



**Australian Government**  
**Australian Taxation Office**

# Review of the Petroleum Resource Rent Tax

ATO submission

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## Section 1 – Introduction

- 1.1 The Australian Taxation Office (ATO) welcomes the opportunity to contribute to the independent review into the operation of the Petroleum Resource Rent Tax (PRRT), crude oil excise and associated Commonwealth royalties to help better protect Australia's revenue base and ensure that oil and gas projects are paying the right amount of tax on their activities in Australia.
- 1.2 This submission is divided into two parts; Part A (sections 2 to 6) focussed on PRRT, and Part B (sections 7 to 9) covering crude oil excise.
- 1.3 This submission addresses the terms of reference released by the Treasurer on 30 November 2016 as they relate to the ATO's role of administering the PRRT and excise within the existing legislative framework. Matters specifically addressed are:
  - > the design features of the PRRT and crude oil excise regimes and the effect of these features
  - > the reasons for the decline in petroleum tax revenue
  - > how the ATO administers the PRRT and crude oil excise.

# PART A – Petroleum Resource Rent Tax

## Section 2 – Operation of the PRRT

- 2.1 The *Petroleum Resource Rent Tax Assessment Act 1987* (Act) details the operation and administration of the Petroleum Resource Rent Tax (PRRT).
- 2.2 When the Act came into effect from 1 July 1986, the PRRT only applied to certain petroleum projects in Australia's offshore areas beyond coastal waters<sup>1</sup>, with the exception of the Bass Strait project, the North West Shelf project, and the Joint Petroleum Development Area in the waters between Australia and East Timor.<sup>2</sup> The Act replaced the crude oil and liquefied petroleum gas excise<sup>3</sup> and the Commonwealth royalty on wellhead value of production<sup>4</sup>, which had applied to offshore petroleum production. The North West Shelf and onshore petroleum projects were subject to other resource taxation arrangements, including state and Commonwealth royalties, crude oil excise and Resource Rent Royalty.
- 2.3 On 1 July 1990 the Act was amended to apply to the Bass Strait project.<sup>5</sup>
- 2.4 On 1 July 2012 the PRRT was further extended to apply to all Australian offshore and onshore oil and gas projects (including coal seam gas and oil shale projects) and the North West Shelf project, but excluding projects in the Joint Petroleum Development Area.
- 2.5 The PRRT is a profit-based tax. Unlike royalty and excise regimes, the PRRT applies to the profits derived from a petroleum project and not the volume or value of the petroleum produced. The PRRT taxes the economic rent generated from a petroleum project by providing deductions for allowable expenditure and uplifts for carry forward expenditure.
- 2.6 According to the Explanatory Memorandum<sup>6</sup>, the tax is designed to ensure the Australian community receives an appropriate return from the development of its non-renewable petroleum resources. At the same time, it provides companies with an incentive to explore and develop resources by allowing a return to companies commensurate with the risks involved in petroleum exploration and development.
- 2.7 The PRRT is a project-based tax. A petroleum project is taken to exist when there is a production licence in force. A production licence is granted under the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* and various state and territory based legislation.
- 2.8 A petroleum project broadly comprises the operations, facilities and other things required for upstream activities such as the recovery of petroleum, and the processing

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<sup>1</sup> Beyond 3 nautical miles seaward of the territorial sea baseline.

<sup>2</sup> The Joint Petroleum Development Area is subject to Production Sharing Contract arrangements under the *Timor Sea Treaty*.

<sup>3</sup> Imposed under the *Excise Tariff Act 1921*.

<sup>4</sup> Imposed under the *Petroleum (Submerged Lands) (Royalty) Act 1967*.

<sup>5</sup> Prior to the enactment of the *Petroleum Resource Rent Legislation Amendment Act 1991* which subjected the Bass Strait gas production to the PRRT, the production attracted a 10 per cent royalty under the Commonwealth's excise and royalty regime.

<sup>6</sup> Paragraph 1.12 of the Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Amendment Bill 2011, Petroleum Resource Rent Tax (Imposition - Customs) Bill 2011, Petroleum Resource Rent Tax (Imposition - Excise) Bill 2011, Petroleum Resource Rent Tax (Imposition - General) Bill 2011.

and treatment of recovered petroleum to produce marketable petroleum commodities prior to being sold or becoming an excluded commodity.<sup>7</sup>

- 2.9 PRRT is levied on a person in a financial year in relation to a petroleum project at a rate of 40 per cent of the taxable profit. The taxable profit is calculated by subtracting certain deductible expenditure and transferred exploration expenditure from the assessable receipts derived by the person from that project.
- 2.10 PRRT is paid on an entity basis. Each person who earns a taxable profit in relation to a petroleum project is liable to pay the PRRT. The basic formula for calculating PRRT liability is:

***Assessable receipts – Deductible expenditure  
– Transferred exploration expenditure = Taxable profit***

***Taxable profit x PPRT rate (40%) = PPRT liability***

- 2.11 PRRT is levied before income tax. PRRT assessed and paid in a financial year is deductible for income tax purposes. Any amount of PRRT refunded is included as assessable income for income tax purposes.
- 2.12 Deductible expenditure broadly includes expenditure, whether capital or revenue in nature, that is directly incurred by a person in relation to the petroleum project. Deductible expenditure includes cost associated with exploration, development, operation and cessation of project activities.
- 2.13 Expenditure which is not deductible for PRRT purposes includes project financing costs, certain indirect payments and certain payments in respect of administration and accounting activities.
- 2.14 The Act provides for an order of deductibility for different categories of expenditure. General project expenditure is deducted first, followed by exploration expenditure incurred within the project, resource tax expenditure<sup>8</sup>, acquired exploration expenditure<sup>9</sup>, starting base expenditure, closing-down expenditure and finally, exploration expenditure that is transferred from another project.
- 2.15 Assessable receipts broadly comprise the receipts derived by a person from the sale of petroleum, or marketable petroleum commodities produced from the petroleum, recovered from a project. Marketable petroleum commodities include stabilised crude oil, sales gas, liquefied petroleum gas, ethane and shale oil.
- 2.16 Special provisions contained in the *Petroleum Resource Rent Tax Assessment Regulation 2015 (Regulation)*<sup>10</sup> apply to calculating the assessable receipts for sales gas and project natural gas in integrated projects such as liquefied natural gas (LNG) projects. The Regulation essentially provides a framework to determine a price (known as the gas transfer price) for the sales gas or project natural gas that moves from the upstream stage to the downstream stage of the operation in circumstances where there is common ownership of all stages of the operation. It does this by

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<sup>7</sup> An excluded commodity means a marketable petroleum commodity to which any of the following applies:

- > it has been sold
- > after being produced, it has been further processed or treated
- > it has been moved away from the place of its production other than to a storage site adjacent to that place
- > it has been moved away from a storage site adjacent to the place of its production.

<sup>8</sup> In relation to Commonwealth, state and territory excise and royalties paid by onshore petroleum projects and the North West Shelf project from 1 July 2012.

<sup>9</sup> Acquired exploration expenditure represents the exploration component of the cost of acquiring an interest in a petroleum project, exploration permit or retention lease between 1 July 2007 and 2 May 2010.

<sup>10</sup> The *Petroleum Resource Rent Tax Assessment Regulations 2005* applied before the current Regulation was enacted.

allowing the gas transfer price to be determined by an advance pricing arrangement, or by a comparable uncontrolled price, or by the residual pricing method (RPM). The RPM applies two formulas (the cost-plus formula and the netback formula) to calculate the gas transfer price. In both cases, the calculations allow for a rate of return on capital costs incurred.

- 2.17 Where a person incurs deductible expenditure that exceeds their assessable receipts in a financial year, the excess expenditure is carried forward and augmented on a yearly basis until it can be absorbed against future assessable receipts from the project, or transferred to another project.
- 2.18 The uplift rates that apply to augment undeducted expenditure depend on whether it is exploration or general project expenditure, and the time at which the expenditure was incurred.
- 2.19 Broadly, the following three statutory uplift rates are applicable to augment undeducted expenditure:
- > Long Term Bond Rate (LTBR) plus 15 per cent for exploration expenditure
  - > LTBR plus five per cent for development and operating expenditures (including starting base expenditure<sup>11</sup>)
  - > Gross Domestic Product (GDP) factor rate for expenditure incurred more than five years before the granting of a production licence.
- 2.20 As PRRT is essentially an individual project-based tax, undeducted expenditure cannot be offset against assessable receipts from other projects. The exception is exploration expenditure incurred on or after 1 July 1990, which can be transferred to other projects if certain conditions are satisfied.
- 2.21 Closing-down expenditure constitutes expenditure incurred in closing down a project. Closing-down expenditure in excess of assessable receipts is creditable but is limited to the total amount of PRRT paid in respect of the project.
- 2.22 With the extension of the PRRT on 1 July 2012 to onshore petroleum interests and interests in the North West Shelf project, transitional rules generally provide the holder of such interests that existed as at 2 May 2010 with a 'starting base amount'. The starting base amount is intended to provide a shield against a PRRT liability in respect of rights that existed before 2 May 2010 but were not subject to the PRRT at that time. Once a petroleum interest becomes a petroleum project, the starting base amount from 1 July 2012 is able to be immediately deductible. Any unused amounts are uplifted by the LTBR plus five per cent each financial year.
- 2.23 Alternatively, an eligible interest holder may choose to apply the 'look-back approach'. Under the look-back approach, the taxpayer does not receive a starting base amount. Instead, in calculating their PRRT liability from 1 July 2012, taxpayers are able to take into account expenditure incurred from 1 July 2002 that would have been deductible had the PRRT provisions applied to their interest at that time.<sup>12</sup>
- 2.24 Starting base amounts are not transferable between projects. Exploration expenditure taken to be incurred under the look-back approach is also not transferable.
- 2.25 From 1 July 2006 the PRRT became a self-assessment tax. As with other taxes, such as company income tax, when a taxpayer lodges a PRRT return, the Commissioner is taken to have made an assessment of its taxable profit and the PRRT payable.

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<sup>11</sup> See paragraph 2.22.

<sup>12</sup> Where the petroleum interest was acquired between 1 July 2007 and 2 May 2010, the look-back approach may be used to recognise the cost of the acquisition relating to exploration expenditure and is referred to as acquired exploration expenditure.

Furthermore, the return is taken to be a notice of assessment given to the taxpayer on the date of lodgment.

- 2.26 The Act requires a person to furnish to the Commissioner an annual return when the person derives assessable petroleum receipts in a financial year in relation to a petroleum project. A return (and payment of any PRRT payable) is due 60 days after the end of the financial year (i.e. 29 August) or at a later date as the Commissioner allows.
- 2.27 To facilitate the collection of the PRRT, a person is liable to pay three instalments of tax in respect of a petroleum project in each financial year. The instalments of tax are due and payable on 21 October, 21 January and 21 April respectively in a financial year. A person is liable to lodge an instalment statement when an instalment of tax becomes payable.

## Section 3 – Key PRRT data

- 3.1 Due to secrecy and privacy reasons, the Commissioner is unable to disclose taxpayer information except in specific circumstances. The information provided in this submission consists of information that is already, or will be, in the public domain.

### PRRT collections

- 3.2 The PRRT is a secondary tax which has generated over \$33 billion in revenue for the Australian Government since the Commonwealth first received PRRT collections in the 1989-90 financial year. In 2015-16 the PRRT generated approximately \$845 million out of \$343 billion of total taxes collected by the ATO.
- 3.3 Taxation statistics relating to the number of PRRT returns and projects, and the amount of assessable receipts, expenditure (including transferred and carry forward expenditure), taxable profit and PRRT tax paid for the 1999-00 to 2014-15 financial years are available on data.gov.au.<sup>13</sup> Table 1 sets out the PRRT statistics published on data.gov.au as part of the taxation statistics for the 2012-16 financial years.

**Table 1: Taxation statistics for 2012-16 financial years – PRRT**

\$m	2011-12	2012-13	2013-14	2014-15	2015-16
Number of PRRT returns (no.)	75	155	148	149	148
<b>Assessable receipts</b>	12,709	26,319	29,643	25,537	20,111
<b>Deductible expenditure</b>					
Class 2 General	21,515	63,245	79,637	94,756	124,597
Class 2 Exploration	2,170	5,546	8,065	10,402	17,121
Resource Tax	n/a	6,242	6,891	5,943	5,062
Acquired Exploration	n/a	8,389	10,054	13,612	15,213
Starting Base	n/a	65,855	78,673	84,051	91,447
Other	925	393	361	445	1,809
<i>Total</i>	<i>24,610</i>	<i>149,670</i>	<i>183,681</i>	<i>209,209</i>	<i>255,249</i>
<b>Transferred expenditure</b>					
Section 45A	855	560	434	474	298

<sup>13</sup> [https://data.gov.au/dataset/taxation-statistics-2013-14/resource/18524fd7-2ae4-4119-bb47-d73072e8fdcf?view\\_id=aa963b7a-6df9-4439-acc0-3ebbf456374d](https://data.gov.au/dataset/taxation-statistics-2013-14/resource/18524fd7-2ae4-4119-bb47-d73072e8fdcf?view_id=aa963b7a-6df9-4439-acc0-3ebbf456374d).

Section 45B	1,659	873	800	308	317
<i>Total</i>	<i>2,514</i>	<i>1,433</i>	<i>1,234</i>	<i>782</i>	<i>615</i>
<b>Taxable profit</b>	3,961	3,203	4,468	3,052	2,114
Carry forward expenditure	18,376	127,987	159,740	187,506	237,867
<b>PRRT tax paid on taxable profit</b>	1,584	1,281	1,787	1,221	845

3.4 The PRRT payable figures and the names of all PRRT payable entities for the 2013-15 years of tax are also published on data.gov.au as part of the ATO's annual *Report of entity tax information*.<sup>14</sup>

**Table 2: Entity tax information for 2013-15 years<sup>15</sup>**

Name	ABN	PRRT Payable	
		2013/14 \$	2014/15 \$
AWE (Offshore PB) Pty Ltd	29008988930	5,315,502	1,290,297
AWE Oil (Western Australia) Pty Ltd	32008939080	5,358,875	
BHP Billiton Petroleum (Australia) Pty Ltd	39006923879	381,369,378	340,737,757
BHP Billiton Petroleum (Bass Strait) Pty Ltd	29004228004	559,866,686	293,921,172
BHP Billiton Petroleum (Victoria) Pty Ltd	12006466486	26,555,124	28,110,468
ESSO Australia Resources Pty Ltd	62091829819	538,485,033	265,070,131
Mitsui E&P Australia Pty Ltd	45108437529	63,010,702	82,422,986
Peedamullah Petroleum Pty Ltd	17009363820	5,508,558	211,763
Quadrant PVG Pty Ltd	51129604860		114,654,288
ROC Oil (WA) Pty Ltd	83083143382	10,493,858	3,727,953
Talisman Oil & Gas (Australia) Pty Ltd	77111708868	9,099,656	3,471,458
Vermilion oil & Gas Australia Pty Ltd	29113023591	75,117,597	36,801,589
Woodside Energy Ltd	63005482986	85,795,767	31,087,035

3.5 PRRT collection peaked in 2000-01 at almost \$2.4 billion and has been in decline since that time.

3.6 The decline in PRRT revenue may be due to a range of factors, including:

- > the design features of the PRRT which underpin the regime mean a PRRT liability is only incurred after the statutory threshold of return has been generated by a petroleum project
- > projects that are yet to enter the production phase will have significant tax shields due to the large amount of exploration and general expenditure incurred, carried forward and uplifted prior to generating any assessable receipts. Exploration expenditure may also be transferred between projects
- > PRRT collections are highly variable due to commodity prices, production levels, foreign exchange rates, and project development and operating costs
- > the natural decline in petroleum production from key petroleum projects.

<sup>14</sup> See paragraph 5.6.

<sup>15</sup> *Report of entity tax information* is taken at a specific point in time, hence the small variation in total PRRT payable between Table 1 and Table 2.



- 3.7 As a tax on profits above a certain rate of return, collections would be anticipated to increase where there is a period of sustained high commodity prices. However, these market conditions may also trigger increased exploration expenditure for new resources, which can then be transferred to shelter the increase in PRRT otherwise payable.
- 3.8 Separately, when onshore projects and the North West Shelf project were brought into the PRRT in 2012, a key factor in their future PRRT profile is the starting base amount and a deduction for the payment of other resource taxes such as excise and state based royalties. A starting base based on prevailing market value of the resource (which itself reflects some form of net present value (NPV) of the resource based on a market discount rate), will mean PRRT will only be payable when the ultimately realised return on that project significantly exceeds the return implied by its market value. For example, if the augmentation rate on expenditure equals or exceeds the market discount rate implied by the market value starting base, a project which performs to expectations will not pay PRRT.
- 3.9 Total carry forward expenditure grew sharply from \$18 billion in 2011-12 to \$128 billion in 2012-13 primarily because of the extension of the PRRT in 2012 to include onshore and the North West Shelf projects. The extension of the PRRT allowed for additional deductions of existing expenditure by way of a starting base amount. Where these amounts exceed assessable receipts, they are carried forward and uplifted each year.
- 3.10 The Mid-Year Economic and Fiscal Outlook 2016-17 was released in December 2016 and included revenue estimates for PRRT. The estimates were revised from the estimates published in the 2016-17 Budget.

**Table 3: Mid-Year Economic and Fiscal Outlook 2016-17 PRRT revenue estimates**

	Actual	Estimates		Projections	
\$m	2015-16	2016-17	2017-18	2018-19	2019-20
Petroleum Resource Rent Tax <sup>16</sup>	741	950	900	900	900

## The PRRT tax base

- 3.11 The PRRT taxpayer population<sup>17</sup> currently comprises around 54 economic groups and 145 taxpayers. The PRRT taxpayer population increased from about 75 to 155 taxpayers with the extension of the PRRT from 1 July 2012.
- 3.12 A person can apply to the ATO to register its interest in a petroleum project for PRRT. In 2015-16 there were 1,082 PRRT registrations.
- 3.13 In 2015-16 148 annual returns were lodged in relation to 62 projects. In 2015-16 only six projects were making taxable profits, and therefore paid PRRT.

<sup>16</sup> This item includes a small amount of Minerals Resource Rent Tax receipts relating to a pre 2013-14 income year which cannot be separately disclosed owing to taxpayer confidentiality.

<sup>17</sup> Comprising taxpayers with PRRT lodgment obligations because they derive assessable receipts in a year of tax in relation to a petroleum project.

**Table 4: PRRT lodgment details for 2013-16 financial years**

	2013-14	2014-15	2015-16
PRRT returns	148	149	148
Lodging projects	60	62	62
Lodging economic groups	54	52	54
Entities with a PRRT liability	12	12	Not yet published
Projects with a PRRT liability	9	8	6

## Section 4 – Main external reviews

### 2009 Australian National Audit Office review

- 4.1 The ATO has been administering the PRRT since its introduction in 1987. Since this time, the ATO's administration has been the subject of a performance audit by the Australian National Audit Office (ANAO). The audit found that overall the ATO has administered the PRRT in a generally effective manner.
- 4.2 On 20 May 2009 the ANAO tabled in Parliament its final report titled *Administration of the Petroleum Resource Rent Tax* (2009 ANAO Report). The objective of the performance audit was to assess the effectiveness of the ATO's administration of the PRRT. The ANAO identified four key areas for review: general administration; compliance; promoting certainty in administering the PRRT; and governance arrangements.
- 4.3 The ANAO found:
- > the ATO effectively undertakes the core administration elements of the PRRT, which was supported by industry stakeholders
  - > PRRT compliance arrangements and plans are cohesive and compliance activities are based on sound risk management processes
  - > the ATO has taken action to increase the level of interpretative assistance and advice to PRRT taxpayers
  - > PRRT governance arrangements are sound
  - > external stakeholders indicated skilling levels of ATO staff are generally high for PRRT administration.
- 4.4 However, the ANAO also made the following four recommendations:
- > Recommendation No 1 – to increase the extent to which the ATO makes timely inquiries to resolve apparent PRRT payment anomalies where this has significant tax liability implications
  - > Recommendation No 2 – to provide more extensive written guidance about key aspects of PRRT
  - > Recommendation No 3 – to strengthen the capacity of the PRRT Centre of Expertise<sup>18</sup>
  - > Recommendation No 4<sup>19</sup> – to extend the approach taken in *2008-2009 PRRT Compliance Strategies* to develop, monitor and report against key performance indicators for each recommended strategy.

<sup>18</sup> The PRRT Centre of Expertise was dissolved in around 2011.

<sup>19</sup> The ATO only agreed in part to Recommendation No 4.

## Annual ANAO audit

- 4.5 Each year the ANAO conducts an audit of the ATO's financial statements. In recent years the ANAOs focus has been on the accuracy of the PRRT data transferred from the form, to the business system, through to the financial statements. The ANAO has not identified any issues with this process.

## 2010 Policy Transition Group

- 4.6 On 21 December 2010 the Policy Transition Group (PTG) which was established by the Australian Government provided its report on the new resource taxation arrangements relating to the proposed Minerals Resource Rent Tax (MRRT) and the expanded PRRT. The PTG was established to advise on the technical design of these new arrangements. The PTG made 94 recommendations of which recommendations 68 to 94 relate to the extension of the PRRT to onshore projects.
- 4.7 The report contained the following recommendations and advice to government in relation to the extension of the PRRT in the context of PRRT administration:
- > Recommendation 91 – the Treasury and ATO continue to engage with industry to progress the administrative design and implementation of the extension of the PRRT to all petroleum projects, including:
    - establishing an implementation group involving industry representatives, relevant advisors and officials from the Department of Resources, Energy and Tourism, the Treasury and the ATO
    - providing practical early guidance on the extension of PRRT and taxpayer obligations
    - establishing capability in both the ATO and key intermediaries to support industry in complying with the law
  - > Recommendation 92 – government should ensure the ATO is appropriately funded to provide interpretive and administrative support to industry in their transition to the extended PRRT
  - > Recommendation 93 – to ensure the extension of the PRRT achieves its intended purpose efficiently and equitably with minimal compliance and administration costs, the Board of Tax should review the operation of the extended PRRT within five years of its implementation (noting that it has not yet been five years since implementation)
  - > Recommendation 94 – the ATO should provide guidance on circumstances that may warrant a remission of penalties by the ATO in cases of inadvertent errors, particularly in the first two years of the extended PRRT
  - > Advice to government 3 – as part of extending the PRRT, the Australian Government could consider amending the PRRT legislation to provide for:
    - substituted accounting periods for taxpayers who use them for income taxation
    - an instalments regime that is responsive to the potential for significant within-year variability in petroleum profits and a final reconciliation period that fits within entities' tax calendars
    - the ability of the ATO to obtain PRRT relevant information from third parties such as project vendors or joint venture operators
  - > Advice to government 4 – the ATO could consider adapting the administrative design of the PRRT, to provide workable certainty to taxpayers and minimise the

- costs of complying with and administering the extended PRRT. These practices should include:
- providing for annual PRRT returns, including the option to lodge returns prior to the receipt of PRRT income, to support the provision of certainty regarding historic expenditure
  - guidelines for joint venture partners and operators, and the ATO in relation to joint venture accounts and substantiation of expenditure.
- 4.8 The government accepted all of the PTG's 94 recommendations relating to the new resource taxation arrangements, including the recommendations relating to the extension of the PRRT. In its media release dated 24 March 2011 the government announced it would consider advice provided by the PTG beyond the terms of reference to amend the PRRT legislation as fiscal circumstances permit.
- 4.9 The ATO has undertaken a number of measures to improve the administration of taxes, including the PRRT. Such measures include the following:
- > the ATO's increased focus over the past few years on a prevention before correction approach, and commitment to real-time transparency and consultation assist to facilitate the timely resolution of PRRT issues (for instance, through premium engagement vehicles such as the Annual Compliance Arrangements (ACA) and the Advance Pricing Arrangements (APAs))<sup>20</sup>
  - > the ATO has issued a number of PRRT technical discussion papers dealing with the scope of the deductible expenditure and excluded expenditure provisions, and examples on the deductibility of common expenditure items across a range of practical situations. In addition, the ATO has issued a number of rulings on aspects of the PRRT law, and more recently, practical compliance guidelines on the deductibility of general project expenditure. The ATO also maintains guidance material on its website, which addresses key topics that an existing and potential PRRT taxpayer will need to know about the PRRT
  - > the ATO was part of the Resources Tax Implementation Group established by the government to oversee the implementation of the MRRT and the extension of the PRRT
  - > to assist taxpayers to comply with the extended PRRT, the ATO issued a number of early guidance papers covering key features of the PRRT, including: market value starting base; starting base market valuation risk factors; record-keeping for starting base; determining the market value of an interest in a petroleum project; and measuring the market value of property, plant and equipment
  - > the ATO published on its website information relating to the ATO's administrative approach to MRRT and PRRT administrative penalties for the period from 1 July 2012 to 30 June 2014, and the ATO's administrative approach to PRRT joint ventures
  - > in recent years, the ATO has improved its expertise by having dedicated officers with strong knowledge in the PRRT in the relevant groups which have the management of the PRRT work program.
- 4.10 The impact of these measures addresses either wholly or in part the recommendations made by the ANAO and the PTG.

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<sup>20</sup> See paragraphs 5.16 and 5.17.

## Section 5 – ATO’s administration of the PRRT

- 5.1 As the government’s principal revenue collection agency, the ATO has responsibility for the administration of the Act, including the collection of PRRT. Under the Act, the Resources Minister is the certifying minister for the issuance of a combination certificate, which enables two or more projects to be treated as constituting a single petroleum project. At a policy level, the Treasury and Department of Industry, Innovation and Science (DIIS) are jointly responsible for the PRRT legislation.
- 5.2 The PRRT compliance work program is predominantly managed by an operations team in the Public Groups and International (PG&I) Business Line located in Perth. The operations team is supported by a risk and intelligence function performed in Melbourne. Broadly, the PG&I Business Line has responsibility for all publicly listed and international entities. The PG&I Advice and Guidance area manages the provision of advice relating to PRRT matters. The operations and advice area are technically supported by the Tax Counsel Network, which identifies and manages high risk interpretive issues, and includes several tax counsel who specialise in tax issues relating to the extractive industries, including PRRT. Other aspects relating to the administration of the PRRT such as reporting, registration and debt are managed by the Service Delivery Group.
- 5.3 Due to the nature of projects potentially subject to PRRT, the ATO is able to comprehensively identify all potential PRRT taxpayers. The ATO then uses risk-based approaches to ensure its resources and efforts are focused on those taxpayers and issues posing the greatest risks to the tax system. The ATO uses data and analytics to better target monitoring and assurance activities and design techniques to make better use of taxpayers’ natural data systems. For those relatively few taxpayers with whom the ATO has more significant concerns, the approach will have more of an enforcement focus (eg. audit and litigation).

### Registration and reporting

- 5.4 The ATO provides an administrative registration process which facilitates the collection of relevant information to enable the effective processing of annual returns, quarterly statements and other statements<sup>21</sup> furnished to the Commissioner. The ATO encourages all entities to register even though they will not have any PRRT obligations until they are deriving assessable petroleum receipts. To register for PRRT, an entity completes, and furnishes to the Commissioner, a form which collects information about the entity, the petroleum project, when assessable petroleum receipts are expected to be derived, and financial institution account details.
- 5.5 The Service Delivery Group is responsible for the processing of PRRT registration forms, returns and statements in the ATO’s Integrated Core Processing (ICP) system, which is the primary register for all taxpayer accounts. These documents provide the ATO with the basic information to undertake broad accuracy checks of the main elements contributing to the assessment of the PRRT payable.
- 5.6 From 2015, certain taxpayers are subject to the recently enacted corporate tax transparency rules. Under these rules, the ATO has a legislative duty to produce the *Report of entity tax information* annually, which reports information about certain

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<sup>21</sup> Other statements include: the PRRT deductible expenditure schedule (requires the detailing of deductible expenditure incurred for all years from the year in which the entity first incurred expenditure for a project up to, and including, the year in which the entity lodged its first return); the notification of transfer of PRRT exploration expenditure; the notification of transfer of an interest in a petroleum title; and the starting base return.

corporate tax entities.<sup>22</sup> Uniquely to PRRT taxpayers, from 1 July 2013 the ATO is also required to publish, and has published, every amount of PRRT paid, and not just an amount that exceeds a particular threshold amount.

## Risk-differentiation framework

- 5.7 The ATO's taxpayer engagement is governed by the risk-differentiation framework (RDF). The RDF is used to tailor strategies for dealing proportionately with taxpayers and risks to the tax system. This ensures the ATO focuses its resources on the highest risks to the tax system.
- 5.8 In considering which taxpayers to review and the frequency and intensity of such reviews, the ATO assesses the relative likelihood of each taxpayer not meeting its tax obligations, and the consequence of potential non-compliance using the RDF model. The RDF model comprises four different categories. Taxpayers are rated based on the economic consequence of non-compliance and the likelihood of non-compliance.
- 5.9 The ATO uses a variety of data sources at the whole of system and taxpayer level to detect risks. For higher consequence taxpayers, the ATO's primary source of data is the intelligence gathered from its ongoing engagement with these taxpayers, returns and statements. For lower consequence taxpayers, the ATO's primary source of data is returns and statements. Data is analysed to identify inconsistencies, patterns and trends.
- 5.10 All taxpayers classified as higher consequence receive a letter from the Commissioner to their Board explaining their categorisation and outlining the key risks based on their operations and interactions with the ATO.

**Figure 1: Risk-differentiation framework – four quadrant model**



- 5.11 RDF categorisations are reviewed each year. A taxpayer's categorisation is ultimately decided upon by a moderation panel after considering recommendations from the relevant compliance teams.
- 5.12 As a result of the RDF moderation process for the 2015-16 year, seven economic groups have been classified as key taxpayers for PRRT purposes.
- 5.13 For these key taxpayers, the ATO will take a particularly close interest in their risk management and governance frameworks in order to manage and treat tax compliance risks. Key taxpayers are expected to fully disclose potentially contestable matters to the ATO as they arise. The ATO will assign the necessary resources to ensure a good working relationship and increase its understanding of the taxpayer's business. Where a potentially contestable matter is identified, the ATO will work with

<sup>22</sup> The *Report of entity tax information* is available on the [data.gov.au](http://data.gov.au) website.

key taxpayers to resolve the matter and evaluate compliance with the law. For key taxpayers, the ATO is less likely to use its formal powers of access and questioning for additional information. However, the ATO will escalate matters if it is unable to obtain the information and evidence needed to form a view in a timely manner.

- 5.14 For lower consequence taxpayers, the ATO will generally undertake targeted activities to deal with tax compliance concerns. These activities are more likely to be reviews and audits, and the ATO may contact taxpayers to seek assurance that a particular transaction has been treated correctly. The ATO use data and intelligence analysis to confirm the lower consequence categorisation. This can involve activities such as requesting targeted information about specific issues identified in the market or business operations, and activities involving normal review processes. For PRRT lower consequence taxpayers, the ATO provides education and assistance through information published on the ATO website.

## Tax assurance

- 5.15 The ATO's PRRT compliance strategy focuses on early engagement approaches such as ACAs and APAs. The ATO also obtains assurances through post-lodgment activities including a range of reviews and audits, reviews of ACAs and annual compliance reviews of APAs.
- 5.16 ACAs are voluntary arrangements that allow the ATO to tailor a key taxpayer's compliance relationship with the ATO, rather than working through more conventional post-lodgment compliance approaches such as risk reviews and audits. As a pre-condition to entering into an ACA, a key taxpayer must satisfy the ATO:
- > it has good tax risk management procedures that align with relevant ATO guidance<sup>23</sup>
  - > it is willing to work with the ATO to establish the ACA and throughout the term of the ACA
  - > it will fully identify and disclose all material transactions and risks.
- An ACA typically has a cycle of three years.
- 5.17 The ATO may enter into APAs with operators and participants of petroleum projects in order to determine, in advance of controlled transactions, an appropriate set of criteria for the determination of the transfer pricing of those transactions over a fixed period of time. Parties enter into APAs for various reasons but primarily to mitigate risk. Once entered, an APA is reviewed by the ATO to ensure the conditions (described as 'critical assumptions') listed in the APA have not been breached, and the terms of the APA have been met.
- 5.18 The two main post-lodgment compliance activities are risk reviews and audits. A risk review is typically the first step following case selection and is designed to assess whether tax risks arise from a taxpayer's self-assessment. A risk review determines if there are any compliance issues requiring a more in-depth investigation and response. They provide an opportunity to resolve concerns about compliance issues and in most cases avoid the need for an audit. A risk review can either be broad in scope and involve ongoing dialogue and information gathering to assess and treat identified tax risks (known as a comprehensive risk review), or intentionally narrow in scope and involve the examination of one or more specific risks identified (known as a specific review). An audit is more comprehensive than risk reviews and involves intensive case examination when material underpayment of PRRT is a risk.

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<sup>23</sup> For instance the *Tax Risk Management and Governance Review Guide*.

- 5.19 To assist in detecting risk and providing assurance taxpayers are paying the correct amount of tax, the ATO monitors and analyses data from a variety of sources. The ATO's primary sources of data are the PRRT returns and associated schedules, and the intelligence gained through engagements with industry, professional bodies and advisors. The ATO also monitors and analyses industry expenditure, production and price data, and compares this data to PRRT return data to identify current and emerging PRRT risks.
- 5.20 The ATO obtains cross-assurance of annual returns by comparing the PRRT positions of joint venture participants engaged in the same project. Most projects are undertaken by independent participants as joint venturers where commercial tensions exist between these independent participants. Where discrepancies exist between project participants, they are investigated if the discrepancies are not within tolerance levels or cannot be readily explained by the taxpayer to the ATO.

## Advice and guidance

- 5.21 The ATO provides guidance and an early warning system to assist taxpayers to better manage PRRT risks. The ATO works with taxpayers and their advisors to provide guidance and certainty through a range of communication types. Taxpayers can then make informed decisions about their tax affairs. To do this, the ATO provides public advice and guidance to help taxpayers understand how the law applies to them and to assist them meet their obligations.
- 5.22 Public advice and guidance includes:
- > documents published on the ATO legal database such as public rulings and practical compliance guidelines
  - > content on the ATO website, ato.gov.au
- 5.23 On 17 December 2014 the ATO issued Taxation Ruling TR 2014/9 *Petroleum resource rent tax: what does 'involved in or in connection with exploration for petroleum' mean?*, which ruled the words 'exploration for petroleum' bear their ordinary meaning. This ruling (which was previously released on 21 August 2013 in draft form as TR 2013/D4) was published following the decision in *ZZGN v Commissioner of Taxation*<sup>24</sup> (ZZGN Decision) which clarified the scope of the meaning of exploration expenditure for PRRT purposes.
- 5.24 On 12 September 2016 the ATO published the following practical compliance guidelines<sup>25</sup> to assist taxpayers to comply with the deductible expenditure provisions in particular situations:
- > PCG 2016/12 *Petroleum Resource Rent Tax – deductibility of general project expenditure relating to the overhead component of time written costs*; and
  - > PCG 2016/13 *Petroleum Resource Rent Tax – deductibility of general project expenditure*.

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<sup>24</sup> [2013] AATA 351.

<sup>25</sup> Practical compliance guidelines provide practical compliance solutions where there is uncertainty in how laws apply in practice, it is impractical (imposes a significant compliance burden) to apply the tax laws as written, or tax laws are no longer relevant to contemporary commercial practices.



5.25 The following table outlines the current public advice and guidance material on PRRT.

**Table 5: Current ATO public advice and guidance on PRRT**

Date	Product ID	Topic
<i>Tax Rulings</i>		
3 Sep 2008	TR 2008/6	Treatment of geosequestration expenditure and receipts
17 Dec 2008	TR 2008/10	Application of <i>Petroleum Resource Rent Tax Assessment Regulations 2005</i> to an integrated gas-to-liquid operation
04 Feb 2009	TR 2009/1	Transfer of expenditure incurred in relation to a project that did not have a production licence to other taxable projects of the person or other group companies under sections 45A and 45B of the <i>Petroleum Resource Rent Tax Assessment Act 1987</i> where the expenditure is taken to be incurred by the person under sections 48 and 48A of that Act
17 Dec 2014	TR 2014/9	What does 'involved in or in connection with exploration for petroleum' mean?
<i>Miscellaneous tax ruling</i>		
17 Nov 2004	MT 2004/1	Effects of transferring an interest in an exploration permit or retention lease
01 Apr 2015	MT 2008/2	Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable
<i>ATO Interpretative Decisions</i>		
17 Mar 2005	ATOID 2005/111	Hedging expenses (gains and losses)
04 May 2005	ATOID 2005/135	Losses incurred under forward contracts – year ended 30 June 2004
13 May 2005	ATOID 2005/136	Gains derived under forward contracts – year ended 30 June 2004
13 May 2005	ATOID 2005/137	Deductibility of selling expenses – put option premiums
11 May 2007	ATOID 2007/96	Transferability of exploration expenditure: project interest transferred from common owner to common acquirer
11 May 2007	ATOID 2007/97	Transferability of exploration expenditure: project interest transferred from common owner to group member
05 Sep 2013	ATOID 2013/48	Petroleum project – entitlement to receive receipts from the sale of petroleum
<i>Practical Compliance Guidelines</i>		
12 Sep 2016	PCG 2016/12	Deductibility of general project expenditure relating to the overhead component of time written costs
12 Sep 2016	PCG 2016/13	Deductibility of general project expenditure
<i>Website content (ato.gov.au)</i>		
Current	<a href="#">PRRT information on ato.gov.au</a>	Various topics, including PRRT entities, record keeping, risks, concepts and working out PRRT

Notes:

Public rulings are binding advice and express the ATO's interpretation of the laws it administers.

ATO Interpretative Decisions are edited versions of decisions made on an interpretative matter. ATO IDs are produced to help ATO staff apply the law consistently and accurately to particular situations. They do not provide advice to taxpayers and are not rulings.

5.26 Private rulings are one of the key mechanisms in Australia's self-assessment system to provide taxpayers with certainty of tax treatment in relation to a specific scheme or circumstance. As part of the ATO's early engagement process, a taxpayer can request an early engagement discussion if it is seeking advice for a complex transaction it is considering, or has implemented.

5.27 Over the last two years, four taxpayers had entered into a private ruling with the ATO in respect of PRRT issues. Two taxpayers requested an early engagement discussion but did not ultimately proceed with applying for a private ruling.

## Consultation program

- 5.28 The ATO engages on PRRT topics with various industry consultation forums including the Energy and Resources (E&R) Working Group, which is the peak body for industry engagement and is chaired by the Deputy Commissioner PG&I – Public Groups. The E&R Working Group comprises representatives from tax professional bodies, resource industry associations and the ATO. The group works to identify and address administrative and technical issues, and concerns relating to the implementation and the ongoing operation of various taxes administered by the ATO, including the PRRT.
- 5.29 The ATO also engages with the peak national body representing Australia’s oil and gas exploration and production industry, Australian Petroleum Production and Exploration Association (APPEA), on a quarterly basis to identify and resolve significant technical and administrative issues.
- 5.30 More recently, the ATO consulted with industry on the remaking of the *Petroleum Resource Rent Tax Assessment Regulations 2005* which was due to sunset on 1 April 2016. The ATO assisted the Treasury and the Office of Parliamentary Counsel (OPC) with the drafting of the new Regulation. The key changes were aimed at reducing compliance costs and regulatory burden. For instance, as a result of the introduction in the new Regulation of an election to use a participant-based formula for calculating the net-back component of the RPM in certain circumstances, a number of taxpayers will no longer require an APA in order to modify the RPM in working out the relevant component of the net-back formula based on each taxpayer’s own project product.
- 5.31 In addition, after consulting with industry and professional bodies represented on the E&R Working Group and other tax advisors, the ATO published two practical compliance guidelines which outline the ATO’s compliance approach to applying the general project expenditure provisions in the Act to specified circumstances.<sup>26</sup>

## E&R strategy

- 5.32 The ATO has an E&R Industry Strategy Team within the PG&I Business Line. This is a specialised team who work with all taxpayer engagement teams in order to deliver an agile, integrated, co-ordinated and whole-of-taxation approach across the whole E&R sector at an industry wide level.
- 5.33 The E&R Industry Strategy Team focuses on a number of risk areas in order to build understanding of how these risks present for Australian taxpayers and how they affect the Australian and international tax systems. One of the risk focus areas includes PRRT deductible expenditures and assessable receipts.
- 5.34 The E&R Industry Strategy is also responsible for:
- > gaining assurance across all of Australian major E&R projects, including some of Australia’s major onshore and offshore oil and gas projects
  - > developing public guidance products which assist taxpayers with their tax compliance
  - > identifying and treating new and emerging risks across the E&R industry which impacts all taxation obligations administered by the ATO, including PRRT risks
  - > developing education and engagement activities for working with taxpayers in the “next 1,000” (i.e. the next (approx.) 1,000 largest taxpayers excluding the (approx.) 100 largest corporate groups) who may have little or no interactions with the ATO

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<sup>26</sup> See paragraph 5.24.

- > providing a differentiated and tailored engagement approach at a project and taxpayer level which allows for assurance at the taxpayer, project and industry levels
  - > devoting resources to project manage the ATO's approach to learning and development as well as managing internal and external stakeholders.
- 5.35 The ATO has more recently moved to treat tax risks through a clustering approach by improving the ATO risk management approach by grouping similar behaviours or manifestations for more timely and effective treatment. The ATO is currently developing a PRRT cluster.

## Section 6 – Key PRRT risks

- 6.1 The ATO has focused on the following broad categories of risks associated with the administration of the PRRT:
- > assessable receipts
  - > deductible expenditure
  - > transferable exploration expenditure
  - > starting base expenditure
  - > governance and record keeping.

### Assessable receipts

- 6.2 Assessable receipts for a petroleum project can be understated due to a number of reasons, including:
- > the misrepresentation of the 'taxing point' in relation to a petroleum project. It is at the 'taxing point' that assessable receipts are brought to account and up to which eligible project expenditures incurred are deducted to determine the PRRT taxable profit
  - > the misapplication of the Regulation in relation to an integrated gas-to-liquid project such as an LNG project
  - > the overstatement of expenses associated with the sale of marketable petroleum commodities, including related party expenses.
- 6.3 Broadly, assurance over assessable receipts is obtained by comparing annual returns lodged by each participant in a petroleum project. In addition, the ATO obtains assurance via its engagement with key taxpayers via ACAs and associated reviews of their governance arrangements.
- 6.4 When examining the accuracy of assessable receipts, the ATO will seek to understand the methodologies used for determining assessable receipts, including:
- > the determination of the relevant 'taxing point' by identifying when a marketable petroleum commodity becomes an excluded commodity
  - > the actual terms of any contractual arrangements and the implementation of those arrangements
  - > how assessable receipts are correctly identified and captured by the relevant system
  - > how assessable receipts are determined for each marketable petroleum commodity using the arm's length price

- > how expenses payable are correctly identified.
- 6.5 The determination of assessable receipts is the subject of a number of court decisions. In *Woodside Energy Ltd v Commissioner of Taxation*<sup>27</sup> (Woodside Decision) the Full Federal Court found hedging losses are not capable of being regarded as expenses payable in relation to the sale of marketable petroleum commodities for the purposes of determining assessable petroleum receipts. In *Esso Australia Resources Pty Ltd v Commissioner of Taxation* [2011]<sup>28</sup> the Full Federal Court considered the taxpayers' liability to PRRT as co-venturers in offshore petroleum recovery operations in the Bass Strait and associated onshore processing and storage facilities at Longford and Long Island Point. The case concerned issues relating to the 'taxing points'; in particular whether a marketable petroleum commodity exists, and if so, the manner in which it becomes an excluded commodity.
- 6.6 When examining the methodologies used to calculate assessable receipts for an integrated gas-to-liquid operation under the Regulation, the ATO will seek to understand the following:
- > the compliance with any APA (including any critical assumptions)
  - > if a comparable uncontrolled price is used, information on how the price was determined and how it is applied
  - > if the RPM is used, the inputs used in the formulas as detailed in the Regulation to calculate the gas transfer price at the point where the upstream stage ends and the downstream stage begins, including: details of phase points<sup>29</sup>; and the capital costs. The greatest risk is taxpayers incorrectly allocating less capital costs to the upstream stage, which reduces the gas transfer price determined under the Regulation
  - > the application of the arm's length principle relating to related party sales, back-to-back sales, and/or sales affected by collateral arrangements, functions performed by related parties, and sales and marketing functions.
- 6.7 The details of how each taxpayer may have applied the Regulation to their particular circumstances are not publicly disclosed by the ATO due to the secrecy and privacy provisions contained in the *Taxation Administration Act 1953*, which makes it an offence for taxation officers to disclose such information except in specified circumstances. However, the ATO has adopted a mix of strategies including risk reviews, audits, ACAs, APAs and guidance to assist and monitor taxpayer compliance with the requirements of the Regulation.

## Deductible expenditure

- 6.8 Taxpayers may overstate deductible expenditure for a petroleum project by including expenditure they should exclude and non-project related costs (i.e. costs that do not have the requisite nexus to the petroleum project as required by the Act). The legal test for the deductibility of expenditure for PRRT purposes under the Act is a narrower test than the test for income tax, and has historically been an area of disputation between the ATO and industry.<sup>30</sup>

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<sup>27</sup> [2009] FCAFC 12; 74 ATR 922.

<sup>28</sup> FCAFC 154; (2011) 199 FCR 226; 86 ATR 525.

<sup>29</sup> The points in the process where the ratio of project product to total product flowing through the operation changes.

<sup>30</sup> See *Commissioner of Taxation v Mount Isa Mines Ltd* (1991) 28 FCR 269; *Woodside Energy Ltd v Commissioner of Taxation (No 2)* [2007] FCA 1961.

- 6.9 Similar to the assurance approach in relation to assessable receipt risks, the ATO attains assurance over deductible expenditure claims by comparing annual returns lodged by each participant in a petroleum project. This provides assurance over material differences in claimed deductible expenditure. However, this return comparison does not detect the risk when all participants are claiming the same expenditure incorrectly. Historically, disputes and amendments have been focused on the application of the excluded expenditure provisions, with a particular focus on costs incurred 'indirectly' in carrying on or providing operations, facilities or other things comprising a petroleum project.
- 6.10 When examining how deductible expenditure is calculated, the ATO will seek to understand the relevant methodologies used, including:
- > the records and systems used to identify deductible expenditure that is related to the particular petroleum project
  - > how deductible expenditure is characterised
  - > how deductible expenditure is apportioned (including upstream and downstream apportionment)
  - > the process undertaken to determine and apply the correct uplift rate to each class and type of carried forward deductible expenditure.
- 6.11 The characterisation of expenses and the deductibility of expenditure under the Act have been the subject of a number of court decisions. In *Esso Australia Resources Pty Ltd v Commissioner of Taxation*<sup>31</sup> (Esso Decision) the High Court refused to grant special leave to Esso to appeal against the decision of the Full Federal Court, which found the costs relating to office facility, administrative, accounting expenditure and service fees were 'indirectly' incurred and therefore constituted excluded expenditures under the Act. The Court further found that certain 'mutualised research charges' did not constitute general project expenditure as the relevant work was not conducted in carrying on activities comprising the project.<sup>32</sup> The operation of the general project expenditure provision in the Act was further considered in *PTTEP Australasia (Ashmore Cartier) Pty Ltd v Commissioner of Taxation*.<sup>33</sup>
- 6.12 In view of the significant investment required to carry out petroleum projects, a significant number of projects are undertaken by a number of independent participants as joint venturers. In view of the commercial tensions that exist between these independent joint venturers, the likelihood of 'overcapitalisation' is minimised. In the experience of the ATO, the joint venture partners are only willing to commit funds that develop the petroleum project in the most economic manner. Previously, where project operators engaged related parties to provide particular services on their behalf, there was a risk these services may have been inflated to take advantage of the augmentation rates. However, as a result of legislative amendments arising from the Esso Decision<sup>34</sup>, the majority of these services are now limited to the amount actually incurred by the related party, thereby eliminating the risk of any profit element.

<sup>31</sup> [2012] FCAFC 5; (2012) 200 FCR 100; (2012) 87 ATR 124.

<sup>32</sup> The Full Federal Court in finding the expenditure incurred under the service agreement was not deductible appeared to have formed the view that apportionment of such a liability was not possible for the purposes of the Act. On 30 July 2013 amendments were made to the Act to provide certainty to industry following the High Court's decision not to grant special leave to appeal (see *Tax Laws Amendment (2013 Measures No 2) Act 2013*). Following the decision, a number of draft taxation rulings concerning aspects of PRRT deductibility and a miscellaneous taxation ruling were withdrawn and not replaced (Draft Taxation Rulings TR 2010/D4, TR 2010/D5 and TR 2010/D6, and Miscellaneous Taxation Ruling MT 93/2).

<sup>33</sup> [2013] FCA 1175.

<sup>34</sup> The Full Federal Court held payments made by a PRRT taxpayer to a third party for project activities are taken to have the same characteristics as the actual expenditure incurred by the third party in undertaking or providing the activity. However, a third party who is unrelated to the taxpayer is unlikely to provide the taxpayer details of all the expenditure incurred in providing the service, including commercial-in-confidence information, in order for the taxpayer to determine the extent to which the

- 6.13 Following the Esso Decision, taxpayers were invited to self-assess and exclude indirect expenditure and expenses charged to participants on a generalised basis. During this period, some taxpayers made amendments to their deductible expenditure claims that ranged between 0.1% and 1.6% of the total general project expenditure claimed.
- 6.14 To support reasonable apportionment of deductible expenditure, the ATO provides information on its website on when an entity may need to apportion a payment, the practices that may help an entity apportion its payments, and record-keeping obligations that may be sufficient to meet the substantiation requirements for PRRT purposes.
- 6.15 As a result of the ATO's consultation with relevant stakeholders on the practical application of the deductible expenditure provisions, the ATO issued two practical compliance guidelines on deductible expenditure (see paragraph 5.24).

## Transferable exploration expenditure

- 6.16 Taxpayers may also overstate transferable exploration expenditure from a petroleum project by misclassifying petroleum project development expenditure as project exploration expenditure, and transferring exploration expenditure of a petroleum project that does not satisfy the applicable transfer rules.
- 6.17 The scope of the meaning of exploration expenditure for PRRT purposes is different to income tax, and has historically been an area of dispute between the ATO and industry prior to the matter being clarified by the ZZGN Decision. In that decision, the Administrative Appeals Tribunal held the meaning of exploration for PRRT purposes relies on the ordinary meaning whereas the income tax meaning has been statutorily extended to include feasibility studies incurred to evaluate economic feasibility of mining.
- 6.18 Following the ZZGN Decision, on 17 December 2014 the ATO finalised Taxation Ruling TR 2014/9 *Petroleum resource rent tax: what does 'involved or in connection with exploration for petroleum' mean?*, which applies to expenditure incurred from the date of the issue of the Draft Taxation Ruling 2013/D4 (21 August 2013).
- 6.19 The ATO also released a decision impact statement (DIS), which outlined the ATO's response to the ZZGN Decision including the administrative treatment. In the DIS, the ATO acknowledged that, prior to the issue of TR 2013/D4, the Commissioner had an approach contrary to the views contained in that Draft Taxation Ruling (and TR 2014/9), of accepting a wider range of feasibility expenditure fell within the meaning of exploration expenditure for PRRT purposes. The ATO did not seek to disturb claims for expenditure incurred on or before 21 August 2013 where taxpayers had self-assessed, or will self-assess on the basis that exploration for petroleum included certain expenditure types. This means that some types of feasibility expenditure incurred on or before 21 August 2013 are augmented at the higher rate and are potentially transferable between projects.
- 6.20 Broadly, assurance over transferred exploration expenditure is obtained through the annual review of transferred exploration expenditure schedules. Material amounts are tested against publically available information. In addition, the ATO attains assurance through its engagements with key taxpayers in the form of ACAs and associated

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payment was deductible. The legislative amendments ensured the 'look-through' approach is not required in relation to payments to unrelated third parties for project activities. Where a PRRT taxpayer makes a payment to a related contractor, 'look through' is required to ensure that excluded costs and related party profit margins are not taken into account in determining the deduction available to the taxpayer.

reviews of their governance arrangements and transferred exploration expenditure claims.

## Starting base expenditure

- 6.21 Taxpayers may overstate their starting base expenditure for a petroleum project by:
- > using inappropriate valuation methodologies
  - > misallocating upstream and downstream assets
  - > misapplying the look-back approach (including the deduction of expenditure that should be excluded).
- 6.22 Since the 2012 extension of the PRRT, the ATO has conducted risk reviews in relation to starting base returns furnished to the Commissioner. The risk reviews examined how the relevant starting base amount was calculated and the taxpayer's record keeping obligations. The outcomes of the risk reviews resulted in amendments to the starting base amounts in certain cases.

## Record keeping

- 6.23 Taxpayers may misstate their PRRT liability due to inadequate record keeping and governance by:
- > simply relying on operator provided joint venture accounts rather than undertaking their own PRRT analysis
  - > having inappropriate or insufficient risk mitigation to comply with their PRRT obligations
  - > inadequately recording PRRT related transactions and decisions.
- 6.24 To address the risk of inadequate record-keeping, the ATO provides guidance on its website on record-keeping for PRRT, including joint venture record-keeping requirements. As part of any compliance activities, the ATO will generally seek assurance a taxpayer's PRRT governance and risk identification and management processes (including accounting and control mechanisms) are appropriate. In the recently published PCG 2016/13, the ATO provided guidance by way of an example as to what would constitute effective internal management processes that provide a fair and reasonable basis to ensure only genuine general project expenditure is deducted.

## Other risks

- 6.25 The ATO has commenced consultation with relevant stakeholders on the following PRRT risks with a view to the ATO being in a position to provide broader public guidance that will minimise the risks of non-compliance and assist taxpayers to voluntarily comply with the requirements of the law<sup>35</sup>:
- > the treatment of undeducted expenditure and other associated issues under the Act when a production licence reverts to a retention lease
  - > when a payment is considered to constitute closing-down expenditure within the meaning of the Act

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<sup>35</sup> In relation to the first three dot points, see matters under consultation at <https://www.ato.gov.au/general/consultation/what-we-are-consulting-about/matters-under-consultation/matters/#P201642>.

- > the application of the expenditure deductibility provisions of the Act to social infrastructure cost<sup>36</sup>; and
- > the application of the PRRT to floating LNG (FLNG) technology, which will require greater consideration of the apportionment of expenditure in view of the fact it will be carrying on both upstream and downstream activities in relation to a number of petroleum products on the vessel.

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<sup>36</sup> Social infrastructure cost relates to cost arising from a statutory requirement or an entity's social licence to operate. This includes sponsorship cost and cost to build a hospital, road, transport, water and sewerage and any other facility for the general community.



## PART B – Crude Oil Excise

### Section 7 – Operation of Crude Oil Excise

#### Introduction

- 7.1. The excise regime applying to the production of crude oil and condensate is administered by the Australian Taxation Office. A number of Commonwealth acts interact to provide for the effective imposition of excise duty on the production of stabilised crude petroleum oil and condensate<sup>37</sup> (Crude Oil Excise).

#### Rationale for the Crude Oil Excise

- 7.2. The Commonwealth introduced Crude Oil Excise in August 1975 to redistribute to the community some of the gains producers received from increased world prices. The level of excise applied has sought to balance the return to the community against the need to ensure incentives remained for companies to explore for and produce oil in Australia.
- 7.3. Parliament effectively ended import parity pricing of crude oil, which was introduced in the 1978-79 Budget, when full deregulation of the domestic crude oil supply and marketing arrangements took effect on 1 January 1988. Since then, prices of domestic crude oil have reflected world market prices.<sup>38</sup>

#### Operation of the Crude Oil Excise

- 7.4. Crude Oil Excise applies to crude oil and condensate produced onshore and within the offshore areas of the North West Shelf exploration permits.<sup>39</sup>
- 7.5. Crude Oil Excise is a production based excise and the amount of duty payable is influenced by volume and price. The excise operates by determining a price for an area (which varies from area to area) from which crude oil is sourced and calculating duty based on production (volume) levels in that area. The price for an area is represented by the volume weighted average of the realised price (VOLWARE) of excisable crude oil or condensate. Excise duty liability is imposed if the initial cumulative threshold and annual thresholds are exceeded.

#### Initial Cumulative threshold

- 7.6. The first 4767.3 ML (approximately 30 million barrels) of crude oil and/or condensate produced from an offshore field is *exempt* from excise duty.<sup>40</sup> In contrast, the same quantity from an onshore field has a *free* rate of excise duty. This subtle distinction renders all onshore production, including the 4767.3 ML threshold, subject to the excise licensing and reporting requirements of the excise system. Production of crude

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<sup>37</sup> This includes the *Excise Act 1901*, *Excise Tariff Act 1921*, *Petroleum Excise (Prices) Act 1987* and *Petroleum Excise (Prices) Regulations 1987*.

<sup>38</sup> Parliament of Australia, Parliamentary Library, last updated 17 October 2001, [Crude Oil Excise and Royalties \(Research Paper 29 2000-01\)](#)

<sup>39</sup> The North West Shelf Exploration permit areas are WA-1-P and WA-28-P.

<sup>40</sup> Exemption introduced in July 1987 with the objective of encouraging the development of oil discoveries.

oil and condensate from a single field (some fields produce both) is added together to determine when production from a field exceeds the 4767.3 ML threshold.

### Annual free production concessions

- 7.7. An oil producing field may consist of, or encompass, one or more production areas. After exceeding the initial cumulative threshold, a production area within a field will need to exceed an annual production threshold before Crude Oil Excise is payable. The annual thresholds apply separately in respect of the type of product (crude oil or condensate) coming from each production area.<sup>41</sup>
- 7.8. Each crude oil production area is prescribed as 'old', 'intermediate', or 'new'.<sup>42</sup> The classification of the production area is based on the date the relevant accumulation was discovered and developed. Classification affects the annual threshold rates that apply before Crude Oil Excise is payable. Condensate production areas have no such distinction and use only one threshold being the same as new crude oil production areas of 500 ML per annum.
- 7.9. Only offshore producers currently pay Crude Oil Excise. There are no onshore producers paying, as the initial 4767.3 ML threshold and annual thresholds have not been exceeded for any prescribed production areas.

### Calculating the VOLWARE

- 7.10. A producer's excise liability is worked out by applying the relevant crude oil rate<sup>43</sup> to the VOLWARE.
- 7.11. The VOLWARE price for a month for an oil producing region is obtained by dividing the sum of the transaction prices received for sales of excisable crude oil or condensate occurring in the month by the total quantity of that crude oil or condensate respectively.<sup>44</sup> The formula for this is:

$$\text{VOLWARE price for a month} = \frac{\text{Sum of transaction prices* of crude oil or condensate sales}}{\text{Total quantity of crude or condensate**}}$$

\*There are certain rules governing the calculation of the transaction price.

\*\*A VOLWARE price is calculated separately for excisable crude oil and for excisable condensate produced from **each** producing region.<sup>45</sup>

- 7.12. For the purposes of determining the VOLWARE price, an oil producer must provide to the Minister particular information in relation to each transaction concerning the sale of excisable crude oil or condensate in a month.<sup>46</sup>
- 7.13. The *Petroleum Excise (Prices) Act 1987* gives the Minister<sup>47</sup> or a person authorised by the Minister, the power to determine VOLWARE prices. The Minister has delegated<sup>48</sup>

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<sup>41</sup> Refer to Table 3 – Crude Oil and Condensate Excise Rates, 'Review of the Petroleum Resource Rent Tax' Issues Note, 20 December 2016, Treasury.

<sup>42</sup> Defined in section 3 of the *Excise Tariff Act 1921*.

<sup>43</sup> Refer to Table 4 – Crude Oil and Condensate Excise Rates, 'Review of the Petroleum Resource Rent Tax' Issues Note, 20 December 2016, Treasury.

<sup>44</sup> *Petroleum Excise (Prices) Act 1987* subsection 7(1).

<sup>45</sup> An oil producing region is a production area or two or more production areas within the meaning of section 5B of the *Excise Tariff Act 1921*.

<sup>46</sup> For full details of the information required to be given, see Regulation 4 of the Prices Regulations.

<sup>47</sup> On commencement, the *Petroleum Excise (Prices) Act 1987* was administered by the Minister for Primary Industries and Energy. Policy administration of the Act currently resides with the Treasurer.

this power to specific ATO personnel while retaining responsibility over the remaining provisions.

## 8. Crude oil excise collections

### Factors influencing Revenue Collection

- 8.1 The performance of the oil and gas industry in Australia is influenced by fluctuations in oil and gas prices, exchange rate movements, domestic and export demand for oil and gas and annual production volumes.<sup>49</sup> Australia's crude oil and condensate output has fluctuated over the past five years but has generally trended downwards.
- 8.2 Over the last three years there has been a decline in the oil price from around US\$100 to US\$30 a barrel. The price of crude oil as at 13 January 2017 was US\$52.37 per barrel. As crude oil and condensate sale prices are denominated in US dollars, movements in the exchange rate between the Australian and US currencies have a direct effect on revenue earned by local producers.<sup>50</sup> In the last five years the Australian dollar has generally depreciated against the US dollar, while world prices of crude oil have declined.<sup>51</sup>

Chart 1 – Crude oil prices historical chart<sup>52</sup>



- 8.3 The combined effect of production volumes, exchange rates and world oil prices on Crude Oil Excise is shown in Chart 2. Crude Oil Excise has generally been declining in more recent times largely reflect the reduction in world oil prices.

<sup>48</sup> The Tax Office delegate is an employee of the Tax Office attached to a particular position number authorised by the relevant Minister under sections 7, 9 and 10 of the *Petroleum Excise (Prices) Act 1987*.

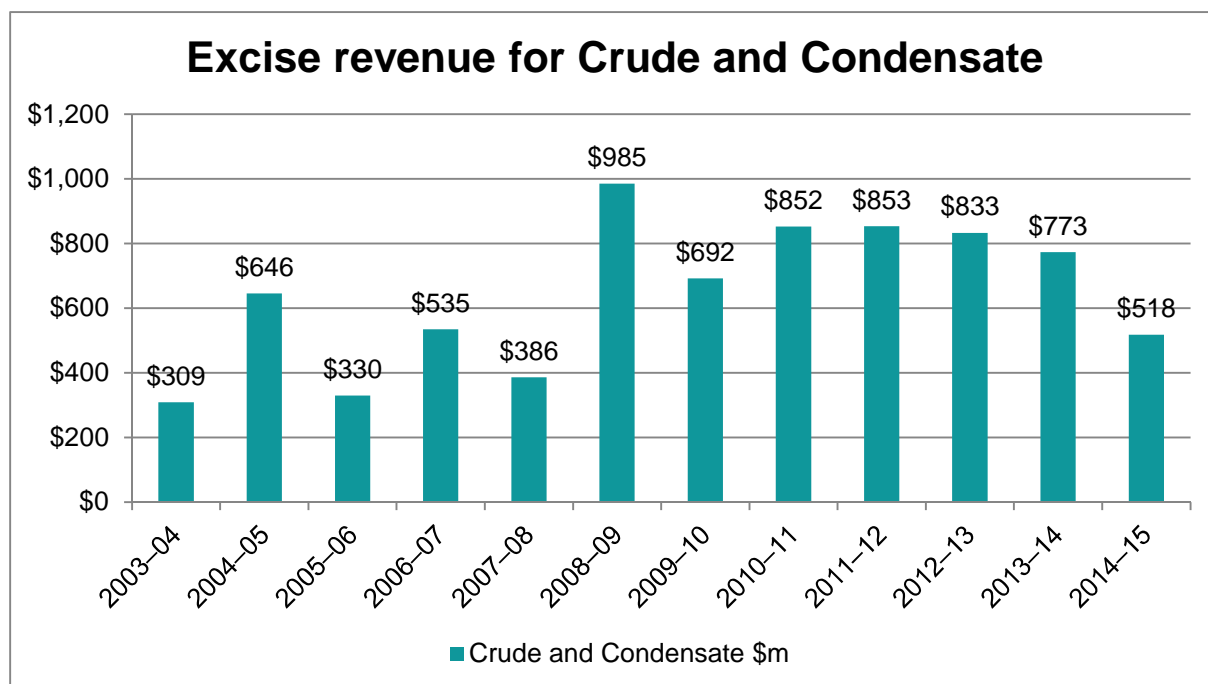
<sup>49</sup> IBISWorld report: IBISWorld Industry Report B0700, 'Oil and Gas Extraction in Australia', September 2016.

<sup>50</sup> Ibid.

<sup>51</sup> Ibid.

<sup>52</sup> [Crude oil price historical chart, viewed on 9th January 2017](#)

Chart 2 — Crude Oil Excise Collections between 2003 to 2015<sup>53</sup>



## 9. Issues for Comment

The following matters were posed as issues for comment in the *Review of the Petroleum Resource Rent Tax Issues Note*<sup>54</sup>:

- 1 The overall performance of the excise regime and whether it is operating as intended.

ATO response – In the ATO’s view the excise regime for crude oil and condensate is operating in accordance with its legislative intent.

- 2 The reasons for the decline in petroleum taxation revenue including the impact of conditions in the industry and features of the tax regimes.

ATO response – The reasons for decline in excise revenue from crude oil and condensate production is due to reducing production levels and lower prices in recent years. Oil prices and production volumes are key components in determining excise liability on production.

<sup>53</sup> [Taxation statistics 2013–14 Excise: Excisable products and excise liabilities, 2003–04 to 2014–15 financial years](#)

<sup>54</sup> Australian Government The Treasury 2016.

## Glossary

Term	Description
Advance pricing arrangement (APA)	An agreement between the ATO and a taxpayer on the future application of the arm's length principle to the taxpayer's dealings with international related parties.
Annual compliance arrangement (ACA)	An administrative arrangement that helps to identify tax issues early to avoid costly audits and tax disputes. It helps to manage the compliance relationship with a large taxpayer in an open and transparent environment.
Annual compliance review (ACR)	Under the terms of an APA, the taxpayer prepares and lodges annually an ACR signed by the public officer for each year of tax covered by the APA. The ACR need contain only sufficient information to detail the actual results for the relevant year and to demonstrate compliance with the terms of the APA.
Audit	An audit is the systematic, independent and documented process for obtaining evidence and evaluating it objectively to determine the extent to which audit criteria are fulfilled.
Australian National Audit Office (ANAO)	The Australian National Audit Office (ANAO) is a specialist public sector practice providing a full range of audit and assurance services to the Parliament and Commonwealth public sector entities and statutory bodies.
Energy and Resources (E&R) Working Group	The Energy & Resources Working Group comprises representatives from tax professional bodies, resource industry associations and the ATO. The working group consults on issues relating to income tax, resource rent taxes (petroleum resource rent tax and the now-repealed minerals resource rent tax), other taxes as they directly impact on the energy and resources sector, and general administration issues affecting the mining and petroleum industries.
Policy Transition Group (PTG)	The PTG was established by the Government on 3 August 2010 to advise on the technical design of the new taxation arrangements relating to the proposed Minerals Resource Rent Tax (MRRT) and the extended PRRT.
Practical compliance guideline (PCG)	Practical compliance guidelines provide practical compliance solutions where there is uncertainty in how laws apply in practice, it is impractical (imposes a significant compliance burden) to apply the tax laws as written, or tax laws are no longer relevant to contemporary commercial practices.
Public Groups and International (PG&I)	The ATO's PG&I Business Line has responsibility for all public groups, foreign owned entities and international strategy.
Residual pricing method (RPM)	A methodology contained in the PRRT Regulation enabling a PRRT liability to be calculated in the upstream component of an integrated gas-to-liquid operation, where there is no arm's length price and no comparable uncontrolled price.
Risk differentiation framework (RDF)	The RDF helps us assess a taxpayer's tax risk and determine the intensity of our response in a coherent, consistent and considered way. It complements the compliance model, which suggests an appropriate choice of remedy.
Risk review	The process of identifying potential risks, quantifying their likelihood of occurrence and assessing their likely impact against objectives.
Top 1000	Multinational and public companies tax performance program – streamlined and tailored reviews providing justified trust. That is, that the right amount of tax is being paid or identifying areas of non-

compliance. Reviews will commence in 2016-17. A total of 1,000 reviews will be completed over the life of the Taskforce.



