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SUBMISSION TO AUSTRALIA'S FUTURE TAX SYSTEM REVIEW

BP AUSTRALIA PTY LTD

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EXECUTIVE SUMMARY

BP Australia welcomes the opportunity to participate in this initial consultative phase of the Review of *Australia's Future Tax System.* Our submission focuses on establishing the strategic priority of stimulating infrastructure investment in Australia to meet demand from Asia. We look forward to working collaboratively with the review team, and the Australian Government, to contribute to the development of policy as the Review progresses.

Key messages:-

1. The review of the existing Federal and State systems for taxing resources in Australia should be done in a collaborative and open way engaging with stakeholders to ensure policy development is fair and equitable (level playing field) across both the minerals and petroleum sectors. Reform proposals should be consistent for onshore and offshore investments and any incentives offered carefully targeted, aligning to the Government's priorities for delivering energy security to Australia. BP recommends introducing accelerated depreciation for infrastructure to remove the current disincentive to invest in long life gas to liquids projects. It is important to narrow the gap between pre tax and post tax returns and ensure that projects that are economic pre tax are not discouraged due to an inappropriate tax burden. Existing tax depreciation rates for upstream investment serve to lengthen payback periods and are uncompetitive with depreciation regimes in the rest of the world. Unless remedied this will put major Australian resource projects at risk.
2. Tax reform that materially upsets the basis upon which previous investment decisions have been made, or creates significant transitional uncertainty, should be avoided to protect Australia's reputation as a stable country to invest in. We believe the tax treatment of existing investments should largely remain unchanged.
3. There are a number of major upstream projects in Western and Eastern Australia that are currently being evaluated. Consultation with the industry is critical to ensure tax does not stop otherwise viable projects, that there are no surprises and that there is robust sanctioning of as many projects as possible.
4. The review should also consider tomorrow's energy security. Tax reform proposals should not ignore the interrelationship between environmental taxation and energy security. For example, incentives are required, outside of the proposed emissions trading scheme, to remedy market failures and encourage investment in "green" technologies like solar photovoltaic panels. BP believes Tax reform should compliment the Government's Carbon Pollution Reduction Scheme ("CPRS") and include consideration of accelerated depreciation to stimulate "green" investment across all of its business segments.

BP's Vision for Australia

Our strategy to continue to invest in Australia recognises, despite cyclical downturns from time to time including the current global financial crisis, that structurally Australia is positioned very well to supply the resource needs of Asia. By that we mean there will continue to be, over an extended period of time, a significant demand pull from Asia for

Australia's natural resources resulting in potential for significant investment in local infrastructure. We also expect capital and skills to flow into Australia from Asia. This demand for infrastructure investment will be focussed primarily in the West and in Queensland whereas most of the country's population is in the South East. The scale and pace of the demand from Asia will be significant. Whilst infrastructure investment in resources extraction will be more focussed in the West and in Queensland, wealth created will also flow to the population in the South East. All of Australia will benefit. The Government has an opportunity to create the necessary policy framework to encourage faster investment in infrastructure to enable the resources extraction opportunity presented to the country to be captured early.

Summary of key taxation recommendations for the Review Team

Business	**Base**	**Growth**	**Low Carbon***
Exploration & Production	No change	Move towards "cash flow" taxation by allowing accelerated depreciation (3 year write off) for development expenditure	Carbon Pollution Reduction Scheme ("CPRS") transitional support for Energy Intensive Trade Exposed LNG*
Refining & Marketing	No change	Move towards "cash flow" taxation by allowing accelerated depreciation (3 year write off) for investment in clean fuels capability; introduce 40% R&D credit for eligible expenditure and keep current definition of R&D	CPRS transitional support for Energy Intensive Trade Exposed Refining*
Alternative Energy	No change	Move towards "cash flow" taxation by allowing accelerated depreciation (3 year write off) for CCS and Solar photovoltaic (PV) development expenditure	CPRS credit for carbon stored; National Gross FIT to replace State Net FIT systems

* Refer to BP Australia's submission on the CPRS Green Paper for additional information

Resources Taxation for Australia

The review of Australia's tax system is an opportunity for the Government to position Australia as being internationally competitive on taxation across the range of Energy businesses, a position it cannot claim today. Moreover the review is an opportunity for the Government to take action to not put at grave risk the opportunity fate has delivered to Australia – to realise the potential from Asian demand for our resources.

Specifically BP believes the Government should act expeditiously to modernise the tax depreciation schedules for infrastructure spending by providing accelerated depreciation to stimulate investment. Presently, the current long life (15 – 20 year write off allowances in the resources sector) are impeding viable pre tax resources projects and are completely uncompetitive with other countries competing for BP's capital. In our Exploration & Production business moving towards cash flow taxation for development expenditure would be entirely consistent with the policy behind the introduction of Petroleum Resource Rent Tax in Australia whereby immediate deductibility of all costs is allowed and no tax is payable until all costs have been recovered.

It is insightful that the North West Shelf project, itself recognised as a marvellous success, only reached its return of capital in 2000 - some 15 years after first production. The current economics of the Browse project, a priority but threatened project for BP in this region, show a total joint venture capital commitment of between A$37B and A$45B, but with a minimum 20 year payback discounted from 2008. The change to a 3 year depreciation schedule proposed by BP would reduce the payback period on Browse by 3 years. BP believes the current risks faced in Australia by investors with such a long pay back period are too high. The pay back period is driven by the anonymously slow tax depreciation entitlements which are among the slowest for upstream capital expenditure anywhere in the world.

By introducing accelerated depreciation for development expenditures the amount of tax the Government will receive over the life of projects will not change. It is purely a change in the timing of the receipt so that less tax is paid in the very early years and more in the later years. We believe these changes are essential to restore competitiveness to the upstream sector and ensure investment is not discouraged. It is clear that the swift development of large scale gas to liquids and other projects will shape much of the wealth and prosperity of Australia for decades to come.

Other countries have recognised the importance of sustainable competitive fiscal regimes and have introduced reforms to allow oil companies to achieve a faster pay back on upstream investment. We summarise recent reforms to resource tax depreciation schedules in other countries that we believe should guide the Government.

Country	Year of change	Capital allowances	Other
UK	2002	100% immediate deduction for development expenditure (previously slow train 25% pa WDA); immediate 100% exploration deduction unaffected.	Royalty abolished. CT rate for resources sector increased from 30% to 40% (current 28% CT rate does not apply to resources sector)
Norway	2005	Depreciation for offshore plant is straight line over 6 years; all LNG developments is straight line over 3 years; immediate 100% deduction for exploration	State tax CT 28% + Special tax CT 50% effectively a 78% CT rate; same tax base for both; interest expense allowed against both; 30% uplift permitted on development capex taken straight line over 4 years for Special tax
Angola		Depreciation 4 years straight line; + uplift of 40% over four years straight line.	
Indonesia	1989	Depreciation at 25% but balance allowed in full in year 5;	Investment credit of 110% for deepwater (increased to 125% for very deepwater in 1992) and 55% for gas fields
Azerbaijan		Depreciation 5 years straight line	

We believe the UK model has proven to be an inspired reform because no UK resources project pays any tax unless payback has been reached – a unique feature. The Norway model also provides incentives for investment, in a more complex fashion but means for every $100 of development capex, a company will secure an undiscounted cash tax reduction of $93.

For resources taxation in Australia BP recommends at a minimum:-

- Introducing accelerated depreciation (3 year write off) for development expenditure for corporate income tax, as has been argued for by APPEA
- Retaining 100% immediate deduction for exploration expenditure including the acquisition of post 1 July 2001 mining rights
- Retaining PRRT for Offshore Projects other than the North West Shelf Project but to work with industry to ensure a level playing field when comparing onshore and offshore gas to liquids projects (including coal methane gas projects).
- Retaining Crude Oil Excise (but no further reform of rates) and Royalty for North West Shelf Project, as has been argued for by Woodside

Our recommendation to retain Crude oil excise and Royalty for the North West Shelf project is driven by the complexity in trying to introduce reform part way through the project's life. If PRRT had applied to the project from commencement it would never pay PRRT because of the generous compounding rates for expenditure that would have applied. Determining the level of carry forward deductions today utilising current compounding rates, and taking into account excise and royalty already paid, would pose significant risks to revenue that are predictable under the current crude oil excise and royalty regime.

We encourage the Review Team and the Government to collaborate with the upstream resources sector and explore options for inspired reform including consideration of scraping corporate income tax altogether for new upstream projects (onshore and offshore) and replacing it with a modified Petroleum Resource Rent Tax – a pure cash flow tax regime that would align pre tax and post tax project economics.

Developing new energy supplies for the future.

The discovery of new energy supplies is a critical issue for the future. Australia became a net importer of oil and gas in 2003-04 and has seen an increasing trade deficit in them ever since[1]. Globally, access to new energy resources is also becoming an increasing concern not because the world is running out of resources "below the ground", but because commercial (capability gaps) and political factors "above the ground" are constraining access and development ability. Australia therefore needs a clear focus on increasing the discovery of both conventional and unconventional resources for the future.

Conventional resources include the exploration for more traditional hydrocarbons, often in frontier areas. "At present, only 17 per cent of Australia's offshore sedimentary basins and 26 per cent of potentially prospective onshore basins are covered by petroleum

[1] "Key Statistics 2008" Australian Petroleum Production and Exploration Association.

permits, so we simply do not know what resources remain to be discovered"[2]. However rising supply costs have increased the commercial risk being undertaken in an exploration campaign because seismic and drilling activities have increased dramatically in cost. Incentives to encourage exploration should also be considered as part of the review. For example, the introduction of an investment allowance for exploration in frontier areas at a rate of 175% of eligible exploration expenditures would be one such mechanism that could well stimulate further activity as has been argued for by APPEA.

Challenges for our downstream businesses in meeting higher community and regulatory expectations

Refining and Marketing

In our downstream business we have recently invested in excess of $300m in our two Australian refineries in order to complete major maintenance overhauls and unit upgrades. Both of our refineries are now producing diesel at one of the highest environmental standards in the world, having invested to reduce the levels of sulphur content by 98% to less than 10 parts per million (ppm) since 2003. Lower amounts of sulphur in diesel can deliver lower emissions of pollutants from engines including carbon monoxide, carbon dioxide and sooty exhaust fumes.

BP's refineries have consistently led the Australian oil refining industry in reducing the sulphur content in diesel. The BP Kwinana Refinery in Perth and BP Bulwer Refinery in Brisbane together invested in modifications to their refineries that reduced dramatically the sulphur content in diesel from 500ppm to 50ppm in 2003, two years ahead of government requirements. Once again both refineries have been able to meet the Federal Government's new fuel standards ahead of the 2009 deadline.

BP is now in the process of ensuring all of its import terminals are capable of handling imported diesel that meets the new specifications.

BP has actively supported the development of progressively tighter mandatory fuel quality standards, and our commitment to low sulphur diesel is a demonstration of our commitment to invest in our refinery assets and supply infrastructure in Australia. The R&D tax concession has supported our efforts at both refineries.

BP supports the Federal Governments review of the National Innovation System and the recommendations of the report entitled *Venturous Australia*. BP is comfortable with replacing the Research and Development (R&D) tax concession with a simpler 40% tax credit system for large businesses. In particular the move to a credit system separates the level of R&D support from the prevailing corporate tax rate, i.e. the value of the R&D Tax Concession is not diluted should the corporate tax rate reduce. BP recommends the retention of the current definition of R&D to avoid complexity and uncertainty that would arise with any change.

On Downstream fuels tax BP is broadly comfortable with the overall fuels taxes framework in Australia. It is robust and does not require substantial change. This is particularly so after the major reform that the previous government introduced from 1 July

[2] "Strategic Leaders Report" Australian Petroleum Production and Exploration Association.

2006 following consultation with BP and the industry. The position we have today is a step forward from where we were previously.

The Government can further support by encouraging industry to invest in cleaner fuels capability by offering incentives through the income tax system. Offering accelerated depreciation for investment in clean fuels capability may stimulate further industry investment comparable to BP's.

Alternative Energy

BP has contributed to the Wilkins review and has made a principled case for transitional incentives that could potentially be delivered through the tax system as well as through direct expenditure to stimulate investment in alternative energy sources e.g. solar photovoltaic panels. We note in that submission market failures today that are preventing robust investment that will not be addressed by the CPRS. We would be happy to discuss our submission to the Wilkins review with the Henry Review team at any time.