



Excise Tariff Amendment (Condensate) Bill 2008

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Economics Section

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Excise Tariff Amendment (Condensate) Bill 2008

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Portfolio: Treasury

Commencement: On the date of the Royal Assent.

Links: The [relevant links](#) to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at <http://www.aph.gov.au/bills/>. When Bills have been passed they can be found at ComLaw, which is at <http://www.comlaw.gov.au/>.

Purpose

The purpose of the Bill is to end the current exemption from excise of condensate produced in the North West Shelf project area and onshore areas, and to replace it with a new system which imposes excise on condensate.

Background

Crude oil produced in Australia falls into three categories:

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

Condensate is a form of light crude oil. It is a by-product of so-called ‘wet’ natural gas and is used mainly to produce petrol.

Not all crude oil—technically called ‘stabilised crude petroleum oil’—is subject to excise. Some is subject to the [petroleum resource rent tax](#). The oil that is subject to crude oil excise reflects the constitutional division of responsibility between the Commonwealth and the States. The following categories **are subject** to the crude oil excise:

- with respect to offshore projects, the Commonwealth levies excise—and a royalty—on the North West Shelf
- coastal waters projects are subject to excise—and State royalties, and

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- onshore projects are subject to excise.

Whereas some crude oil is subject to excise, condensate is excise-free.

Excise is based on the value of sales. This is the product of:

- the volume of annual sales and
- the average realised price of that annual volume (measured in megalitres).

The first 4,767 megalitres (the metric equivalent of 30 million barrels) of crude oil produced from a field are exempt.

The value of sales is known as VOLWARE (from the volume-weighted average realised price).

The rates of excise:

- are set as a percentage of VOLWARE
- rise as the annual sales volume increases—that is, the marginal rates rise—and
- vary depending on whether the oil is old, new or intermediate.

As an example, the current rates of excise on new oil are set out in the following table. These are the rates that the Bill proposes to apply to condensate.

Annual sales (megalitres)	Percent of VOLWARE
0 to 500	0
Over 500 to 600	10
Over 600 to 700	15
Over 700 to 800	20
Over 800	30

History

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. In determining of the level of excise, the Government of the day sought to balance the return to the community against the need to ensure adequate incentives for exploration and production of oil. This was evident in the major changes to

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the excise rates which occurred on 23 October 1984. Before that date, 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 previous oil excise scale. Such fields became eligible for concessional treatment under a new 'intermediate' excise category.

The exemption of condensate from excise was introduced in 1977 in the context of international oil prices exceeding domestic prices. The following is the relevant excerpt from the Budget speech given by the then Treasurer, the Hon. Phillip Lynch, dealing with crude oil policy (bolding added):

The world price of crude oil has risen dramatically in recent years but only very minor adjustments have been made to the price of crude from Australian wells. Australian crude is now substantially underpriced. Without significant new discoveries in the next few years, indigenous crude oil would fall from meeting about 70 per cent of total Australian demand to about 30 per cent from 1985. We cannot afford a pricing policy that flies in the face of all energy conservation principles by condoning excessive consumption of our scarce presently known supplies of crude. We are moving to an appropriate energy pricing structure. The National Energy Advisory Committee has the whole question of national energy policy under urgent study and is reporting progressively to the Government on it. We also need a pricing policy that encourages new exploration and ensures full economic recovery of known deposits. In partial recognition of these truths, the previous Government announced, and we have maintained, a policy of applying import parity prices to oil discovered after 14 September 1975. But the previous Government did nothing to conserve the usage for existing fields, to increase the extent of recovery from them, or to develop new fields based on discoveries already made. An estimated 400 million barrels of oil could be recovered in Australia at import parity prices that would not be recovered at existing prices. This would add about 20 per cent, or about two years' present requirements, to the reserves which could be economically recoverable at present prices. Following a Government reference in May 1976, the Industries Assistance Commission has made recommendations directed to an orderly transition towards import parity prices for all local oil. The Government endorses this objective and has adopted an approach based essentially on the Commission's recommendations. An annually increasing proportion, or six million barrels per annum, whichever is the greater, of crude oil from each field or new development within fields discovered before 14 September 1975, will be sold at import parity prices, with the remainder sold at the present fixed prices for each field. For the first year, commencing tonight, the proportion of oil per field to be sold at import parity prices will be 10 per cent of production. In the three subsequent years, the corresponding proportions will be 20, 35 and 50 per cent. Beyond this, it is the Government's intention to move to full import parity as soon as possible thereafter; accordingly it will, prior to the end of the period, review the matter.

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The Government believes that not all the additional profits resulting from these decisions should remain with the producers, and that the community should obtain a return from the exploitation of these resources which adequately reflects their value. The fact that the recently increased value of crude oil stems essentially from action by a cartel of foreign oil producers makes the community interest in that enhanced value all the more obvious. In view of this, the Government has decided to increase the production levy on crude oil from \$2 to \$3 per barrel. The Government is, meanwhile, examining whether the levy should be replaced by a resources tax. **The levy will not apply to condensate marketed separately from a crude oil stream; such condensate may now be sold at commercially negotiated prices.** Nor will the levy apply to liquefied petroleum gas fields not yet in production. **This will assist the marketing of L.P.G. and condensate from fields already discovered but not yet developed in the North West Shelf and the Cooper basin.** Condensate sold commingled in a crude oil stream will continue to be treated as crude oil for pricing and levy purposes. The levy on liquefied petroleum gas from currently producing fields will remain at \$2 per barrel.¹

The exemption was intended to encourage the development of the liquefied natural gas (LNG) industry in the North West Shelf and thus can be seen as a form of ‘infant industry’ assistance.

The rates of excise on ‘old oil’ and ‘new oil’ were reduced on 1 July 2001. These changes were made under the [Excise Tariff Amendment \(Crude Oil\) Act 2001](#). The justification for the reductions was that the lower rates might stimulate further evaluation of the fields which were producing ‘old oil’ and ‘new oil’.²

This Bill contains provisions which refer to 1 July 1987 being the date on which earlier major changes to excise arrangements were made. In particular, the first 30 million barrels of oil from offshore fields that began production after 1 July 1987 were exempted from excise. (The first 30 million barrels for onshore fields were also made excise-exempt).³

Position of significant interest groups/press commentary

The LNG industry has, not surprisingly, reacted negatively to the decision. These reactions have taken two main forms.

Firstly, the industry argues that the decision undermines investor confidence, and that this could threaten future investment.

1. Hon. Phillip Lynch, Treasurer, Budget Speech 1977-78, pp. 23–24.

2. For further information, see the Bills Digest for the Bill for this Act, at <http://www.aph.gov.au/library/pubs/bd/2001-02/02bd053.htm>.

3. For a discussion, see *Budget Paper No. 1 1987-88*, pp. 328–331.

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Secondly, the Government made the decision without consulting the industry and the industry claims that this has had the effect of undermining relations between the Government and the industry. For example, the [Chief Executive](#) of the Australian Petroleum and Exploration Association Limited took the view that the decision creates uncertainty and expressed concern about the lack of consultation.⁴ Mr Don Voelte, the Chief Executive of Woodside Petroleum Limited, a major participant in the LNG industry, [made it clear](#) in a formal ASX announcement that Woodside is considering its position following the decision, stating that:

.. the relief from condensate excise was among a range of measures between the North West Shelf participants and the Commonwealth and Western Australian governments that underpinned the economic viability of the project, while guaranteeing early financial returns to government.

This is not a loophole which is being closed, or a free ride which has come to an end. This is a negotiated fiscal arrangement which formed the basis of Australia's largest resource development.⁵

He further stated that the existing taxation arrangements had underpinned more than \$25 billion in investment in the North West Shelf Venture, providing billions of dollars in revenues to the Western Australian and Commonwealth governments over the past 24 years. The arrangements resulted in revenues to government flowing from first production, many years before the project had recouped its costs. This contrasts with the current petroleum resource rent tax regime, in which tax is only paid once a project has recouped its costs.⁶

Pros and cons

The effect of the excise is to reduce profits of condensate producers. This follows from the fact that energy prices in general, and crude oil prices in particular, are determined on world markets. In other words, Australia is a 'price taker' so far as crude oil prices are concerned. Australian producers thus cannot pass the excise on to international consumers and so will bear the excise in full.

There are different views as to the desirability of the excise. On the one hand, it could be argued that the LNG industry has long since lost its 'infant industry' status and that assistance is no longer justified. The exemption was granted when it was difficult for the

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4. Belinda Robinson, '*Industry Concerned Over Budget Surprise*', Media Release, 14 May 2008.
 5. Don Voelte, 'Imposition of excise on North West Shelf condensate', ASX Announcement, 14 May 2008.
 6. See Richard Webb, 'Petroleum Resource Rent Tax', *Research Note*, No. 20, Parliamentary Library, 2000-01, at <http://www.aph.gov.au/library/pubs/rn/2000-01/01rn20.pdf>.

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partners in the North West Shelf project to justify the costs of proceeding with the development. The industry has since grown strongly and growth is projected to continue.⁷ It could also be argued that the exemption is a distortion in the taxation regime, and that applying the same rate of excise on condensate as on new oil would eliminate a distortion. This argument is strengthened by the fact that condensate, sold commingled in a crude oil stream, is subject to excise.

On the other hand, it could be argued that the decision undermines investor confidence in an international industry in which Australia has to compete for investment. Such investment is sensitive to the taxation regimes applying in different countries. The imposition of the excise may thus deter future investment in Australia by reducing returns to Australian producers. Further, while the decision may be seen as a means of capturing some of the windfall profits resulting from current prices, this situation may not prevail should international energy prices fall in the future, and is thus opportunistic.

Position of other political parties

According to an [article](#) in *Australian*:

... the Coalition is refusing to guarantee Senate passage for the Government's \$2.5 billion tax hike on condensate from the North West Shelf, citing concerns that the move will raise gas prices in Western Australia and possibly flow through to the cost of petrol.⁸

In a [press release](#), the Shadow Minister for Resources, Energy and Tourism, Senator the Hon. David Johnston, criticised the excise on the grounds that it would adversely affect Australia's oil security position, and discourage local offshore exploration.⁹

For further background, the reaction of the industry to the proposal, arguments for and against the proposal, and financial implications, see the [Bills Digest](#) for the Excise Legislation Amendment (Condensate) Bill 2008.¹⁰

7. For a review of the LNG industry, see Mike Roarty, 'Australia's natural gas: issues and trends', *Research Paper*, no. 25, Parliamentary Library, 2007–08, <http://www.aph.gov.au/library/pubs/rp/2007-08/08rp25.pdf>, accessed on 26 May 2008.

8. Lenore Taylor, 'Coalition threatens to block tax hike', *Australian*, 23 May 2008, p. 2.

9. Senator the Hon David Johnston, '*Budget 2008: Rudd – Whitlam Copy Cat*', Media Release, 14 May, 2008.

10. Richard Webb, Excise Legislation Amendment (Condensate) Bill 2008, *Bills Digest No. 115, 2007–08*, Parliamentary Library, Canberra, Australia, 27 May 2008.

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Financial implications

Budget Paper No. 1 2008-09 shows the financial implications for the Budget as set out in the Table below.

Revenue (\$ million)¹¹

	2007-08	2008-09	2009-10	2010-11	2011-12
Australian Taxation Office	107.2	673.1	763.1	753.4	753.4
Department of Resources, Energy and Tourism	-13.4	-109.1	-127.7	-127.7	-127.7
Total	93.8	564.0	635.4	625.7	625.7
Related Expense (\$ million)					
Department of the Treasury	80.0	72.3	84.1	85.1	85.1
Department of Resources, Energy and Tourism	-8.9	-72.8	-85.1	-85.1	-85.1
Total	71.1	-0.5	-1.0	-	-

The related expense refers to the compensation that the Commonwealth will pay to Western Australia for the royalty revenue loss that Western Australia will incur as a consequence of imposing excise on condensate.

Main Provisions

The Bill amends various sections of the *Excise Tariff Act 1921* (Excise Tariff Act). The Schedule of Amendments has two parts. Much of **Part 1** is devoted to changing definitions. **Part 2** contains application and transitional provisions.

11. Source: Budget Paper No. 1, 2008-09, p. 19.

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Items 2 to 13 of the Bill amend existing subsection 3(1) of the Excise Tariff Act which is a definitions provision.

Items 2 to 4 deal with offshore production. **Item 2** inserts a new definition of ‘exempt offshore condensate’ into existing subsection 3(1). **Item 3** repeals the existing definition of ‘exempt offshore oil’ and replaces it with a new definition of the term, meaning stabilised crude petroleum oil that is included in ‘exempt offshore oil and condensate’.

As already stated, excise generally applies only after a production threshold, namely, 4767.3 megalitres—the equivalent of 30 million barrels—has been reached. **Item 4** defines ‘exempt offshore oil and condensate’ to mean the first 4767.3 megalitres as defined in either **new paragraphs (a) or (b)**. **Proposed paragraph (a)** of the definition provides that where an exempt offshore field produces stabilised crude petroleum oil **and** condensate, both contribute to the 4767.3 megalitres threshold. **Proposed paragraph (b)** of the definition provides that where an exempt offshore field produces **either** stabilised crude petroleum oil or condensate (but not both), either contributes to the threshold. These provisions apply to fields where neither oil nor condensate was produced before 1 July 1987.

The existing definition of ‘oil producing region’ in the Excise Tariff Act is the same as that in the *Petroleum Excise (Prices) Act 1987*. **Item 6** extends the existing definition to include:

- a production area for ‘old oil’ from which condensate is obtained and which is recognised by regulation, as an oil producing region or
- two or more production areas from which condensate is obtained.

The purpose of **item 6** is to ensure that all fields producing condensate will be subject to excise.

Items 10 to 12 deal with onshore production. **Item 10** inserts a new definition of ‘pre-threshold onshore condensate’ into existing subsection 3(1) of the Excise Tariff Act. **Item 11** substitutes a new definition of ‘pre-threshold onshore oil’ to mean stabilised crude petroleum oil that is included in the pre-threshold onshore oil and condensate. **Item 12** inserts a new definition of ‘pre-threshold onshore oil and condensate’. The definition encompasses three situations where production contributes to the threshold:

- where production is of both oil and condensate: **proposed paragraph (a)** of the definition
- oil only: **proposed paragraph (b)** of the definition or
- condensate only: **proposed paragraph (c)** of the definition.

Items 15 to 24 of the Bill amend existing section 5B of the Excise Tariff Act which relates to petroleum.

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Existing subsection 5B(2) of the Excise Tariff Act provides that where two or more kinds of petroleum are mixed together (such as stabilised crude petroleum oil and condensate), the principal character of the mixture determines how the mixture is treated for crude oil excise purposes subject to the following:

- where there is a mixture of stabilised crude petroleum oil and a petroleum product other than condensate which is deemed to be stabilised crude petroleum oil: **proposed subsection 5B(3)**
- where there is a mixture of condensate and a petroleum product, the petroleum in the mixture which is deemed to be condensate: **proposed subsection 5B(3A)**.

According to the Explanatory Memorandum the result of the amendments in **items 17 to 20** is that condensate produced from one well and mixed with stabilised oil from another is no longer excise free.¹²

Items 21 to 24 of the Bill are consequential amendments.

Item 25 repeals existing sections 6AB and 6AC of the Excise Tariff Act. The main effect of **proposed section 6AB** is to standardise the definition of ‘applicable petroleum prices’ to all four categories of production. The amount of excise payable is based on applicable petroleum prices. These prices are subject to determination under the *Petroleum Excise (Prices) Act 1987* for the purpose of calculating VOLWARE and hence excise. When the VOLWARE is finalised and a determination has been issued, the applicable petroleum price is that contained in the determination. Where the final VOLWARE price has not been determined and an interim VOLWARE price has been calculated, the applicable petroleum price is that used to calculate the interim VOLWARE price. **Proposed section 6AB** inserts the words ‘for stabilised crude petroleum oil or condensate (as the case requires)’ in reference to the VOLWARE price.

Proposed section 6AC deals with the application of the excise regimes for ‘old oil’, ‘intermediate oil’ and ‘new oil’ to different producing regions.

The term ‘production area’ is defined in existing section 5B of the Excise Tariff Act to mean separate areas for old oil¹³, new oil¹⁴ and intermediate oil¹⁵. **Item 27** inserts **proposed section 6CA**. **Proposed subsection 6CA(1)** provides for a new definition of ‘prescribed condensate production area’ which is able to be prescribed by by-laws,

12. Explanatory Memorandum, p. 17.

13. In accordance with section 6B of the Excise Tariff Act.

14. In accordance with section 6C of the Excise Tariff Act.

15. In accordance with section 6D of the Excise Tariff Act.

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registered under the *Legislative Instruments Act 2003*.¹⁶ Under **proposed section 6CA** the excise on condensate will be calculated in similar terms to those in existing sections 6B to 6D of the Excise Tariff Act. **New subsection 6CA(10)** sets out the rates of excise as shown in the table above.

According to **item 31**, the proposed amendments will apply to condensate produced after midnight (by legal time in the Australian Capital Territory) on 13 May 2008. **Subitem 31(4)** of the Bill provides that, for the avoidance of doubt, the provisions of the Bill do not affect any excise in relation to stabilised crude petroleum oil produced before midnight (by legal time in the Australian Capital Territory) on 13 May 2008.

16. According to **proposed subsection 6CA(13)** the by-law is able to take effect before the date that it is registered under the *Legislative Instruments Act 2003*.

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