



Planning for the extended Petroleum Resource Rent Tax regime



Almost a year since the Federal Government first announced changes to the taxation of resources in Australia, the oil and gas industry continues to face uncertainties in relation to the transitional rules under the proposed expansion of the Petroleum Resource Rent Tax (PRRT).

While the recent Federal Government announcement on 24 March 2011 endorsed the full package of the Policy Transition Group's (PTG's) recommendations and provided some clarity regarding the design of the expanded PRRT, many issues are likely to remain unresolved until exposure draft legislation is released. Moving forward and planning for implementation in this environment will be a challenge for affected companies. However, it is important that you plan now, to ensure you are well prepared for any substantive enactment of the law in the future.

This article explores the actions that you can take in preparation for the proposed changes and provides guidance for navigating the current issues being faced and the uncertainties that still remain.

The story so far

On 2 May 2010, the Rudd Federal Government announced a proposed Resources Super Profits Tax (RSPT) to

apply to all resources. On 2 July 2010, the Gillard Federal Government replaced the proposed RSPT with a new series of reforms, including:

1. A Minerals Resources Rent Tax (MRRT) for iron ore and coal
2. An extended PRRT regime

Under the proposed changes, the PRRT regime will be extended to all Australian onshore and offshore oil and gas projects, including the North-West Shelf liquefied natural gas (LNG) project and coal seam methane projects (with the exclusion of the Joint Petroleum Development Area which is governed by the Timor Sea Treaty). The extended PRRT is proposed to apply from 1 July 2012.

Broadly, under the extended PRRT regime, the key features will remain the same, with upstream profits derived from extraction and early stage processing of petroleum to be taxed at 40%.

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To assist with consultation regarding the design of the Minerals Resource Rent Tax (MRRT) and the PRRT, the Government established the PTG in August 2010. The PTG released its paper providing recommendations on the transitional rules for existing projects late last year.

Following a review of the PTG's recommendations, the Federal Government accepted all 98 recommendations on 24 March 2011.

The Federal Government also announced a Resource Tax Implementation Group to undertake consultation with the resources sector as the legislation is developed, with draft legislation expected to be released in the first half of 2011.

Therefore, despite the possible political hurdles facing the Federal Government before the taxes can be enacted, taxpayers should progress with planning for the potential implementation of the proposed new taxes now.

Planning the way forward

Given that the extended PRRT regime is proposed to commence on 1 July 2012, the timeline for implementation is tight. Therefore, despite the remaining uncertainties, oil and gas companies should plan ahead to ensure that they are fully prepared for the proposed PRRT extension. This includes:

- ▶ Identifying the project(s) and the ring fence based on current and future production licences
- ▶ Evaluating the three approaches to the valuation of the starting base as at 1 May 2010, to determine the best outcome based on the augmentation impacts outlined above

- ▶ Modelling the overall PRRT impact on projects
- ▶ Preparing for tax accounting and reporting including estimating the impact of deferred tax assets and liabilities, keeping in mind the requirement to disclose the tax impact on financial statements when the law is substantially enacted
- ▶ Planning for systems and process changes to ensure data up to project ring fence can be identified and captured
- ▶ Mobilising resources internally to manage the implementation

The Resource Tax Implementation Group established by the Federal Government will continue to engage with industry on the administrative design and implementation of the extension of the PRRT. Affected companies should look to engage with the implementation group and participate in the development of legislation. By having a strong understanding of the important transitional issues and outcomes, taxpayers will be in a position to consult with the implementation group to ensure a fair and efficient PRRT regime, one that gives taxpayers sufficient certainty when moving towards production and when evaluating the competitiveness of existing commercial projects.

Transitional issues

Although the PTG recommendations provide the core design features of the transitional rules, there are still several transitional issues that need to be worked through, including the following:

Topic	Explanation	Issue
Definition of a project	The PTG has recommended that the existing combination certificate regime be retained and widened to accommodate the combination of projects that exhibit a degree of integration in extraction and processing, are managed as integrated operations or use the same downstream infrastructure.	The retention of the combination certificate regime may create an administrative burden for onshore coal seam gas projects which have a significant number of petroleum titles over a large geographical area. There also remain existing issues involving the combination of projects by wholly owned groups where each company does not hold an interest in each project.
Location of taxing point and value for GTL projects	Under the PRRT, the taxing point is the point at which petroleum is sold or a marketable petroleum commodity (MPC) becomes an excluded commodity. MPCs include crude oil, condensate, liquid petroleum gas and sales gas. For integrated gas-to-liquid (GTL) projects, such as LNG, special provisions apply under the current PRRT regulations to determine the price of sales gas by way of: <ol style="list-style-type: none"> 1. An advanced pricing arrangement (APA) 2. A comparable uncontrolled price (CUP) 3. A residual pricing methodology (RPM) 	Affected taxpayers will need to consider where the taxing point arises and the appropriate pricing methodology, for example, whether an RPM or other transfer pricing methodology will apply. The taxing point may also set the ring fence for assets and expenditure included in the starting base. The PTG recommended various options for transitioning GTL and gas-to-electricity (GTE) projects including a simplified RPM which taxpayers will need to consider.
Calculation and valuation of starting base	The PTG recommendations regarding the starting base provided the following options for valuation of the starting base: <ol style="list-style-type: none"> 1. A market value method 2. A book value method 3. A look-back approach 	There remain a number of issues in determining the starting base, including: <ol style="list-style-type: none"> 1. Which method a taxpayer should apply 2. The timing of deductions and augmentation
Royalty credits	A key design feature of the proposed expanded PRRT is the availability of a credit for state royalties paid by onshore oil and gas projects.	The Federal Government has accepted that all current and future royalties will be creditable for PRRT purposes. However, a mechanism governing the interaction between Commonwealth and State governments, as well as potential future increases to state royalties is yet to be developed.
Potential changes to the existing PRRT provisions	The PTG has issued advice to Government being: <ol style="list-style-type: none"> 1. That the PRRT definition of 'exploration' be aligned with the income tax definition 2. That the test for deductibility of expenditure be amended to one of 'necessarily incurred' expenditure 	It is unclear whether the Federal Government will also adopt the advice put forward by the PTG. The characterisation of expenditure between exploration and general is important from both an augmentation and expenditure transferability perspective. Whether a deductibility of expenditure test based on 'necessarily incurred' will provide greater certainty for taxpayers remains to be seen.
PRRT administration	The Federal Government also accepted the PTG's various administrative recommendations to simplify transitional compliance costs and to improve ongoing administration.	Some of these recommendations are in the form of advice to Government and it remains to be seen whether the Government will adopt this advice where it relates to the existing PRRT regime.

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