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Mr Geoff Francis
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By email: prrt@treasury.gov.au

Dear Mr Francis

Petroleum Resource Rent Tax – Exposure Draft Legislation

The Australian Petroleum Production & Exploration Association (APPEA) welcomes the opportunity to comment on the exposure draft legislation released to implement key aspects of the Federal Government's announcements to reform the petroleum resource rent tax (PRRT). APPEA notes that the first phase of changes primarily cover modifications to the augmentation rates and the removal of onshore projects from the scope of the tax.

The comments outlined below address a range of technical issues associated with the Exposure Draft legislation (Part A) and a number of policy issues that APPEA considers warrant further consideration in terms of the overall impact of the new provisions (Part B).

Part A: Technical Comments

Impact of Combining Projects

In order to clarify the impact of combining existing projects with post-July 2019 projects, the second bullet point of paragraph 1.35 of the Explanatory Materials should read as follows:

- *a pre-combination project that relates to one of the post-July production licences in the combined project first derived assessable receipts after the grant of the first post-July 2019 production licences.*

In addition, it would also be helpful if the example 1.1 in paragraph 1.36 of the Explanatory Materials be amended as follows:

- *Project Alpha was granted a production licence in 2010, with production commencing in 2015. Following successful drilling, a second production licence is granted in 2020 for an adjacent gas field.*

- *The joint venture applies for and is granted a combination certificate for the project. Because one of the production licences was granted after 1 July 2019, the ten year period will commence at the time the combined project first derived assessable receipts after the granting of the second production licence in 2020.*

Ministerial Combination Decisions

Section 20 of the PRRT Act provides for the combining of petroleum projects. A project can be combined by:
- following the application by project participants; or
- by the Minister in the absence of an application.

The introduction of the ten (10) year limit on the uplift at LTBR + 5 percentage points for general project expenditure and the manner in which the 10 year limit applies to combined projects means that it is no longer appropriate for the Minister to be able to combine projects in the absence of an application by the project participants. To retain the present Ministerial power has the potential to disadvantage project participants and create a significant retrospective impact to the operation of the tax by materially changing the treatment of past costs incurred within a project.

Accordingly the opening words of section 20 should be amended to read as follows:

> *"Subject to this section, where within the qualifying period in relation to a production licence in relation to a petroleum project, the Resources Minister on application or request in accordance with subsection (4), having regard to:" …*
>
> In addition, the words *"(other than from an officer in the performance of his or her duties)"* should be deleted from subsection (4).

Ten Year Uplift Rate

The stated intent of changes to the general expenditure uplift rate in the Government's response to the PRRT review was:

> *"…for PRRT projects that successfully apply for a production licence after 1 July 2019, the general expenditure uplift rate will be Long Term Bond Rate (LTBR)+5 percentage points* ***until 10 years from the financial year in which a project first earns assessable petroleum receipts****, after which the uplift rate for remaining deductions will be LTBR."*

Similarly, the Government's statement in relation to the changed exploration uplift rates was as follows:

> *"for exploration expenditure incurred or transferred from 1 July 2019, the uplift rate will be LTBR+5 percentage points* ***for 10 years from the time the expenditure***

is incurred, with any remaining augmented amount maintained in real terms by applying the GDP deflator until the expenditure is deducted."

Given that the augmentation of expenditure does not occur in the year in which the expenditure was incurred, the references in items 4, 44 and 76 of the Bill to "10 years or more" appear to limit the application of the LTBR plus five percentage points by one year. Accordingly, these references should be changed to "more than 10 years".

Transferred Exploration Expenditure – Incorrect Uplift Outcome

The government announced that exploration expenditure transferred from 1 July 2019 will be uplifted at LTBR plus 5 percentage points for 10 years from the time the expenditure is incurred, and thereafter at the GDP rate. This treatment applies irrespective of when the expenditure was actually incurred. However, exploration expenditure transferred on or after 1 July 2019 will seemingly not be entitled to be uplifted at LTBR plus 5% for 10 years if the expenditure was incurred more than 5 years before the earlier of (i) the production licence for the recipient project being granted (or applied for) or (ii) 1 July 2019.

Consistent with the policy intent that the time of incurrence of exploration expenditure is irrelevant for transfers occurring from 1 July 2019, the ordering rule which requires the transfer of ABR expenditure (or standard uplift expenditure under the terminology adopted by the new rules) before GDP expenditure (clauses 24, 25, 33 and 34 of Schedule 1 to the PRRT Act) would no longer be appropriate as it would continue to distinguish between these two categories of expenditure based upon when the recipient project's production licence is applied for or granted.

Transferability of Onshore Exploration Expenditure

After the date of effect of the proposed changes to the regime (1 July 2019), the transferability of onshore petroleum exploration expenditure incurred by taxpayers in the period 1 July 2012 to 30 June 2019 is unclear. Under the present law, eligible exploration expenditure is capable (subject to the holding rules) of being transferred to a PRRT paying project held by the same taxpayer. One reading of the proposed new law is that previously eligible expenditure will no longer be transferable after 30 June 2019 as a result of the provision that excludes the scope of the regime from applying to onshore petroleum projects (from 1 July 2019). If correct, such an outcome raises a number of issues.

From a policy perspective, the cost will fall almost entirely on companies that have been exploring onshore for natural gas. This is an activity that has been actively encouraged by the Federal Government. APPEA's assessment suggests that through a combination of the holding rules that restrict the transferability of exploration expenditure and the small number of companies that have both explored onshore since 2012 and hold offshore production interests, the quantum of taxpayers impacted will be quite limited. However, the impacts could in some

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cases be sizable, including for Australian based entities that have been required to book tax benefits in their respective accounts due to the transferability provisions that presently exist.

Wider deductibility has been a key design feature of the regime since 1991. As the system has operated as a fully integrated regime (covering the offshore and onshore) since 2012, exploration transferability in some cases has been a material consideration in investment decisions. Some companies have de-risked their onshore exploration decisions by utilizing the regime wide transferability provision.

While a design feature of PRRT is that general project expenditures effectively 'expire' when a project ceases to exist (through not being transferable), exploration deductions can be retained and utilized into the future, subject to the various holding and transferability rules. While the decision to remove onshore projects from the scope of the regime recognizes that PRRT is unlikely to be paid from onshore projects due to a combination of state based resource charges and project profitability, the decision to effectively 'dissolve' onshore exploration expenditures incurred by companies in the period 2012 to 2019 represents the removal of an entitlement to legitimate deductible expenditures.

With a view to addressing this uncertainty, APPEA has identified a number of options that could be implemented that both address the Government's broader objective to reform key aspects of the regime while also maintaining a taxpayer's ability to potentially transfer past onshore exploration expenditure.

Option 1: Five year transitional window

A transitional provision could be included within the PRRT Act to continue to allow taxpayers who have incurred onshore exploration expenditure in the period 1 July 2012 to 30 June 2019 to transfer such expenditure (subject to the normal holding provisions) to offshore projects where a PRRT liability exists. This provision could have a sunset of five years, ending on 30 June 2024. Following this time, an entitlement to transfer any undeducted onshore exploration expenditure would expire.

Option 2: Modified augmentation

A second approach would see the retention of a taxpayer's ability to transfer eligible onshore exploration expenditure incurred in the period 1 July 2012 to 30 June 2019, however modified augmentation rules would apply. One such option could see all onshore exploration expenditure incurred within the relevant period not being eligible for augmentation, or perhaps only being kept constant in real terms using the GDP factor rate.

We consider it important for clarity to be provided around this issue, as past decisions have been made on the operation of the transferability provisions. Taxpayers should ideally not be disadvantaged purely because they have previously been unable to fully utilize the transferability provisions that existed when the regime covered both onshore and offshore projects.

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Removal of Schedule 2 of the PRRT Act – Impact on North West Shelf Retention Leases

The proposed removal of provisions relating to starting base amounts including repeal of Schedule 2 creates uncertainty for the North West Shelf project with regard to the status of starting base amounts for retention leases and exploration permits in force at the time of PRRT transition which are yet to be included in starting base expenditure under s35E(1A) of the Act.

Further clarity is required to ensure that these amounts will continue to be eligible to be included in starting base expenditure in the financial year that a production licence is derived from the relevant retention leases or exploration permits and that the amounts remain subject to the limited period of review as currently provided for by subclause 23(5) of Schedule 2 to the PRRT Act. The changes to remove provisions relating to starting base amounts in the PRRT inheritance rules (sections 48 / 48A) and functional currency rules (sections 58K / 58M) should also be considered further in this regard.

Exemption from Lodgment of an 'Onshore' PRRT Return for 2018-19

APPEA supports the provision contained in Schedule 2 (Part 3, 98) that exempts a taxpayer from furnishing a PRRT in relation to the year that starts 1 July 2018 where the person does not have a taxable profit for that year of tax and sections 45A and 45B do not require the taxpayer to transfer expenditure.

It is clear that in almost all cases, taxpayers will meet the relevant conditions that provides for the exemption. Notwithstanding this provision, a taxpayer will effectively need to prepare a PRRT return in order to demonstrate that they do not have a taxable profit in relation to the year of tax.

To provide the flexibility to ensure taxpayers can utilize the exemption with the necessary degree of certainty, it is recommended that a simple example be included in the Explanatory Memorandum. Specifically, the example could indicate that if the total assessable receipts of a PRRT project for the year 2018-19 are less than the undeducted eligible expenditure from the prior year, a taxable profit could not be expected to arise for the year 2018-19 in relation to that project. As such, a PRRT return is not required to be lodged for that project for the year 2018-19, unless requested by the Commissioner.

Part B: Design/Policy Issues

Distinction between 'New' and 'Old' PRRT Projects

The proposed rules require old projects to become new projects when they are combined with a new Production Licence. It is common across the industry (including within LNG projects) to have investment decisions made and infrastructure built with the economic intention to develop Production Licenses and Retention Leases held at the time of making the investment decision.

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APPEA is concerned that excluding pre-existing Retention Leases which formed part of investment decision of existing projects from the old rules is changing the underlying economics of previous investment decisions and consideration should be made to include these narrow set of Retention Leases in the definition of an old PRRT project.

Operation of the 90-day Combination Rule

APPEA is recommending that the qualifying period of 90 days to apply for a combination certificate is modified whilst the Gas Transfer Pricing Regulations review is occurring. APPEA is concerned that due to the 90-day time limit, a taxpayer will be required to decide to combine production licenses without understanding the impact of any Gas Transfer Pricing Regulation changes.

10 Year Augmentation Limit – General Application

A key design feature of the Government's announced changes to the regime is the introduction of a ten year cap on the operation of the general project augmentation provisions for 'new' projects. Following ten years from the time of first deriving assessable petroleum receipts from a project, the carry forward rate for 'new' project expenditures effectively falls from the long term bond rate plus 5 percentage points to the long term bond rate. The potentially negative impact of this change needs to be understood under a number of different scenarios.

Scenario 1: Ramp-Up Production

While some projects are characterized by peak production during the early years of their lives (for example, many oil projects), there have been a number of gas developments in Australia where production levels have ramped up over relatively lengthy periods of time. Such projects often require significant levels of incremental capital investment well after the commencement of first commercial production. By way of the example, first commercial domestic gas production from the North West Shelf project commenced in 1984, however the export phase did not commence until 1989. Significant amounts of project investment were made many years after the commencement of production to facilitate the export phase of the project.

Under the proposed new provisions, large amounts of capital expenditure for projects with this type of production profile will potentially have reduced access (if any at all) to the higher levels of augmentation, despite incurring significant outlays.

Scenario 2: Late-Life Capital Reinjection

As some projects enter the latter stages of production, investors have the option of extending the productive lives of assets either through enhancing production from existing reservoirs or tapping into new sources of petroleum from within a project licence area. Alternatively, petroleum can be sourced from third parties that can see the lives of mature projects considerably extended. In both cases, an investor may be required to outlay significant new amounts of capital expenditure, much of which will be incurred many years after the initial

commencement of production from a project. As with Scenario 1, expenditures will potentially be subject to the lower augmentation provisions, as they will be incurred more than ten years after the initial commencement of production.

Under both of the scenarios outlined above, it will be important for the design of the PRRT regime not to act as an impediment to future investment within existing projects. Post the implementation of the present package of legislation, APPEA recommends that further discussions be held between industry and government to assess the potential long term consequences of this measure.

In addition to the above comments, a number of marked up changes to the Explanatory Memorandum are also attached for your consideration.

APPEA would be pleased to further expand on any of the matters raised above. Contact is Noel Mullen, email nmullen@appea.com.au.

Yours sincerely

Malcolm Roberts
Chief Executive

Enc.

TREASURY LAWS AMENDMENT (PETROLEUM RESOURCE RENT TAX REFORMS NO. 1) BILL 2019

EXPOSURE DRAFT EXPLANATORY MATERIALS

DRAFT

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
ABR	Augmented Bond Rate
Act	*Petroleum Resource Rent Tax Assessment Act 1987*
GDP	Gross Domestic Product
LNG	Liquefied natural gas
LTBR	the Government long-term bond rate
PRRT	Petroleum Resource Rent Tax

Chapter 1
Uplift rates for carried-forward expenditure

Outline of chapter

1.1 Schedule 1 to the Exposure Draft amends the Act to reduce the uplift rates that apply to certain categories of carried-forward expenditure.

Context of amendments

1.2 The PRRT is a profit-based ~~cash flow~~ tax on petroleum production, designed to ensure the Australian community receives a fair return on the extraction of Australia's finite petroleum resources while minimising disincentives for business to invest in the petroleum industry.

1.3 Section 22 of the Act outlines the formula on which PRRT is payable. A person is subject to tax on the taxable profit they receive for a year of tax in relation to a petroleum project (section 21). The taxable profit is the person's assessable receipts (section 23) less the sum of their deductible expenditure (section 32) and exploration expenditure transferred to the petroleum project (Division 3A of Part V).

1.4 The categories of deductible expenditure are:

- general project expenditure;
- exploration expenditure, which must~~can~~, in certain circumstances, be transferred between certain petroleum projects;
- resource tax expenditure, which is grossed-up by the PRRT rate (40 per cent) to give credit for royalties and excise paid on a petroleum project's output;
- acquired exploration expenditure and starting base expenditure, which recognise investments made in petroleum projects that transitioned to the PRRT regime; and
- closing-down expenditure, which can give rise to a refundable credit to the extent of prior PRRT liabilities.

1.5 PRRT liabilities are calculated on a project basis meaning deductible expenditure can generally only be used to offset assessable receipts from the same petroleum project and generally cannot be transferred to other projects of the taxpayer. Exploration expenditure is an exception to this principle.

Expenditure uplifts

1.6 Due to their nature, petroleum projects experience periods of negative cash flow during exploration and construction before a project becomes cash flow positive. Taxpayers may carry-forward unutilised expenditure to offset future positive cash-flow periods.

1.7 The PRRT applies an uplift rate to carried-forward expenditure. The uplift rates are specific to different types of expenditure and are generally calculated by reference to either an ABR consisting of the LTBR and a premium, or the GDP factor outlined in section 2A of the Act.

Review of the PRRT

1.8 The Government initiated a Review of the Petroleum Resource Rent Tax, led by Michael Callaghan AM PSM, on 30 November 2016. The Review considered whether the PRRT was operating as it was originally intended and the reasons for a rapid decline of Australia's PRRT revenues.

1.9 The Callaghan Review received significant input from a wide range of industry and other community stakeholders. The Government released the Review on 28 April 2017.

1.10 The Review found that, while the PRRT remained the preferred way to achieve a fair return to the community without discouraging investment, ‘changes should be made to PRRT arrangements to make them more compatible with the developments that have taken place in the Australian oil and gas industry.’

1.11 For example, since the PRRT was introduced in 1988, the nature of petroleum production has changed, shifting from crude oil and condensate to a more significant role for LNG. Over the past 30 years, oil and condensate production has nearly halved, and LNG production has increased over sevenfold.

1.12 LNG projects are characterised by a considerably longer development timeline, increasing the delay between an initial investment and positive cash flow. This, in turn, increases the total uplift applied to expenditure over the course of a project.

1.13 In this context, the Review identified that PRRT uplift rates for deductible expenditure are now overly generous.

Government response – tranche one

1.14 On 2 November 2018, the Government released its final response to the Review. The Government's response is available on the Treasury website: www.treasury.gov.au.

1.15 The Government is implementing its response to the Review in two tranches of legislation. The first tranche of legislation is contained in this Exposure Draft and will:

- lower the uplift rates that apply to certain categories of carried-forward expenditure; and
- remove onshore petroleum projects from the scope of the PRRT (see Chapter 2).

Government response – tranche two

1.16 The second tranche of amendments will implement the following changes announced in the Government response:

- improved rules will be introduced to identify petroleum projects to ensure the true scope of each project is recognised;
- more corporate groups will be able to access the benefits of grouping, including group lodgement obligations and broader access to functional currency rules;
- greater certainty will be created for deductible expenditure arising before a petroleum project starts to derive assessable receipts by taxpayers being required to lodge annual PRRT returns, and receive assessments, after they start holding an interest in an exploration permit, retention lease or production licence rather than when they start generating assessable receipts from production;
- taxpayers will be able to use a substituted accounting period for PRRT purposes if they have adopted the period for income tax purposes ;
- a new power for the Commissioner of Taxation to administratively exempt projects from PRRT obligations where they are clearly unlikely to pay PRRT in the foreseeable future until they start production or PRRT becomes payable;
- the PRRT general anti-avoidance provisions will be strengthened to reflect changes made to Part IVA of the *Income Tax Assessment Act 1936*.

1.17 The Government intends to progress the second tranche of legislation in 2019. The Government also intends to progress consequential amendments to regulations in 2019.

Review of Gas Transfer Pricing Regulations

1.18 Further to these legislative reforms, the Treasury will commence a review into the regulations that determine the price of gas in integrated LNG projects for PRRT purposes. The Treasury will consult closely with the industry and community. The Treasury will consult and report back to Government within 12 to 18 months.

Summary of new law

1.19 Schedule 1 to the Exposure Draft amends the Act to reduce the uplift rates that apply to certain categories of carried-forward expenditure.

1.20 For petroleum projects that successfully apply for a production licence from 1 July 2019 (based on the date specified in a production licence notice), the general expenditure uplift rate will be the LTBR+5 percentage points until the year ten years from the financial year in which a project first derives assessable petroleum receipts, after which the uplift rate for remaining deductions will equal the LTBR.

1.21 For exploration expenditure incurred or transferred from 1 July 2019, the uplift rate will be LTBR+5 percentage points for ten years from the time the expenditure is incurred, with any remaining amount maintained in real terms by applying the GDP factor until the expenditure is deducted.

1.22 Where exploration expenditure incurred before 1 July 2019 is deducted within a petroleum project, the current uplift rate equal to the LTBR+15 percentage points (if it currently applies) will continue to apply until 1 July 2019. From that date, the uplift rate equal to the LTBR+5 percentage points will apply.

1.23 Lower uplift rates will limit the scope for excessive compounding of deductions. These changes will ensure the production of petroleum resources is taxed appropriately while continuing to support the development of Australia's LNG industry.

Comparison of key features of new law and current law

New law	*Current law*
Pre-July 1990 expenditure	
No change.	General expenditure (Class 1 ABR general expenditure) and exploration expenditure (Class 1 ABR exploration expenditure) incurred prior to 1 July 1990 is subject to an uplift rate equal to the LTBR+15 percentage points.
General expenditure	
No change.	General expenditure incurred more than five years prior to a production licence being applied for (Class 1 GDP factor expenditure) is subject to an uplift rate equal to the GDP factor.
No change for existing petroleum projects where the production licence was applied for prior to 1 July 2019. General expenditure incurred less than five years prior to a production licence being applied for in relation to a new petroleum project is subject to: • until ~~for~~ the year which is ten years after the project first derives assessable petroleum receipts – an uplift rate equal to the LTBR+5 percentage points; and • then – an uplift rate equal to the LTBR. Class 2 ABR general expenditure is relabelled Class 2 uplifted general expenditure.	General expenditure incurred less than five years prior to a production licence being applied for (Class 2 ABR general expenditure) is subject to an uplift rate equal to the LTBR+5 percentage points.

New law	***Current law***
Exploration expenditure	
No change for exploration expenditure incurred prior to 1 July 2019 and more than five years prior to a production licence being applied for, which continues to be subject to an uplift rate equal to the GDP factor. Exploration expenditure incurred on or after 1 July 2019 (Class 2 uplifted exploration expenditure) is subject to: • for the ten years after the expenditure is incurred – an uplift rate equal to the LTBR+5percentage points; and • then – an uplift rate equal to the GDP factor.	Exploration expenditure incurred more than five years prior to a production licence being applied for (Class 2 GDP factor exploration expenditure) is subject to an uplift rate equal to the GDP factor.
From 1 July 2019, exploration expenditure incurred prior to that date and less than five years prior to a production licence being applied for is subject to an uplift rate equal to the LTBR+5 percentage points. Exploration expenditure incurred on or after 1 July 2019 is subject to: • for the ten years after the expenditure is incurred – an uplift rate equal to the LTBR+5 percentage points; and • then – an uplift rate equal to the GDP factor. Class 2 ABR exploration expenditure is relabelled Class 2 uplifted exploration expenditure.	Exploration expenditure incurred less than five years prior to a production licence being applied for (Class 2 ABR exploration expenditure) is subject to an uplift rate equal to the LTBR+15 percentage points.

New law	***Current law***
Transferred exploration expenditure	
All exploration expenditure transferred between petroleum projects from 1 July 2019 is subject to: • for the ten years after the expenditure is incurred – an uplift rate equal to the LTBR+5 percentage points; and • then – an uplift rate equal to the GDP factor.	The uplift rate for transferred exploration expenditure is either the LTBR+15 percentage points or the GDP factor depending on the date the expenditure was incurred and the application date of the receiving project's production licence.
Resource tax expenditure	
No change.	Resource tax expenditure is subject to an uplift rate equal to the LTBR+5 percentage points.
Closing down expenditure	
No change.	Closing down expenditure is not uplifted but is creditable at 40 per cent of the excess over assessable receipts, to the value of the entity's past PRRT liabilities.

Detailed explanation of new law

General expenditure uplifts

1.24 General expenditure incurred less than five years prior to a production licence being applied for (Class 2 ABR general expenditure) is currently subject to an uplift rate equal to the LTBR+5 percentage points (section 34A of the Act).

1.25 General expenditure incurred less than five years prior to a production licence being applied for in relation to a new petroleum project is subject to the following uplift rates:

- until the year which is ~~for the~~ ten years after the project first earns assessable petroleum receipts – an uplift rate equal to the LTBR+5 percentage points; ***[Schedule 1, item 4, subsection 34A(4) (paragraph (c) of the definition of 'uplift rate') of the Act]***
- then – an uplift rate equal to the LTBR. ***[Schedule 1, item 4, subsection 34A(4) (paragraphs (a) and (b) of the definition of 'uplift rate') of the Act]***

New petroleum projects

1.26 A petroleum project is generally a new project subject to the amended general expenditure uplift rates if:

- there is a production licence notice for the project and the notice specifies a date on or after 1 July 2019; or
- if there is no production licence notice, the production licence was granted on or after 1 July 2019.

[Schedule 1, items 4 and 5, subsection 34A(4) (subparagraphs (a)(i) and (ii) of the definition of 'uplift rate') and subsection 34A(5) (definition of 'post-June 2019 licence') of the Act]

1.27 A production licence notice specifies the day sufficient information has been provided to support an application for a production licence (subsection 258(7) of the *Offshore Petroleum and Greenhouse Gas Storage Act 2006*). As such, the date specified in the notice is often referred to as the application date, even if an incomplete application was made at an earlier date. ***[Schedule 1, items 1 and 5, subsection 34A(5) (paragraph (a) of the definition of 'post-June 2019 licence') of the Act and the note to subsection 258(7) of the Offshore Petroleum and Greenhouse Gas Storage Act 2006]***

1.28 Similar principles are relevant for determining whether general expenditure was incurred less than five years prior to the application for the production licence (paragraph 34A(1)(a) of the Act).

New combined projects

1.29 Petroleum projects may be combined under combination certificates issued by the Minister for Resources if the projects are sufficiently related (subsection 20(1) of the Act). All of the production licences relating to the Bass Strait exploration permit are taken to be a single petroleum project, as are the licences relating to the North West Shelf exploration permits (subsection 19(1A) and 19(1B) of the Act).

1.30 A combined petroleum project is a new project subject to the amended general expenditure uplift rates if one or more of the production licences that make up the combined project:

- is subject to a production licence notice and the notice specifies a date on or after 1 July 2019; or
- if there is no production licence notice, the production licence was granted on or after 1 July 2019.

[Schedule 1, items 4 and 5, subsections 34A(4) (subparagraphs (b)(i) and (ii) of the definition of 'augmented bond rate') and subsection 34A(5) (definition of 'post-June 2019 licence') of the Act]

1.31 Petroleum projects and combined projects that are not new projects are not subject to the amendments to the general expenditure uplift rates. Class 2 ABR general expenditure incurred in relation to these petroleum projects continues to be uplifted at the rate equal to the LTBR+5 percentage points. ***[Schedule 1, item 4, subsection 34A(4) (paragraph (c) of the definition of 'uplift rate') of the Act]***

The amended general expenditure uplift rates

1.32 The uplift rate equal to the LTBR+5 percentage points continues to apply in relation to new petroleum projects before the project derives assessable petroleum receipts and for the ten years after the projects first derives assessable petroleum receipts. ***[Schedule 1, item 4, subsection 34A(4) (paragraph (c) of the definition of 'uplift rate') of the Act]***

1.33 After this period elapses, the uplift rate equal to the LTBR begins to apply to the general expenditure that relates to the petroleum project. ***[Schedule 1, item 4, subsection 34A(4) (subparagraph (a)(iii) and (iv) of the definition of 'uplift rate') of the Act]***

1.34 It does not matter who derives the assessable petroleum receipts as the test applies on a project basis.

1.35 For combined projects, the ten-year period during which the current uplift rate continues to apply begins when:

- the combined project first derives assessable petroleum receipts; or
- a pre-combination project that relates to one of the post-July 2019 production licences in the combined project first derived assessable petroleum receipts.

[Schedule 1, item 4, subsection 34A(4) (subparagraphs (b)(iii) and (iv) of the definition of 'uplift rate') of the Act]

1.36 Where a pre-combination project was itself a combined project, the provisions apply in a recursive manner.

Example 1.1 Combined projects

Project Alpha was granted a production licence in 2010. Following successful drilling, a second production licence is granted in 2020 for an adjacent gas field.

The joint venture applies for and is granted a combination certificate for the project. Because one of the production licences was granted after 1 July 2019, the ten year period will commence at the time the combined project first derives assessable receipts.

Example 1.2 Additional combinations

Further to Example 1.1, a third production licence is combined with the project in 2023. There is no change to the ten year period because it was already triggered by the first post-June 2019 licence.

1.37 Once a combined project is subject to the amendments and the uplift rate equal to the LTBR begins to apply to the project, the project is always subject to this uplift rate. If one or more, but not all, of the production licences cease, the combined project is taken to continue (subsection 19(3) of the Act).

1.38 The continuing combined project will continue to be a new project subject to the new uplift rate even if the remaining production licences were issued prior to 1 July 2019 or had not derived assessable petroleum receipts before that time.

Example 1.3 Combined project where a production licence ceases

> Further to Example 1.1, but disregarding Example 1.2, the second production licence ceases in 2025. In 2028, a third production licence is granted and is combined with the first production licence. There is no change to the ten year period that commenced when the combined project first earned assessable receipts.

Class 1 GDP factor expenditure

1.39 General expenditure incurred more than five years prior to a production licence being applied for (Class 1 GDP factor expenditure) is not subject to the amendments and remains subject to an uplift rate equal to the GDP factor (section 35 of the Act).

Exploration expenditure uplifts

1.40 Exploration expenditure incurred more than five years prior to a production licence being applied for (Class 2 GDP factor exploration Expenditure) is currently subject to an uplift rate equal to the GDP factor.

1.41 Exploration expenditure incurred less than five years prior to a production licence being applied for (Class 2 ABR exploration expenditure) is currently subject to an uplift rate equal to the LTBR+15 percentage points.

Exploration expenditure incurred before 1 July 2019 and retained in the same petroleum project

1.42 Class 2 ABR exploration expenditure incurred before 1 July 2019 and retained within the same petroleum project continues to be subject to an uplift rate equal to the LTBR+15 percentage points until 1 July 2019. ***[Schedule 1, item 44, subparagraph 8(3)(a)(i) and paragraph 8(3)(b) (subparagraph (i) of the definition of 'uplift rate') in Schedule 1 to the Act]***

1.43 From 1 July 2019, the exploration expenditure is subject to an uplift rate equal to the LTBR+5 percentage points indefinitely. ***[Schedule 1, item 44, paragraph 8(3)(b) (subparagraph (ii) of the definition of 'uplift rate') in Schedule 1 to the Act]***

Example 1.4 Exploration expenditure incurred before 1 July 2019

Project Beta was granted a production licence in the 2010-11 financial year. Its sole operator incurred total exploration costs of $500 million in the 2007-08 financial year.

Project Beta starts to earn assessable receipts and is entitled to deduct the exploration expenditure in the 2021-22 financial year. The uplift rate equal to the LTBR+15 percentage points applies up to and including the 2018-19 financial year because the exploration expenditure was incurred after 1 July 1990 and less than five years before the production licence came into effect.

From the 2019-20 financial year, the uplift rate equal to the LTBR+5 percentage points applies.

1.44 Class 2 GDP factor exploration expenditure incurred before 1 July 2019 continues to be uplifted at the rate equal to the GDP factor indefinitely.

Example 1.5 Class 2 GDP factor exploration expenditure

Project Gamma was granted a production licence in the 2010-11 financial year. Its sole operator incurred total exploration costs of $500 million in the 2000-01 financial year.

Project Gamma starts to earn assessable receipts and is entitled to deduct the exploration expenditure in the 2021-22 financial year.

The GDP factor uplift applies indefinitely as the exploration expenditure was incurred after 1 July 1990 and more than five years before the production licence came into effect. There is no change in the uplift after 1 July 2019.

Exploration expenditure incurred after 1 July 2019

1.45 From 1 July 2019, there is no distinction drawn between exploration expenditure incurred more than five years prior to a production licence application being made and expenditure incurred at a later time. ***[Schedule 1, items 34, 35 and 36, clause 1 (definitions of 'ABR expenditure year', 'GDP expenditure year' and 'standard uplift expenditure year') in Schedule 1 to the Act]***

1.46 All exploration expenditure incurred on or after 1 July 2019 is subject to the following uplift rates:

- for the ten years after the exploration expenditure is incurred – an uplift rate equal to the LTBR+5 percentage points; ***[Schedule 1, item 44, subparagraph 8(3)(a)(ii) and paragraph 8(3)(b) (subparagraph (iv) of the definition of 'uplift rate') in Schedule 1 to the Act]***
- then – an uplift rate equal to the GDP factor. ***[Schedule 1, item 44, paragraph 8(3)(b) (subparagraph (iii) of the definition of 'uplift rate') in Schedule 1 to the Act]***

Exploration expenditure transferred before 1 July 2019

1.47 Exploration expenditure transferred prior to 1 July 2019 continues to be transferred subject to the following existing uplift rates:

- for expenditure incurred by the transferring entity more than five years prior to the date specified in the receiving project's production licence notice (or the date of the grant if there is no notice) – an uplift rate equal to the GDP factor (Clause 38 in Schedule 1 to the Act);
- for expenditure incurred by the transferring entity less than five years prior to the date specified in the receiving project's production licence notice (or the date of the grant if there is no notice) – an uplift rate equal to the LTBR+15 percentage points. ***[Schedule 1, items 75 and 76, paragraph 37(1)(c) and paragraph 37(2)(c) (subparagraph (i) of the definition of 'uplift rate') in Schedule 1 to the Act]***

Exploration expenditure transferred after 1 July 2019

1.48 All expenditure transferred after 1 July 2019 is subject to the amended uplift rates, regardless of when the expenditure was incurred. That is, all exploration expenditure transferred on or after 1 July 2019 is transferred subject to the following uplift rates:

- for the ten years after the expenditure is incurred – an uplift rate equal to the LTBR+5 percentage points; ***[Schedule 1, items 75 and 76, paragraph 37(1)(d) and paragraph 37(2)(c) (subparagraph (iii) of the definition of 'uplift rate') in Schedule 1 to the Act]***
- then – an uplift rate equal to the GDP factor. ***[Schedule 1, item 76, paragraph 37(2)(c) (subparagraph (ii) of the definition of 'uplift rate') in Schedule 1 to the Act]***

Example 1.6 Exploration expenditure transferred after 1 July 2019

Project Delta was granted a production licence in the 2010-11 financial year. Its sole operator incurred total exploration costs of $500 million in the 2007-08 financial year, which are never deducted within the project.

The operator also has an interest in Project Theta that has a notional taxable profit and, without transferred exploration expenditure, would pay PRRT in 2020-21.

The operator is required to transfer its exploration expenditure from Project Delta to Project Theta. The uplift rate equal to the LTBR+5 percentage points applies for the ten years from the 2007-08 financial year during which the exploration expenditure was incurred. From the 2017-18 financial year to the 2020-21 financial year, the augmented total is uplifted at the rate equal to the GDP factor.

1.49 It would not change the outcome in Example 1.6 if the production licence was granted at an earlier time within five years of the financial year in which the exploration expenditure was incurred.

Consequential amendments

1.50 Class 2 ABR general expenditure is relabelled Class 2 uplifted general expenditure. This reflects the change of the uplift rate to incorporate the GDP factor for some financial years. Similarly, Class 2 ABR exploration expenditure is relabelled Class 2 uplifted exploration expenditure. This reflects that this class applies to all exploration expenditure incurred on or after 1 July 2019. ***[Schedule 1, items 2, 3, 6 to 34, 37 to 39, 41, 44, 47, 50 to 52, 54, 56, 61, 75 and 76, the formula and the definition of 'augmented bond rate' in subsection 34A(4), sections 34A, 35A, paragraphs 32(c), 32(e), 35(3)(c), 35C(5)(c), 35C(5)(e), 35E(3)(c), 34E(3)(e), 48A(5)(b), 58K(2)(a) and 58M(2)(a), subparagraphs 48(1)(a)(i), 48K(1)(b)(iii), 58K(1)(b)(iii), 58M(1)(c)(iii), the notes to paragraph 48A(5)(c), subparagraphs 48(1)(a)(ia) and subsections 36A(1) and 36B(1), and the headings to subsections 58K(2) and 58M(2) of the Act, and clause 1 (definition of 'augmented bond rate'), clause 5 (paragraph (a) of the definition of 'notional taxable profit'), clause 37, subclauses 8(3) to (7), and paragraphs 6(1)(a) and 7(a) in Schedule 1 to the Act]***

1.51 The concept of an ABR expenditure year in Schedule 1 to the Act is relabelled a standard uplift expenditure year. This incorporates the 2019-20 financial year and future financial years. ***[Schedule 1, items 34 to 36, 40, 42 to 46, 48, 49, 51, 53, 55, 57 to 60, 62 to 76, clause 1 (definitions of 'ABR expenditure year', 'GDP expenditure year' and 'standard uplift expenditure year') clauses 24, 33 and 37, subclauses 8(3) to (7), paragraphs 6(1)(b) and 7(b), and subparagraphs 25(c)(i) and 34(c)(i) in Schedule 1 to the Act]***

Application provisions

1.52 The amendments commence on 1 July 2019. ***[Clause 2 of the Exposure Draft]***

1.53 The amendments generally apply from 1 July 2019. The application of the amendments to expenditure incurred prior to that date and petroleum projects that were the subject of a production licence notice that specifies an earlier date are discussed earlier in this Chapter.

Chapter 2
Onshore petroleum projects

Outline of chapter

2.1 Schedule 2 to the Exposure Draft amends the Act to remove onshore petroleum projects from the scope of the PRRT. Onshore petroleum projects are generally not expected to result in PRRT liabilities but can reduce taxpayers' PRRT liabilities for offshore projects because of the transfer of exploration expenditure.

Context of amendments

2.2 The PRRT originally only applied to certain petroleum projects in Commonwealth waters. Onshore petroleum projects were subject to other resource taxation arrangements, including State and Commonwealth royalties, crude oil excise and the Resource Rent Royalty.

2.3 From 1 July 2012, the *Petroleum Resource Rent Tax Assessment Amendment Act 2012* extended the PRRT to onshore petroleum projects, including coastal waters within State and Territory jurisdictions, and the North West Shelf.

2.4 The Review of the Petroleum Resource Rent Tax noted that:

> A key feature of the extension of the PRRT to onshore projects and the North West Shelf … project in 2012 was that transitioning projects were provided with a starting base amount that is carried forward and uplifted at LTBR plus 5 percentage points until it is applied against the assessable receipts of the project. These projects have very large starting bases mainly because most used the market value approach, including the value of the resource, to determine their starting base and the valuation was done when oil prices were relatively high…
>
> The extension of PRRT to onshore projects has also meant that these projects can transfer exploration expenditure to other PRRT paying projects within a wholly owned group of companies, which is likely to have lowered PRRT revenue since 2012.

Summary of new law

2.5 Schedule 2 to the Exposure Draft amends the Act to remove onshore petroleum projects from the scope of the PRRT. Onshore petroleum projects are generally not expected to result in PRRT liabilities but can reduce taxpayers' PRRT liabilities for offshore projects because of the transfer of exploration expenditure.

2.6 Removing onshore petroleum projects from the PRRT addresses the integrity risk posed by transfers of exploration expenditure and removes the regulator burden associated with the PRRT for these projects. Onshore oil and gas projects will continue to be subject to State royalties.

Comparison of key features of new law and current law

New law	*Current law*
The PRRT ceases to apply to onshore petroleum projects.	PRRT applies to onshore petroleum projects.

Detailed explanation of new law

2.7 Petroleum projects are based on production licences. The definition of a 'production licence' in the Act is an expanded definition of the same defined term in the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (paragraph (a) of the definition). The expanded definition includes licences in the Western Greater Sunrise area governed by the Timor Sea Treaty (paragraph (b)) and onshore production licences (paragraph (c)).

2.8 Other PRRT concepts are defined in a similar manner.

2.9 Schedule 2 to the Exposure Draft amends definitions to remove the parts of the definitions that relate to onshore petroleum projects and repeals other definitions specific to onshore projects. This has the effect of removing onshore petroleum projects from the PRRT. ***[Schedule 2, items 1, 3, 5, 6, 8 to 25 and 27, section 2 (definitions of 'access authority', 'applicable commencement date', 'block', 'consolidated group', 'created', 'excluded fee', 'exploration permit', 'exploration permit area', 'head company', 'holder of a registered interest', 'infrastructure licence', 'MEC group', 'member', 'onshore area', 'onshore petroleum project', 'pipeline licence', 'post‑30 June 2008 petroleum project', 'production licence', 'production licence area', 'production licence notice' 'provisional head company', 'registered holder', 'retention lease', 'retention lease area' and 'subsidiary member') and section 2AA of the Act]***

Consequential amendments

Combination of petroleum projects

2.10 Subsection 20(1) of the Act allows the Resources Minister to combine petroleum projects into a single project where the projects are sufficiently related. The factors the Minister must take into account in deciding whether to combine petroleum projects differ for the combination of onshore and offshore projects. Amendments are made to subsection 20(1) to reflect the removal of onshore petroleum projects from the PRRT. ***[Schedule 2, items 28 and 29, paragraphs 20(1)(c) and (d) of the Act]***

2.11 Subsection 20(1A) of the Act prevents the Resources Minister from combining certain onshore and offshore petroleum projects. This subsection is amended to remove this limitation as it is no longer necessary. A requirement the Minister not combine the North West Shelf Project with another petroleum project is retained. ***[Schedule 2, item 30, subsection 20(1A) of the Act]***

2.12 Subsection 20(2) of the Act outlines the period during which the Resources Minister may combine petroleum projects. References in this subsection to the period that applies for the purposes of onshore petroleum projects are repealed. ***[Schedule 2, item 31, paragraph 20(2)(a) of the Act]***

Time expenditure incurred and assessable receipts derived

2.13 Subsection 45(2) allows eligible real expenditure to be incurred for an onshore petroleum project after a particular date. This provision is now unnecessary and is repealed. Other amendments are made to section 45 to reflect this change. ***[Schedule 2, items 53 to 59, section 45 of the Act]***

2.14 Subsection 45(4) concerns the North West Shelf Project. This provision is amended so it no longer relies on the repealed provisions of Schedule 2 to the Act (see paragraph 2.20). The amendment is not designed to alter the date a person may incur eligible real expenditure in relation to the project because the amendment does not apply in previous financial years.

2.15 Under section 31 of the Act, various assessable receipts may be derived in relation to an onshore petroleum project or the North West Shelf Project on or after 1 July 2012 when those projects were brought into the PRRT. Section 31 is amended to remove the unnecessary reference to onshore petroleum projects. ***[Schedule 2, items 37 to 39, section 31 of the Act]***

2.16 Section 31AA of the Act provides that the timing rule in section 45 does not affect the application of Division 2 of Part V (assessable receipts) to onshore petroleum projects or the North West Shelf Project. This ensures that expenditure incurred prior to 1 July 2012 can be taken into account to the extent it is relevant to working out a taxpayer's assessable receipts. An amendment is made to remove the unnecessary references to onshore petroleum projects. ***[Schedule 2, item 40, section 31AA of the Act]***

Consolidation

2.17 Division 8 of Part V of the Act contains provisions related to tax consolidated groups. These provisions allow certain corporate groups to treat all of the entities within the group as a single entity for specific PRRT purposes. The purposes to which this single entity rule extend only apply to onshore petroleum projects. The consolidation regime is therefore repealed. ***[Schedule 2, items 74, 77, 79 and 86 to 91, Division 8 of Part V, and subsections 93(1) and 109(5) of the Act, and items 95, 100, 105 and 110 of the table in subsection 721-10(2), subsections 721-10(5) and (6) and Notes 1 and 3 to subsections 703-50(1) and 719-50(1) of the Income Tax Assessment Act 1997]***

Transfers of exploration expenditure

2.18 Clause 4C in Schedule 1 prevents the transfer of exploration expenditure incurred prior to 1 July 2012 in relation to onshore petroleum projects or the North West Shelf Project. This clause is amended to remove the reference to onshore petroleum projects. ***[Schedule 2, items 80 and 81, clause 4C in Schedule 1 to the Act]***

2.19 The amendment to clause 4C does not allow exploration expenditure incurred prior to 1 July 2012 to be transferred. The amendment only applies from 1 July 2019 at which time onshore petroleum projects cease to be subject to the PRRT or to be capable of transferring any expenditure (other than expenditure transferred with respect to an earlier financial year).

Starting base expenditure

2.20 Schedule 2 to the Act was inserted in 2012 to provide an amount of starting base expenditure for onshore petroleum projects and the North West Shelf Project. The Schedule has no further application in relation to onshore petroleum projects or the North West Shelf Project. For this reason, the Schedule is repealed. ***[Schedule 2, item 84, Schedule 2 to the Act]***

2.21 Various provisions that refer to Schedule 2 to the Act are repealed or amended as a consequence of the repeal of that Schedule. ***[Schedule 2, items 2, 4, 26, 45 to 48, 50, 52, 60 to 65, 67 to 69, 71, 72, 73, 75 and 76, section 2 (the note to the definition of 'assessment' and the definitions of 'acquisition', 'starting base amount', 'starting base asset' and 'value'), subsections 35E(1), 35E(1B), 35E(4), 48(2A) and 48A(7A), paragraphs 35E(1A)(b), 48(3)(c), 48A(5)(ca) and 48A(11)(c), subparagraphs 48(1)(a)(ib), 58K(1)(b)(vi), 58K(1)(b)(vii), 58M(1)(c)(vi) and 58M(1)(c)(vii), and the notes to subsection 35E(1), subsection 44(2), section 61 and subsection 67(2) of the Act]***

2.22 The amendments to section 35E of the Act do not affect the continued availability or uplift of carried-forward starting base expenditure already recognised in relation to the North West Shelf Project under subsection 35E(3).

Other amendments

2.23 The cost of exploration for non-petroleum resources is currently excluded from the PRRT. This exclusion clarifies that the cost of exploration for coal is excluded notwithstanding a project may recover incidental amounts of coal seam gas. Following the exclusion of onshore petroleum projects from the scope of the PRRT, these specific exclusions are no longer required. ***[Schedule 2, items 27 and 51, sections 2AB and 2AC, and subsections 37(2A), (2B) and (2C) of the Act]***

2.24 Assessable petroleum receipts currently include the project natural gas receipts of an integrated operation that recovers petroleum from an onshore petroleum project. Transfer pricing principles apply to calculating the amount of these assessable petroleum receipts. This category of assessable petroleum receipts is removed. Further consequential amendments are required to the transfer pricing rules in the *Petroleum Resource Rent Tax Assessment Regulation 2015*. These amendments will be progressed in 2019. ***[Schedule 2, item 32 to 34, paragraphs 24(1)(a), (e) and (f) of the Act]***

2.25 In reviewing the Act, it was identified that the definition of 'non-arm's length transaction' in subsection 24(2) had become redundant because of an earlier amendment. The definition is repealed. ***[Schedule 2, item 35, subsection 24(2) (definition of 'non-arm's length transaction') of the Act]***

2.26 An example explaining the concept of assessable incidental production receipts is repealed as the example relates to an onshore coal seam gas project. ***[Schedule 2, item 36, the example to subsection 29A(1) of the Act]***

2.27 Section 35C provides a deduction for resource tax expenditure. This includes expenditure on royalties. A reference to State and Territory ownership of petroleum resources is repealed because this reference relates exclusively to onshore petroleum projects. ***[Schedule 2, item 43, subparagraph 35C(3)(c)(i) of the Act]***

2.28 Section 35D provides a deduction for acquired exploration expenditure. In practice, this category of expenditure only applies to onshore petroleum projects. Accordingly, this section and associated provisions are repealed or amended. ***[Schedule 2, items 7, 41, 42, 44, 49, 66, 70, 78, 82 and 83, section 35D, section 2 (definition of 'eligible real expenditure'), subsection 34A(5), paragraphs 32(fb), 35E(3)(h) and 97(1A)(b), subparagraphs 58K(1)(b)(v) and 58M(1)(c)(v) of the Act, and paragraph (a) of the definitions of 'notional taxable profit in clauses 5 and 9 in Schedule 1 to the Act]***

2.29 An amendment is made to the definition of 'Resource Rent Tax area' in the *Excise Tariff Act 1921* to remove a redundant reference to onshore areas. ***[Schedule 2, item 85, subsection 3(1) (definition of 'Resource Rent Tax area') of the Excise Tariff Act 1921]***

Application and transitional provisions

2.30 The amendments commence on 1 July 2019. ***[Clause 2 of the Exposure Draft]***

2.31 The amendments apply to the financial year commencing on 1 July 2019 and later financial years.

2.32 The old law continues to apply to the 2018-19 financial year and earlier financial years. Anything that is required or permitted to be done after 1 July 2019 in relation to an earlier financial year continues to be subject to the old law. ***[Schedule 2, items 92 to 97]***

2.33 A special transitional rule applies to relieve taxpayers from the obligation to lodge a 2018-19 PRRT return in relation to an onshore petroleum project if:

- there is no PRRT payable in relation to the project for that financial year; and
- there is no exploration expenditure that is required to be transferred in relation to the project for that financial year.

[Schedule 2, item 98]

2.34 However, the Commissioner of Taxation may require a person to lodge a return for an onshore project under section 60 of the Act. The Commissioner may also make an assessment of the person's taxable profit under subsection 63(1) of the Act.