



Submission

Consultation Paper: The New Research and
Development Tax Incentive

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APPENDIX 1: CHEVRON IN AUSTRALIA

1.0 EXECUTIVE SUMMARY

Chevron Australia Pty Ltd (Chevron) welcomes the opportunity to provide comment on the Australian Government's consultation paper on "*The new research and development tax incentive*" ("Consultation Paper").

Chevron makes significant investment in research and development ("R&D") activity within Australia which underpins the technology needs of our business and has accessed benefits under the existing R&D Tax Concession for the development of new technologies and processes in the oil and gas industry.

Chevron believes that through the proposed new R&D tax incentive ("tax incentive") the Australian Government should continue to recognise R&D efforts and also provide incentive to companies operating in Australia to invest in innovation and technological development.

In response to the options raised in the Consultation Paper, Chevron:

- ◆ Considers that the introduction of the proposed eligibility criteria measures applied in their entirety will go beyond achieving revenue neutrality.
- ◆ Does not support proposed changes to the definition of eligible R&D activity to require the two criteria of both innovation and high levels of technical risk to be met by the one project. We believe this will disqualify high value adding activities from attracting benefits.
- ◆ Agrees that the tax incentive should generate spillover benefits to industry and the community, but strongly proposes that this should be a policy intent rather than a test for eligibility.
- ◆ Supports the proposed change to allow Australian incorporated companies to access the tax credit regardless of the location of ownership of the resulting intellectual property ("IP").
- ◆ Proposes that any restrictions on R&D eligibility be targeted towards low value adding R&D by applying a refined feedstock provision to support activities.
- ◆ Emphasises that the internal application of a new technology is just as valuable as the direct sale of the IP or products developed as a result of that technology.

Further comment on each of these issues is provided in this submission.

2.0 ABOUT CHEVRON

2.1 Chevron Corporation

Chevron is one of the world's leading integrated energy companies, with subsidiaries that conduct business around the world. The company's success is driven by the ingenuity and commitment of approximately 62,000 employees who operate across the energy spectrum.

We explore for, produce and transport crude oil and natural gas; refine, market and distribute transportation fuels and other energy products; manufacture and sell petrochemical products; generate power and produce geothermal energy; provide energy efficiency solutions; and develop and commercialise the energy resources of the future, including biofuels and other renewables.

2.2 Chevron in Australia

Chevron has been present in Australia for more than 50 years.

Chevron Australia operates the Gorgon Project, the Wheatstone Project and the Barrow and Thevenard Island oilfields. The company is a foundation partner in the North West Shelf Venture and the Browse liquefied natural gas (LNG) development, as well as a significant investor in exploration and appraisal activities offshore north-western Australia, one of four global focus areas for Chevron.

As the largest holder of discovered gas resources in Australia, the Gorgon and Wheatstone Projects form key elements of Chevron's global natural gas commercialisation strategy.

The Gorgon Project is Australia's single largest resource project containing approximately 40 trillion cubic feet (TCF) of natural gas – enough energy to power a city the size of Perth for 800 years.

The Gorgon Project, together with the Wheatstone Project, are expected to bring many benefits to Australia including direct and indirect employment, government revenues, economic growth, opportunities for local goods and services and diversity of natural gas supply.

In addition, Chevron is undertaking its largest drilling campaign in Australia and has secured deepwater drilling contracts for the next few years to support a planned exploration investment of hundreds of millions of dollars.

3.0 REVENUE NEUTRALITY

A guiding policy objective of the tax incentive is that the level of support provided will be revenue neutral over the first four years of operation. The Consultation Paper proposes that this could be achieved by introducing all of the proposed measures, including several targeted at tightening eligibility criteria. It is Chevron's view that introducing the proposed eligibility criteria measures in their entirety will go beyond achieving revenue neutrality.

3.1 Design Principle 6: R&D Activity to involve innovation and high levels of technical risk

Chevron does not believe that the definition of eligible R&D activity should be tightened to require an activity to contain both innovation and high levels of technical risk. This would in effect compound the requirements to test eligibility of core R&D activity. We are concerned that this would disqualify many critical high value adding activities from attracting benefits.

From our business and industry experience it is evident that R&D activities meet either the requirement of innovation or the requirement of a high level of technical risk, but do not meet both criteria. In our view the fact that these activities do not meet both criteria does not reduce the potential spillover benefits resulting from the activity.

We have identified by way of example two types of R&D activities undertaken by Chevron in Australia which would be considered ineligible for a tax credit if both criteria were required to be met by the one project:

3.1.1 High level of technical risk without innovation

The Government recognises the need to develop clean energy solutions, and has specifically developed funding programs to achieve commercial scale application of carbon dioxide (CO₂) injection through the Carbon Capture and Storage ("CCS") Program. CO₂ capture and injection is not a novel concept for the petroleum industry, with several projects in operation around the world. Although the concept is no longer innovative, Chevron's Gorgon Project will be the largest project of its kind in the world with injection rates of up to four times higher than any other project and presents a high level of technical risk in many of the activities necessary to achieve the successful implementation of the injection project. By encouraging companies like Chevron to invest in further developing this technology within Australia, there will be significant spillover benefits resulting from the lessons learnt in mitigating these technical risks which can be applied in future projects.

3.1.2 Innovation without high level of technical risk

Many areas such as basic research, although innovative, will not contain high levels of technical risk. For example, although research into the breeding and migration patterns of an endangered species will result in the development of new knowledge, high levels of technical risk will not be encountered while undertaking the research. The absence of high levels of technical risk does not reduce the flow on benefits resulting from the creation of new knowledge regarding the habitats and life cycle of endangered wildlife, while the spillover benefits include ensuring these species are protected for future generations.

3.2 Design Principle 7: Limitations of Supporting R&D Activity

Chevron agrees that low value adding R&D should not gain high levels of support from a concessional program, however many options presented within the Consultation Paper do not adequately address this issue.

The Venturous Australia Report indicated that the production phase of a project life cycle can create disproportionate claims between the amount of core R&D activity and the benefit accessed. When considering a typical project life cycle we believe that the early stages of development where risks are being addressed and novel solutions are conceptualised should not be subject to limited concessional treatment. Similarly, research hubs created to support the novel or risky aspects of project development should gain full support under the R&D tax incentive as they are rich in R&D activity.

3.3 Design Question 4 - Mechanisms for limiting supporting activity

Chevron does not agree with the concept of applying capping mechanisms or a differential benefit rate for support activity as we do not believe this will prevent low value adding R&D from being claimed. We further believe that these methods will impose an administrative burden upon companies and require accounting systems and processes to be drastically altered to allow access to the concession.

Current accounting systems and procedures are created for project level reporting. To change to a system where the activity must be classified as core or supporting to the R&D objective will require each individual engaged in R&D activity, in addition to cost controllers and project administrators, to have in-depth knowledge of tax legislation to distinguish between core and supporting activities. As core and supporting activities vary dramatically from one project to another, significant education and training in regards to cost reporting would be required at the commencement of each R&D project, adding a significant financial and administrative burden to the R&D process.

Our preferred option would be a version of 4(d) “*supporting activities should only be eligible on a net expenditure basis*”, or similar to the current feedstock provisions. The tightening of feedstock provisions will eliminate small amounts of R&D activity enabling large R&D claims which is raised as a concern in the Consultation Paper. Limiting the claim of supporting activity where the costs are being recouped by a company’s commercial activity, such as during the production phase of company operations, will limit disproportional claims and remove the additional subsidy from companies who are directly recouping the cost of the R&D activity.

Limiting supporting activity through broader feedstock provisions will prevent high value claims being made during a company’s production cycle unless significant value adding, core R&D is present. We believe this reduction in large, low value adding R&D can be achieved by tightening the current feedstock provisions which will ensure the cost of the tax credit is revenue neutral. Restricting disproportionate low value R&D will allow the concession to target high value adding R&D activity undertaken by research hubs or during the early stages of project development.

3.4 Design Question 5 – Excluded Activities

Chevron does not believe that the list of activities excluded from the definition of core R&D activity should be amended. As discussed above, due to the variability between core and supporting activities on any given project, we do not believe it is possible to provide an exclusive list of the required supporting activity to achieve an R&D objective.

For this reason the list of excluded activities should not be extended to include supporting activity.

4.0 FOSTERING INNOVATION AND PROVIDING SPILLOVER BENEFITS

The Consultation Paper clearly intends that the tax incentive supports innovation and rewards companies that invest in developing Australian knowhow as outlined in Principle 5 with the “additionally” and “spillover” requirement. We agree that the incentive should generate spillover benefits for industry and the wider community, however believe that Principle 5 should be used as policy intent rather than a test for eligibility. The following example demonstrates the practical difficulties in attempting to quantify a level of “spillover” which would create significant difficulties in trying to incorporate such a test into the tax credit legislation.

4.1 Chevron Energy Technology Pty Ltd (“CET”) case study

Chevron has global centres of excellence in the USA, Europe, and in Perth, Australia. Each centre provides technical expertise to Chevron and joint venture projects within the geographic region. When determining the location for the centres, one consideration was the level of R&D assistance provided by concessional programs available within each country. The Australian R&D Tax Concession was one determining factor that encouraged Chevron to establish a global centre of excellence in Perth in 2006 to service technology needs of Chevron projects in the southern hemisphere.

Since the incorporation of CET, significant R&D has been undertaken with Universities, dedicated research bodies, local schools and associations. Some of the spillover benefits from this work include:

- Career development and increased graduate employment.
- Increased collaboration and knowledge transfer with Universities and research bodies.
- Industry benefits created by knowledge transfer between joint venture partners.

The value of many of these activities and the benefits created cannot be quantified on an annual basis or in dollar terms, although clearly Australia gains significant benefit from the establishment of this global centre of excellence in Perth.

To ensure high value adding technology development is supported, the new tax credit should recognise that the internal commercialisation or exploitation of the R&D effort provides significant levels of spillover benefits to the Australian economy. Frequently the development of technology will have an immediate application for an internal project and will be a key element in achieving a wider project objective. The spillover resulting from not only the development of the key innovation, but also the wider project, has significant benefits for the whole community. The new tax credit should recognise that commercialisation of R&D through the internal application of a technology is just as valuable as a direct sale of intellectual property or products generated as a result of the R&D program.

5.0 SUPPORTING AUSTRALIAN R&D

5.1 Design Principle 1 – Location of ownership of resulting IP not relevant

Chevron strongly supports Principle 1 which will allow an Australian incorporated company to gain access to the tax credit regardless of the location of ownership of resulting intellectual property (“IP”). As highlighted in our CET case study we believe the process and learning associated with the “activity” provides spillover benefit, hence the Australian community will benefit where the R&D activity is undertaken in Australia.

5.2 Design Question 1 – Exclusions to general rule that R&D activity must be conducted in Australia

In the pursuit of developing leading edge technologies there are times where Australian firms cannot always provide required facilities or expertise to complete a project. In recognition of this, an exception should exist to the general rule to allow small amounts of overseas activity to form part of a tax credit claim. In accordance with the current system we believe that up to 10% of project expenditure should be allowed for R&D activities undertaken overseas, however we believe this system for accessing this benefit should be simplified.

The current requirement for an advanced registration for overseas activity is a complex and time consuming process. By applying a simple cap to overseas expenditure under a self assessment process, companies will be able to further enhance thought exchange with global industry experts and foster innovative thinking in Australia.

6.0 SUMMARY

Chevron believes that the proposed measures for the new tax credit applied in their entirety will significantly reduce the incentive to invest in R&D and go beyond the key objective of revenue neutrality. Many of the measures proposed within the Consultation Paper for tightening the definition of eligible R&D activity and supporting activities will overly restrict access to the benefit for many high value adding R&D activities. Any restrictions to R&D eligibility introduced for the new tax credit should be targeted towards low value adding R&D. We believe this can be achieved by applying a refined feedstock provision to eliminate large production style claims, where the majority of the expenditure stems from support activities which are directly recovered under commercial arrangements.

APPENDIX 1: CHEVRON IN AUSTRALIA

The Gorgon Project

The Chevron operated Gorgon Project is Australia's single largest resource project.

The Greater Gorgon Area gas fields, located between 130 and 200 kilometres off the north-west coast of Western Australia, contain resources of approximately 40 TCF of natural gas and are Australia's largest-known natural gas resource.

To process this natural gas, Chevron plans a subsea development of the Gorgon and Jansz fields, which will be tied back to Barrow Island. Chevron plans to construct a plant on Barrow Island which includes three, five million-ton-per-annum LNG trains and a domestic gas phase of up to 300 terajoules per day.

The Gorgon Project is expected to provide a major and sustained boost to the Western Australian and Australian economies, creating thousands of jobs and opportunities. Based on 30 years of operations, key economic findings from independent research include:

- Peak construction employment in Western Australia of around 6,000 with more than 3,500 direct and indirect jobs throughout the life of the project
- The net present value of Australia's gross domestic product (GDP) is expected to be boosted by \$64 billion
- Locally purchased goods and services (local content) of \$33 billion
- Government revenue of about \$40 billion in today's dollars

The project will be developed within a 300 hectare area on Barrow Island which represents 1.3 percent of the island's land mass. The environmental assessment for the Gorgon Project has been one of the most comprehensive in Australia and demonstrates that responsible resource development can coexist with environmental conservation.

The final investment decision (FID) on the Gorgon Project was reached on 14 September 2009.

Chevron holds a 50 percent interest in the Gorgon Project and its joint venture participants, ExxonMobil and Shell, each hold 25 percent.

Ongoing efforts to reduce greenhouse gas emissions from the Gorgon Project have resulted in a reduction in emissions intensity such that the proposed project will be one of the world's most greenhouse gas efficient sources of LNG. A significant factor contributing to achieving this world class emission intensity reduction is the proposal to geologically store naturally occurring carbon dioxide contained in the reservoir gas which would otherwise be vented to the atmosphere. The Gorgon Joint Venture's commitment to invest more than \$1 billion to reduce the emissions footprint of the Gorgon Project is a clear demonstration of an overall project commitment to tackling greenhouse gas emissions.