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Excise Tariff Amendment (Crude Oil) Bill 2001

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Science, Technology, Environment and Resources and the
Economics, Commerce and Industrial Relations Groups
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Excise Tariff Amendment (Crude Oil) Bill 2001

Date Introduced: 30 August 2001

House: House of Representatives

Portfolio: Industry, Science and Resources

Commencement: The changes to the excise rates and the removal of the threshold price on 'old' oil come into effect on 1 July 2001. The minor amendments in Schedule 2 come into effect on the date of Royal Assent.

Purpose

To encourage exploration for and development of crude oil and natural gas by reducing excise rates on 'old' and 'new' crude oil and by removing threshold price provisions applying to 'old' oil. The Bill also includes minor technical amendments to the *Excise Tariff Act 1921*, (Excise Tariff Act) which imposes the excise.

Background

Taxation of crude oil produced in Australia

The Commonwealth taxes crude oil produced in Australia either by the petroleum resource rent tax (PRRT) or by the crude oil excise and royalties.[1] The PRRT applies to offshore projects located outside the three nautical mile State waters boundary except the North West Shelf and the Timor Gap fields where a joint sharing taxation arrangement between East Timor and Australia will operate. The PRRT applies principally to the Gippsland Basin fields. The Commonwealth levies crude oil excise and a royalty on the North West Shelf. Nearly 70 per cent of production not subject to the PRRT is from the North West Shelf (Wanaea/Cossack fields). The Commonwealth shares the North West Shelf royalty payments with Western Australia. Coastal waters projects lying between the low tide water mark and the three nautical mile boundary are subject to the crude oil excise and State royalties, which the State shares with the Commonwealth. Onshore projects are land-based and are subject to the crude oil excise and State royalties.

In 2001–02, the PRRT is estimated to raise $1.43 billion, and the crude oil excise $400 million. The Commonwealth also receives company tax from oil and gas producers.

The return to the community and the need for incentives to explore and produce

The Whitlam Government introduced the crude oil excise in August 1975 to redistribute to the community via the government some of the gains oil producers received after world prices increased in 1973. Subsequent determination of the level of excise has sought to balance the return to the community against the need to ensure adequate incentives for exploration and production of oil in Australia. This was evident in the major changes to the excise rates on 23 October 1984. Before then, the rates depended on whether oil was classified as 'old' or 'new'. Oil discovered before 18 September 1975 was classified as old oil. New oil was oil produced from naturally occurring discrete accumulations discovered on or after 18 September 1975. The excise revisions of 23 October 1984 were aimed at encouraging the development of a number of old oilfields that had not been developed because of inadequate returns under the old oil excise scale. Such fields became eligible for concessional treatment under a new 'intermediate' excise scale.

Old, intermediate and new oil

There are now three categories of oil for excise purposes:

- old oil is oil discovered and in production before 18 September 1975
- intermediate oil is oil discovered before 18 September 1975 but not developed as of 23 October 1984, and
- new oil is oil produced from naturally occurring discrete accumulations discovered on or after 18 September 1975.

The Bill proposes the reduction of the excise on old and new crude oil.

Basis of excise and rates

Excise is levied under the Excise Tariff Act and the *Petroleum Excise (Prices) Act 1987*. The basis on which excise is levied is the volume-weighted average (VOLWARE) of sale prices. Excise rates are expressed as a percentage of VOLWARE. The first 4 770 megalitres (30 million barrels) from each project are excise-free. Thereafter, rates rise with annual sales volume; that is, marginal rates rise with higher levels of production.

Current rates of excise are shown in Table 1.

Table 1: Current crude oil excise rates

Annual sales (megalitres)#	**Old oil (% of VOLWARE)**	**Intermediate oil (% of VOLWARE)**	**New oil (% of VOLWARE)**
0 to 50	0	0	0
Over 50 to 100	5	0	0
Over 100 to 200	15	0	0
Over 200 to 300	20	0	0
Over 300 to 400	40	15	0
Over 400 to 500	70	30	0
Over 500 to 600	75	50	10
Over 600 to 700	75	55	20
Over 700 to 800	75	55	30
Over 800	75	55	35

Source: Department of Industry, Science and Resources
A megalitre is a million litres

Reasons for the legislation

On 15 August 2001, the Minister for Industry, Science and Resources, Senator the Hon. Nick Minchin, announced the Government's intention to:

> ... reduce certain crude oil excise rates and encourage oil exploration and production, both onshore and offshore.[2]

Senator Minchin noted that a secondary effect could be increased gas discoveries arising from oil exploration. Senator Minchin also stated that the Government's action was:

> ... responding to concerns raised by industry groups that high excise impost on "old" oil fields discourages full commercialisation of these existing valuable resources.[3]

The rationale for the proposed changes is that lower rates of excise on oil production in the older oil and gas fields may provide added incentives for companies to undertake further evaluation of these fields. This, in turn, may result in additional discoveries of both crude oil and condensate and natural gas. Natural gas can occur in close association with crude oil or it can also occur separately as in many of the North West Shelf deposits.

The decision to reduce excise on old and new oil should be seen in the context of declining self-sufficiency. The decline is clearly a motivating factor behind the decision. Senator Minchin stated:

> Ultimately, the consumer and Australia will benefit from efforts to meet Australia's future energy needs through enhancing Australia's self-sufficiency in oil and gas.[4]

The following provides some context for Australia in relation to world reserves of oil and gas and provides background on Australia's level of self-sufficiency.

World and Australian crude oil and gas reserves

As at the end of June 1999, world crude oil reserves stood at 1033.8 thousand million barrels. The Organisation of Petroleum Exporting Countries holds the bulk of world reserves at 802.5 thousand million barrels. At the end of 1999, Australia's reserves were 2.9 thousand million barrels or 0.3 per cent of world reserves.

At the end of 1999, world natural gas reserves stood at 146.43 trillion cubic metres with Australia's reserves standing at 1.26 trillion cubic metres or 0.9 per cent of world reserves.[5]

As is evident from the above figures, Australia has relatively limited reserves of crude oil but is better placed with natural gas reserves. Since the 1960s—when oil and gas were first produced—petroleum has played an increasingly important role in Australia's economy. Nonetheless, there is concern about how much longer Australia's resources of crude oil can last.[6] Australia's crude oil, condensate and natural gas reserves are located predominantly in the offshore Gippsland Basin off Victoria; in the Carnarvon and Browse Basins in offshore north-west Western Australia; the Timor Sea; and in the onshore Cooper/Eromanga Basin in north-east South Australia and south-west Queensland. Crude oil and condensate have been produced from the Gippsland Basin since the mid 1960s. In general terms, crude oil reserves in Australia's earlier developed fields, such as the Gippsland and Cooper/Eromanga Basins, are gradually running down.

Reserve to production ratios and levels of self-sufficiency

Australia's reserves to production ratio for crude oil is 10 years (latest available data). This doesn't necessarily mean that Australia's crude oil reserves will be depleted at current rates of production within ten years. AGSO Geoscience Australia has assessed that the reserve to production ratio has varied between 12 years and eight years between 1982 to 1996 as the depletion of reserves by production has been offset to differing degrees by the discovery of additional reserves. It is obvious that exploration for and development of crude oil reserves needs to be successful to prevent the eventual depletion of crude oil, condensate and natural gas supplies, especially with a relatively low reserve to production figure.

Australia is comparatively well endowed with natural gas reserves compared with liquid petroleum fuels. Natural gas is located in the same basins as crude oil and condensate reserves, although the North West Shelf and Timor Sea are described as being gas-rich. Australia's reserve to production ratio of natural gas is 41 years.

Despite Australia's relative low level of liquid petroleum reserves, crude oil and condensate production is currently running at high levels—peaking at 650 000 barrels a day in 2001—which is enough to make Australia relatively self-sufficient. Self-sufficiency is broadly defined as crude oil and condensate production plus production of naturally occurring liquid petroleum gas divided by Australian consumption. For the fiscal year 2000–01, Australia's level of self-sufficiency was 80 per cent. Australia's refinery intake for fiscal year 2000–01 was 44 708.1 megalitres whilst crude oil and condensate and naturally occurring liquid petroleum gas was 41 822 megalitres.[7]

Despite Australia having a relatively high level of self-sufficiency, all crude oil, condensate and naturally occurring LPG is not further refined in Australia. In fact, in 2000–01, only 38.3 per cent of indigenous output was further refined in Australian refineries. The remainder was exported. It is common practice that much of the output from the North West Self oil and gas fields is destined for large Asian refineries, rather than supplying product to east coast refineries.

Current production

Recent high crude oil prices have encouraged increased production rates at existing operations. This may result in subsequent steeper declines in the production profiles of Australian oil fields as they mature over the medium and longer term. On the other hand, with prices forecast to remain at profitable levels (above $US20 a barrel), high levels of exploration spending are expected to be maintained and more discoveries are expected to be made. Viable projects will be developed as quickly as possible.

New crude oil and condensate prospects, which will undergo further appraisal and development over the next five years, have been identified in offshore waters off north-west Australia. Oil, gas and condensates from the Echo/Yodel, Legendre and Woolybut fields in the Bonaparte basin are scheduled for development in the medium term. Another six fields have been identified as containing hydrocarbons but their size and commercial viability are yet to be assessed. [8]

Position of significant interest groups/press commentary

Mr Barry Jones, Executive Director of the Australian Petroleum Production and Exploration Association has welcomed the proposed excise changes. He said that the Government had made a start toward improving exploration incentives and acknowledging the self-sufficiency problem. The proposals would assist part of the petroleum sector and bring benefits to Western Australia.[9] Woodside Energy welcomed the proposals saying that they would encourage the North West Shelf joint ventures to look again at a number of possible projects which, until now, had been uneconomic to develop. Excise rates of up to 75 per cent had clearly been onerous and a major disincentive to exploration for and development of small marginal fields. Woodside said that the importance of the decision was in its potential to offset Australia's declining self-sufficiency for oil and growing oil import bill.[10]

Main Provisions

Several amendments, for example, **items 3, 4, 10** and **12** replace the term 'relevant oil' with 'old oil', the latter being in keeping with industry usage.

Subsection 6B(3) of the Excise Tariff Act deals with the calculation of the amount of duty on old oil. In particular, it includes an added duty that applies in certain circumstances. The Bill proposes that added duty no longer apply. **Item 11** repeals the subsection and replaces it with a new formula for calculating the amount of duty. Consequently, references to threshold price, threshold quantity and added duty are redundant. **Items 7, 8** and **11** remove the references.

Subsection 6B(4) of the *Excise Tariff Act* contains the volumes to which current rates of excise on old oil apply, while subsection 7B contains the rates applied to these volumes. **Item 14** repeals the six volume tranches[11] in paragraphs 6B(4)(a), (b), (c), (d), (e) and (f) and replaces them with five tranches. **Item 17** repeals the old rates on old oil contained in paragraphs 7B(4)(a), (b), (c), (d), (e) and (f) and replaces them with the new rates. The resulting rates of excise on old oil are shown in Table 2.

Table 2: Proposed excise rates on old oil

Annual sales (megalitres)	Old oil (% of VOLWARE)
0 to 200	0
Over 200 to 300	20
Over 300 to 400	30
Over 400 to 500	40
Over 500 to 600	50
600 and over	55

Item 17 also deletes the reference to 'variable percentage' in paragraph 7B(4)(f). The definition of variable percentage in subsection 6B(1) is no longer required and is repealed by **item 9**.

In the case of new oil, no change to volumes is proposed. But **item 17** replaces the rates of excise on new oil in paragraphs 6C(7)(a), (b), (c) and (d). The resulting volumes and excise rates on new oil are shown in Table 3.

Table 3: Proposed excise rates on new oil

Annual sales (megalitres)	**New oil (% of VOLWARE)**
0 to 500	0
Over 500 to 600	10
Over 600 to 700	15
Over 700 to 800	20
Over 800	30

Delayed entry oil is oil produced while notionally subject to excise but not sold until the area's production became exempt from excise because a Resource Rent Royalty agreement came into effect. Section 6E of the Excise Tariff Act provides that the calculation of duty on such oil be based on the import parity price. But import parity pricing was abolished in 1978. So **item 23** repeals section 6E and replaces it with a formula that bases the calculation of duty on the applicable petroleum price, which is specified in section 6AB. **Item 23** has the effect of treating delayed entry oil on a basis consistent with other categories of crude oil.

Concluding Comments

The revenue forgone by the reductions in excise seems modest, amounting to $80 million over the five years ended 2005–06 or an average of $16 million a year. Industry commentators have acknowledged that the changes to the excise rates on old and new oil are a start to improving incentives to explore for oil and gas reserves. However, it is apparent that higher world prices are a key driver of exploration for and development of

Australia's oil and gas resources. Successful discoveries of economic oil and gas fields would enable Australia's production to rise, resulting in increased self-sufficiency and export earnings.

Endnotes

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1 For a brief discussion of these taxes, see 'Crude Oil Excise and Royalties', Department of the Parliamentary Library, Research Note 29, 2000–01 at http://wopablue/library/pubs/rn/2000–01/01RN29.htm and "Petroleum Resource Rent Tax', Department of the Parliamentary Library, Research Note 20, 2000–01 at http://wopablue/library/pubs/rn/2000–01/01rn20.pdf. For a more extensive description of the taxation of petroleum, see the Australian Petroleum Production and Exploration Association Limited website at http://www.appea.com.au/tax_and_commercial/index.html.

2 Senator the Hon. Nick Minchin, 'Government encourages domestic oil exploration and production', media release 01/371, 15 August 2001 at http://www.minister.industry.gov.au/minchin/releases/2001/august/cmr430%2D01.doc

3 Ibid

4 Ibid

5 bpamocoalive, *Statistical Review of World Energy*, June 2000, pp. 4 and 20.

6 Australian Geological Survey Organisation, *Oil and gas resources of Australia*, Canberra, 1999, p. 41.

7 Commonwealth Department of Industry, Science and Resources, *Australian Petroleum Statistics*, Issue No. 59, June 2001.

8 K. Donaldson and M. Hinchy, 'Oil and Gas, Outlook to 2005–06', in *Australian Commodities*, ABARE volume 8, no. 1, March 2001, Canberra, p. 12.

9 'Australia oil excise cut seen as only first step', Reuters News Service, 17 August 2001.

10 N. Wilson, 'Excise scrapped to oil wheels of exploration', *Australian*, 20 August 2001.

11 Tranches in this context means a volume range, for example, over 200 to 300 megalitres.