254.42	108,529.12	85,978.10		183,873	7,482,000	879,534.25	791,000,000	17.85	23.51	159,405,326.00		159,405,326.00	10,224,000,000
1996-97	535,004.74	126,858.46	68,442.69		193,971	7,486,000	908,276.90	1,308,000,000	20.97	26.79	228,746,772.00		228,746,772.00	10,548,000,000
1997-98	585,191.36	143,769.24	76,496.36		188,001	7,650,000	993,448.33	907,000,000	16.4	24.09	247,409,489.66		247,409,489.66	10,895,000,000
1998-99	490,709.92	138,112.32	67,228.38		192,155	7,819,000	878,205.22	419,000,000	13.31	21.21	176,949,877.24		176,949,877.24	10,974,000,000
1999-00	645,553.71	134,500.61	71,017.90		194,710	7,922,000	1,043,787.67	1,184,000,000	24.50	39.02	344,896,958.00		344,896,958.00	11,189,000,000
2000-01	696,485.06	124,663.92	67,572.64		185,952	7,530,000	1,063,793.95	2,379,000,000	28.28	52.56	526,714,875.00		526,714,875.00	11,919,000,000
2001-02	651,675.71	136,058.08	71,829.31		186,773	7,690,000	1,048,765.70	1,581,000,000	23.8	48.52	428,286,945.00		428,286,945.00	12,388,000,000
2002-03	574,133.18	147,700.33	71,960.98		192,336	7,825,400	985,130.96	1,712,000,000	27.85	47.61	488,589,500.00		488,589,500.00	12,868,000,000
2003-04	490,205.65	130,424.91	67,191.13		194,487	7,913,900	872,438.50	1,185,000,000	31.39	45.99	416,331,506.00		416,331,506.00	13,231,000,000
2004-05	437,191.99	122,469.01	71,702.00		250,226	10,588,900	891,588.85	1,465,000,000	45.12	59.93	549,660,913.00		549,660,913.00	13,608,000,000
2005-06	398,923.06	115,018.35	81,363.95		296,822	12,029,200	890,927.07	1,991,000,000	61.65	82.5	678,825,887.00		678,825,887.00	15,651,000,000
2006-07	400,191.26	126,783.79	78,400.10		352,221	14,332,300	1,031,596.33	1,994,000,000	62.8	79.89	714,091,067.00		714,091,067.00	14,138,000,000
2007-08	445,769.93	119,310.00	68,420.45		336,146	13,678,200	969,645.84	1,871,000,000	94.34	105.19	811,026,024.00		811,026,024.00	14,906,000,000
2008-09	478,769.71	132,327.23	67,836.37		378,704	15,499,900	1,037,437.18	2,184,000,000	68.95	92.41	868,761,581.00	60,900,000.00	929,661,581.00	15,448,000,000
2009-10	470,326.17	153,287.24	70,592.14		439,063	17,896,000	1,131,888.62	1,297,000,000	75.04	85.04	759,612,306.00	21,925,331.00	781,537,637.00	15,506,000,000
2010-11	444,076.85	143,913.78	64,222.81		490,448	19,956,900	1,142,661.09	806,000,000	62.78	93.75	970,376,925.00	21,535,089.00	991,912,014.00	16,121,000,000
2011-12	414,718.70	128,219.49	63,085.10		463,638	18,856,000	1,069,661.70	1,463,000,000	112.43	108.93	935,598,442.00	18,749,522.00	954,347,964.00	16,844,000,000
2012-13	366,744.21	128,929.77	58,665.10		577,594	23,593,000	1,131,933.35	1,817,000,000	108.69	105.85	1,019,886,602.46	18,187,506.63	1,038,074,109.09	18,050,000,000
2013-14	346,880.33	124,194.98	64,125.21		577,594	23,593,000	1,131,933.35	1,817,000,000	109.34	119.04	1,106,892,594.65	11,493,467.24	1,118,386,061.89	18,617,000,000
2014-15	328,188.16	111,403.41	57,250.21		615,548	25,047,400	1,112,390.22	1,870,000,000	73.46	87.78	943,795,896.00	51,000,000.00	994,795,896.00	17,828,000,000
2015-16	316,966.68	117,389.82	52,725.32		1,007,636	41,091,905	1,494,716.67	741,000,000	43.26	59.4	588,000,000.00	6,000,000.00	594,000,000.00	17,900,000,000
2016-17	309,816.28				1,246,633	50,727,000	1,556,449.68	800,000,000	46.89		457,000,000.00		457,000,000.00	18,540,000,000
2017-18	383,444.37				1,674,711	68,145,000	2,038,155.66	800,000,000	54.42		492,000,000.00	135,000,000.00	627,000,000.00	19,230,000,000
2018-19	389,660.28				1,817,936	73,974,000	2,207,596.66	800,000,000	60		463,000,000.00		463,000,000.00	20,760,000,000
2019-20	362,902.77				1,826,811	74,327,000	2,189,514.25	800,000,000	69.82		477,000,000.00		477,000,000.00	21,630,000,000

Table compiled by Kevin Morrison, UTS

Sources for data

Column B - Australian Energy Update 2016 published by Office of the Chief Economist (OCE), department of Innovation and from Australian Petroleum Statistics (APS) issued by OCE

Column C and D also comes from both Australian Energy Update 2016 and APS data

Column E - OCE, and its predecessor Bureau of Resources and Energy Economics (BREE) and Australian Bureau of Agricultural and Resource Economics (ABARE).

Column F - conversion to Barrels of oil equivalent was using the conversion calculator on the Santos Limited website <https://www.santos.com/conversion-calculator/>

Column G - OCE, and its predecessor Bureau of Resources and Energy Economics (BREE) and Australian Bureau of Agricultural and Resource Economics (ABARE).

Column H - PRRT revenue comes from Federal budgets since 1989-90

Column I - OCE, and Western Australia Department of Mines and Petroleum

Column J - Conversion using average exchange rates used by the Australian Bureau of Statistics (ABS) from international trade statistics

Column K and L - Western Australia state budgets

Column M - Queensland state budgets

Column N - Federal state budgets

The green highlights are forecasts by OCE, the PRRT forecasts are from the 2016-17 federal budget

Yellow highlights show the largest value per column

Western 2019-20
Feb 2017
estimate