

16 February 2024

Mr Marty Robinson
First Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

prrt@treasury.gov.au

Dear Mr Robinson,

RE: Petroleum Resource Rent Tax Regulations – updates for tolling arrangements

Thank you for the opportunity to provide a submission on the consultation for the Exposure Draft of the Petroleum Resource Rent Tax Assessment Regulations 2023.

The proposed update to the Regulations occurs at a timely point for the Australian LNG industry. When Treasury commenced its review into the gas transfer pricing arrangements in 2019, the short and medium-term outlook for the industry was focused on maximising use of existing LNG infrastructure. That remains true today, with industry focused on the toll processing of currently undeveloped offshore resources through existing infrastructure as well the potential expansion of these existing facilities.

In this context, it is important that any changes to the Regulations are fit for purpose for tolling arrangements going forward.

Australian Energy Producers and its members have identified a number of issues of concern with the Exposure Draft, and we propose changes to address them, set out in the Appendix to this submission. We believe that if these issues are addressed, the operation of the Regulations to tolling arrangements would more clearly give effect to the Treasury's previous findings and recommendations and be more fit for purpose for tolling arrangements.

If you would like to discuss any aspect of this submission or would like any further information, please contact Wayne Calder (mobile +61 424 852 384 and wcalder@energyproducers.au).

Yours sincerely



Samantha McCulloch
Chief Executive

Appendix

1 Tolling payments between participants within the same relevant operation

The Exposure Draft amends the existing Regulations to clarify that a 'commercial tolling fee' paid by parties under a tolling arrangement can be incorporated into the Residual Pricing Methodology (**RPM**). Doing so makes it clear that the commercial tolling fee to be taken into account for the purposes of determining the value of sales gas for Petroleum Resource Rent Tax (**PRRT**).

Under proposed r 18A(a), in order for a tolling fee to be a 'commercial tolling fee', the fee must be paid under a tolling arrangement between:

- (i) a participant of the relevant operation; and
- (ii) a non-participant of the relevant operation (or a person acting in the capacity of both a participant and a non-participant).

The intended effect of r 18A(a) seems to be to exclude from the RPM calculation a toll payment between participants within the same operation, even where the toll payment represents an arm's length price.

However, there appears to be a tension between new r 18A(a) and the proposed amendment to r 31(3):

- Under the current regulations, r 31(3) precludes a payment between participants from being included as a cost of the integrated operation for the purposes of the RPM calculation.
- This position is proposed to be altered by the Exposure Draft, which introduces an exception to r 31(3) that allows payments between participants to be included as a cost in the RPM where the payment is a 'commercial tolling fee'. *Prima facie* this suggests an intention to include in the RPM toll payments between participants in the same operation.
- However, as defined in r 18A, a 'commercial tolling fee' will not include a toll payment between participants in the same operation (with the exception of a participant acting in more than one capacity as contemplated by paragraph (ii) of r 18A(a)).

Given this tension, it is not entirely clear whether the intended outcome is to exclude or include in the RPM an arm's length toll paid by participants in the same operation.

We also observe that as drafted, r 18A(a) uses the words tolling arrangement in the definition of tolling arrangement, which can be fixed by removing the second use of the word 'tolling' in the paragraph.

Recommendations:

1. Treasury provides clarification on whether the intended outcome is to include or exclude in the RPM an arm's length toll paid by participants in the same operation.
2. Remove the second use of the word 'tolling' in r 18A(a).

2 'Reasonable' arm's length price for tolling

As currently drafted, paragraph (b) of r 18A requires the arm's length price for tolling to be reasonable and determined having regard to the entire commercial context of the tolling arrangement. While we support the qualifier that the arm's length price should be determined having regard to the entire commercial context, the requirement for the price to be 'reasonable' is an undesirable qualifier. This is because:

- (a) determining the arm's length price is already an objective test;
- (b) other provisions employing the arm's length standard, such as under income tax, do not have a reasonableness qualifier, and it is not clear why such a qualifier is necessary in this context; and
- (c) including the reasonableness qualifier imposes an additional burden of proof on the taxpayer and increases the potential for disagreement with the Commissioner as to what is or is not reasonable.

Recommendation: Remove the word 'reasonable' in r 18A(b).

3 Limiting the use of arm's length tolls to participants without cost information

In addition to the limitations in r 18A, as currently drafted r 31(3A)(c) only allows a taxpayer to use an arm's length toll in the RPM calculation if that taxpayer does not have available information about the costs of the tolling operations. This means that where the tolling costs are available to the taxpayer, that taxpayer cannot use the actual tolling fee that it pays even though the tolling fee is an arm's length price.

This limitation is not consistent with Recommendation 8 of the Treasury's Final Report on the PRRT Review of Gas Transfer Pricing Arrangements (the **GTP Final Report**). Treasury's recommendation is that the Regulations should 'ensure that arm's length/commercial transactions for parts of the LNG production chain (that reflect the underlying resource ownership and risks to parties) are used as far as possible as a reference for establishing a gas transfer price'. This recommendation was not expressed as subject to circumstances where costs information is not available; the recommendation gives primacy to the use of arm's length tolls in the RPM. The GTP Final Report clearly states that the approach to the incorporation of tolling costs in the RPM 'should reflect the actual amount paid by the resource owner for activities they have outsourced such as processing and liquefaction'¹ (as opposed to the costs incurred by the downstream infrastructure owner for those activities). When Treasury summarised its recommended principles for tolling arrangements, it recommended the use of the arm's length tolls in the RPM without any qualification to that use being limited to circumstances where tolling costs information is not available to the taxpayer.²

¹ Page 52 of the Final Report.

² Page 60 of the Final Report.

Further, the requirement at r 31(3A)(c) has the potential to result in inconsistent treatment of taxpayers in the same commercial circumstances depending on whether they have costs information available to them. A taxpayer without costs information will be entitled to include the toll in its RPM calculation, while a taxpayer with that information will need to include the costs of tolling. Practically, this may well affect RPM outcomes within a gas-to-liquid operation as generally non-operator participants in that operation will not have tolling cost information available (and will therefore be able to incorporate the arm's length toll in their RPM) while operator participants will have such information available (and therefore will not be able to incorporate the arm's length toll in their RPM). Not only is this potentially unfair between taxpayers, but is also inconsistent with the existing principle that the RPM price is calculated at a project level rather than a participant level (other than in relation to the personal costs).

This outcome would be inconsistent with the Gas Transfer Pricing Terms of Reference which asked Treasury for advice on:

ensuring that the regulations are neutral as far as possible between operations where the owners (or part owners) of gas process their own gas and where gas is processed by third parties.

as those processing their own gas are more likely to have costs information than those having their gas processed.

Finally, there may be circumstances where although tolling cost information is available to the taxpayer, the taxpayer does not have the rights to use that information for the RPM. In such circumstances, under the current Exposure Draft the taxpayer would be precluded under r 31(3A)(c) from using the commercial tolling fee but also legally precluded from using the costs information for the RPM.

Recommendation: Remove the requirement for a lack of access to the tolled cost at regulation 31(3A)(c).

4 Denial of costs attributable to more than one operation

The Exposure Draft introduces a new r 32(2) which excludes from the RPM calculation those costs associated with a relevant operation to the extent that including the cost would result in the cost being attributed to both that operation and any other operation where the cost is used in the RPM for any taxpayer who is a participant in that relevant operation. The Explanatory Statement suggests that this regulation prevents the 'double-counting' of costs that would otherwise occur.

Where costs potentially relate to two relevant operations, there are already a number of measures which prevent double-counting. In particular:

- (a) new r 31(3B) and r 31(3C) directly prevent the tolling fee and the costs of tolling being double-counted in the RPM for a relevant operation;
- (b) where costs relate partly to an operation and partly to another operation, r 31(5) apportions those costs; and

- (c) where there is multiple use of property for project products and other products, r 9 (phase points of an integrated operation) and r 43 (apply energy coefficients to the costs of each phase) apportions the affected costs.

The effect of these rules is that where costs relate to more than one relevant operation, they are appropriately apportioned, preventing any double-counting. Given these circumstances, it is not clear that r 32(2) is necessary, nor what mischief it might be directed at. We note that the GTP Final Report makes no reference to the introduction of a new regulation such as r 32(2).

Further, r 32(2) may create inappropriate outcomes for 'backfilling' arrangements. For example, consider a participant in an existing operation that processes its own petroleum and has included the costs of its tolling infrastructure in its RPM. If that participant finishes tolling its own petroleum later charges a new participant in a separate operation an arm's length toll for tolling that participant's petroleum, r 32(2) might deny the new participant the ability to incorporate the arm's length toll it pays into its RPM calculation on the basis that the toll is a cost that is also attributable to the first operation, as the same infrastructure is used. This would result in the LNG price for the new operation being inappropriately higher despite the actual arm's length toll paid by the new participant. Where the new participant pays an arm's length toll, it should not be subject to a higher price under the RPM simply because the costs of the infrastructure have already been taken into account by the existing infrastructure owner.

Recommendation: Treasury reconsider whether r 32(2) is necessary given the existing apportionment rules and the potential for unintended outcomes.

5 Using change in possession to determine commercial tolling phases

Amendments to r 9 introduce additional phase points for tolling in a relevant operation. As drafted, r 9 refers to a change in the 'possession' of the project product as demarcating the phase point. Although the meaning of the term possession depends upon the text, context and purpose of the statute, there is a risk that the term 'possession' may be interpreted as entailing some ownership rights as well as physical control of something to the exclusion of others. Typically, in a tolling arrangement, the toller will not have ownership, but will have physical control over the petroleum. The toller will physically receive another person's petroleum at a certain defined point and take custody of that person's petroleum. Accordingly, we think the word 'custody' may be more appropriate, as change in custody better aligns with both the physical process that occurs and the typical contractual terms between the parties in tolling arrangements.

Recommendations:

We suggest that the relevant references to 'possession' in r 9 (as amended by the Exposure Draft) be replaced with references to 'custody', as set out below.

9 Phase points of relevant operation

(1) Subject to section 9A, the phase points of a relevant operation are:

- (a) the point where the upstream stage ends and the downstream stage begins; and
- (b) any point in the flow of project product through the operation at which there is expected to be a difference in the ratio of project product to total product flowing through the operation before and after the point; and
- (c) any point in the flow of project product through the operation at which:
 - (i) there is a change in the person or persons who ~~are in possession~~ have custody of the project product; and
 - (ii) at least one of the persons who starts to ~~possess~~ have custody of, or stops ~~possessing~~ having custody of, the project product is a participant in the relevant operation who possesses or possessed the petroleum product in the person's capacity as a participant in that operation; and
 - (iii) the change occurs for the purpose of carrying out one or more of the actions mentioned in section 8 (including for the purpose of returning petroleum product to participants in the operation after one or more such actions are carried out).

6 Relevant GTL / GTE operations without a commercial tolling fee

Regulations 6A and 7A of the Exposure Draft operate to modify the definitions of production year and operating life for tolling arrangements where the fee is not a commercial tolling fee. The principle behind these regulations is not apparent. There is no guidance in the Explanatory Note, and they do not seem to be a basis for these regulations in the GTP Final Report.

Recommendation: Treasury provide further guidance on the principle behind r 6A and 7A for the purposes of consultation.

7 Energy coefficients

The Exposure Draft introduces a new r 43(2) which amends the Regulations to turn-off the application of energy coefficients to commercial tolling phases. We note that the existing drafting may not be sufficient in circumstances where a tolling arrangement involves not only the tolling of project petroleum but also the tolling of other products. In such circumstances, a separate energy coefficient mechanism should apply. One approach would be to make the total phase energy for a commercial tolling phase equal to the energy content of all the petroleum product subject to the commercial tolling fee that enters the phase in the year of tax.

8 Situations of common ownership with no toll charged

In AEP's previous submission dated 14 June 2019, we raised a concern at section 4.2.2 of that submission that the current Regulations do not apply appropriately to tolling arrangements between common owners with no tolling fee. A similar concern was also raised in Chevron Australia Pty Ltd's submission of the same date. This concern does not appear to have been addressed by the Exposure Draft.

Recommendation: Australian Energy Producers re-iterates its previous submission that the Regulations need to be updated to ensure that they apply appropriately to such arrangements.

9 Definitions introduced in the Exposure Draft

9.1 'Source project'

The Exposure Draft introduces a new defined term:

***source project**, in relation to a relevant operation, means the petroleum project from which petroleum is, or will be, recovered in the relevant operation*

The purpose of this new definition is not clear. It appears to conceptually be directed at defining the petroleum project of the person who is having their petroleum processed, i.e. the 'Shipper Project' in a tolling arrangement. Unlike source project, 'Shipper Project' is a term used in the GTP Final Report. The Regulations may be easier to navigate if the terms of 'Shipper Project' and 'Host Project', as referred to in the GTP Final Report, are adopted.

Alternatively, references to 'source project' could be replaced with 'petroleum project' or 'another petroleum project', as the case requires. For example, in relation to regulation 6A, the following amendments could be made which improves clarity and obviates the need for a reference to a 'source project':

Recommendation: Amend 6A as annotated below:

- 6A Relevant GTL operation where there is a tolling arrangement without a commercial tolling fee
- (1) This section applies to a relevant GTL operation if:
 - (a) there is an arrangement (the tolling arrangement) under which a fee is, or will be, paid in consideration of a person or persons carrying out one or more of the actions mentioned in subsection 8(1) or (2) [for a petroleum project](#); and
 - (b) the fee is not a commercial tolling fee.
 - (2) Despite subsection 6(6), the production year for the relevant GTL operation is:

- (a) if an election has been made in relation to the relevant GTL operation under section 50—the 2012-13 year of tax; or
 - (b) otherwise—the year of tax in which sales gas of the ~~source project~~ petroleum project is first processed into liquefied product.
- (3) Despite subsection 6(8), the operating life of the relevant GTL operation is the period beginning with the production year and ending with the latest of the following:
 - (a) the end of the expected operating life of the operation;
 - (b) in a case where a person mentioned in paragraph (1)(a) of this section also carries out an action mentioned in subsection 8(1) or (2) in relation to petroleum recovered from ~~the source project for another relevant GTL operation~~ another petroleum project in which the person is a participant—the last year of tax for any such person in which the petroleum was, or is intended to be, processed into liquefied product;
 - (c) the last year of tax in which the tolling arrangement is in effect.
- (4) Subsections (2) and (3) continue to apply to the relevant GTL operation even if subsection (1) ceases to apply to the relevant GTL operation.

Similar amendments could be made to the equivalent regulation for GTEs, r 7A.

9.2 'Taxpayer'

The Exposure Draft replaces the existing definition of 'taxpayer' with a new definition. Despite the prima facie change in words, the definition of taxpayer remains largely the same, such that it is not clear what the intention of the amendment is.

The Exposure Draft amends the definition of 'taxpayer' by removing the words 'who is a participant in an integrated operation'. Those words are replaced it with a requirement that the person must hold 'an interest in the operation that entitles the person, at the end of at least one phase, to (i) petroleum product of the operation, other than petroleum product that is destroyed, used as fuel or otherwise consumed in the operation or (ii) electricity produced in the operation.' However, under the existing Regulations, 'a participant in an integrated operation' is defined under r 11 as a person who 'holds an interest in the operation that entitles the person to petroleum product or electricity of the operation at the end of at least one phase.' It is not clear what this change is directed at.

Recommendation: Treasury consider whether changes to the definition of taxpayer can be minimised by simply replacing the word 'integrated' with 'relevant', in a manner similar to many of the other regulations throughout the Exposure Draft.

10 Other clarifications

10.1 Greater guidance in the Explanatory Statement

As a general suggestion, we note that the Explanatory Statement could helpfully be expanded to include worked examples covering typical scenarios and cross-references back to the GTP Final Report.

Currently, much of the guidance in the Explanatory Statement is simply a restatement of the regulation, which provides little further guidance to taxpayers (for example, refer to the guidance on page 5 on regulation 6A).

10.2 Clarifications to Note 5 to regulation 29

We suggest the following additional words to Note 5 to regulation 29, to clarify how the commercial tolling fee is incorporated into the RPM calculation in place of the costs associated with tolling:

Note 5: If the participants in the operation pay a commercial tolling fee in consideration of the carrying out of one or more actions mentioned in section 8, then:

- a) costs incurred [by the recipient of the commercial tolling fee](#) in carrying out the action or actions are not treated as costs associated with the relevant operation (see subsections 31(3A) and (3B)); and
- b) because of this, a cost plus price and netback price (and the related RPM price) may be able to be calculated [utilising the commercial tolling fee as a cost of the relevant operation](#) by applying the residual pricing method whether or not information about the costs incurred in carrying out the action or actions is available.