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19 April 2010

The General Manager
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Attention: Mr Gerry Antioch

Email: rdtaxcredit@treasury.gov.au

Research and Development Tax – Revised Provisions

The Australian Petroleum Production & Exploration Association Ltd (APPEA) is the peak national body representing Australia's petroleum exploration, development and production industry. APPEA is writing to highlight the petroleum industry's concerns with respect to aspects of the proposed changes to the research and development tax provisions.

Innovation is fundamental in under-pining the continued supply of reliable and competitively priced energy to Australian consumers and industry. The R&D taxation incentive has historically played an important role in shaping the innovation activities of companies in the Australian oil and gas industry and as such, any new framework or system must operate in a manner that encourages the pursuit of new knowledge and techniques.

While APPEA welcomes a number of the proposed modifications contained in the second exposure draft of the legislation released in late March, the comments provided to APPEA by member companies suggest that in the absence of further clarification on the operation of the new provisions, at best there will be considerable uncertainty as to the scope of eligibility. Depending on the outcome of a range of key interpretative matters, the industry sees the potential for a significant decline in the level of eligibility for claimants who undertake R&D in the sector. A number of specific concerns are outlined below.

Much of the innovation and research activity undertaken by the industry simply cannot be conducted in isolation from normal operations due to a range of scale and operational considerations. In essence, R&D is often conducted either in conjunction with or as a discrete element of an on-going commercial activity to maximise efficiencies and the chances of success. To effectively exclude activities simply because they are undertaken in association with another activity is, in APPEA's view, unduly restrictive.

The issue of what represents 'supporting R&D activities' will present considerable difficulties for both entities planning their R&D programs (and their judgements about

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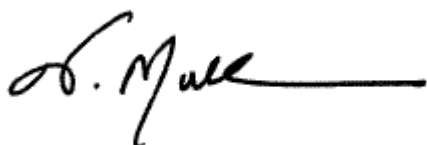
eligibility) and the administrators of the regime. At this stage, there remains very little guidance to assist in defining concepts such as what represents a production activity, with one definition potentially leading to the exclusion of any activity that produces a commercial outcome. In addition, we remain concerned with a number of the elements of the dominant purpose test, with the potential exclusion of many activities that would normally be considered as R&D in nature by any normal measure.

While it is fully recognised that an obligation rests upon entities wishing to utilise any government incentive program, advice from APPEA members suggests that there will be a substantial increase in the administrative and compliance burden associated with the operation of the proposed new provisions, over and above what exists under the current system. Issues that will need to be considered include whether an activity is a core activity, that nature of the supporting activities, the dominant purpose of an activity and its relationship with any existing production processes. The Consultation guide acknowledges that the compliance costs will be at their highest during the early stages of the new regime - this also being a period in which the greatest uncertainty will exist in relation key definitional aspects. APPEA notes that claimants are continuing to be approached by regulators seeking to further clarify and understand the nature of the activities undertaken in the industry – we see this as further increasing the expected uncertainty that will accompany any new operational framework.

APPEA remains concerned that the proposed new framework will see both a narrowing of eligibility for what are often high value R&D activities, and an increase in the compliance burden on claimant under the regime. The net impact of the proposal may see a reduction in the overall R&D effort that will be the detriment of the Australian economy.

APPEA would be pleased to further expand on any of the issues raised in this letter. Contact is Noel Mullen, telephone 02 62670904, email nmullen@appea.com.au.

Yours sincerely



Noel Mullen
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