



Under pressure? Some implications and practical issues with the resources super profits tax for the oil and gas industry

Resources super profits tax: Implications and practical issues for the oil and gas industry

The Government's response to the Henry Review released on Sunday 2 May 2010 proposed the introduction of a new tax; the resource super profits tax (RSPT). The details so far, apart from the Henry Report itself, are limited to what is contained in the Government's paper *The Resource Super Profits Tax: a fair return to the nation* (the Government paper) and accompanying fact sheet, as well as information from initial consultations with the Resources Tax Consultation Panel.

The Government's announcement is short on detail, and provides at the most an outline of the conceptual framework for the proposed measures. The proposed RSPT may conceptually have some similarities to the petroleum resource rent tax (PRRT), but there are many differences and it is vital to recognise and evaluate the RSPT as a new and different regime.

There has been substantial debate about the merit of the measures, focused on issues such as:

- The adequacy of transitional measures based on the book value of project assets
- The RSPT allowance rate based on the ten-year government bond rate (referred to as the 'risk free rate')
- The 40% tax rate when combined with the low RSPT allowance and the concept of 'super profit'.

While the satisfactory resolution of these issues is critical to the implementation of the tax, the purpose of this paper is to examine some of the more detailed issues relating to the RSPT as they stand as at 27 May 2010.

The consultation process is the next critical step, not only to ensure that the broad structural aspects are addressed, but also that the measures incorporate appropriate policy settings. To do this, identifying the important issues and questions must be a priority.

It is also important for you to be able to assess the possible implications for your business via appropriate modelling, not only in terms of your current oil and gas business, but also the implications in the context of possible M&A activity.

The issues and implications noted below are based on our initial assessment of the proposals announced. They are not intended to be a definitive list. We are still in the early stages of the review process and our objective is to continue to consult with stakeholders to understand the issues that require consideration from a whole-of-business perspective. This will help you to model the possible impact of the new rules, including any sensitivities, as well as ensuring all pertinent issues are presented to the Government before legislation is developed.

It is important that some of these issues are clarified as soon as possible, to ensure that disruption to business and investment decisions, as well as M&A activity, created by uncertainty is minimised.

In the Appendix, we provide an overview of the RSPT system and a simple example.

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A. Transitional issues

Opt-in for existing PRRT projects

The announcements state that projects within the scope of the PRRT will remain in the PRRT, unless and until they elect to transfer to the RSPT. This election is proposed to be irrevocable.

Federal Ministers have indicated that certain projects such as Wheatstone and Browse, which would ordinarily be subject to PRRT, will continue to be subject to PRRT and

not fall within the RSPT. The position for other offshore projects that would otherwise have fallen into PRRT is not yet clear.

Issues for consultation

The rules covering the opt-in need to be clarified and will be the subject of industry and professional consultation. Some of the main issues are set out in the table below.

Issue	Description
Definition of 'existing project'	What is meant by an existing project within the scope of PRRT? In light of comments made by Ministers (as noted above), it is important that this is clarified as soon as possible.
Identification of an existing project	When is an existing project identified, i.e. is it the date of announcement or a later date such as 1 July 2012? Will the status of a project (or interest therein) be preserved?
Scope of election	Is the opt-in election to be made on a project-by-project basis, or by each taxpayer in a project?
Transitional rules	Will there be any transitional rules for transferring projects from the PRRT regime to the RSPT regime? Consideration needs to be given to issues such as: <ul style="list-style-type: none">• How will carry forward PRRT credits be treated under the RSPT?• The treatment of those credits within the RSPT regime (quarantining, timing of deductibility, the treatment of credits that are not able to be utilised and any special valuation rules for these).

Practical implications

Once the rules and the issues identified above are clarified and the RSPT is in operation, each project should be individually analysed to see if it should be transitioned from PRRT to RSPT and if so, the best time to make such an election.

There are many important factors that should be addressed. As the opt-in is proposed to be irrevocable, any probable downside or potential upside need to be considered carefully.

Two systems operating in parallel for different projects will present challenges, and not just in administration. There are also the potential consequences of having multiple projects subject to different and separate regimes.

Another example of the practical considerations that could arise is how joint venture participants agree on any decisions to 'opt in', if the decision is required to be made on a project by project basis.

Oil and gas projects outside the scope of the PRRT

For oil and gas projects currently not subject to PRRT, (e.g. onshore projects such as the coal seam gas projects) there are significant issues associated with the transitional rules.

The announcement indicated that a starting base determined by reference to accounting book values in the recent audited accounts would be used. This amount is to be amortised over the first five years, and the starting base of pre-announcement investments is not eligible for transfer to other projects or refund if the amounts are unused (see further discussion below).

For post-announcement acquisitions, there is a question about whether purchasers would need to access historical details. If so, there may be significant practical issues in obtaining such information for taxpayers not previously required to keep such information. Another consideration is whether the inherited base will be eligible for transferability or refund in these circumstances?

RSPT starting base

On the starting RSPT capital account, the Government paper states:

In principle, 100 percent of the accounting book value of existing capital will be included in the RSPT starting base and this value will be taken into account when calculating resources super profits.

There is also a requirement that this value is the book value of existing project assets at the most recent audited accounts available at 2 May 2010.

Firstly, book values of 'capital' and 'project assets' are understood to refer to book value of project field improvement and depreciable assets ('tangible capital' as included in the on-going RSPT capital account).

There may be practical issues with identifying the project's 'audited' field improvement and depreciable asset value. For example, accounting values may not be separately distinguished (particularly on acquisitions) between field improvements and field rights.

The book value of project assets can also be arbitrary. For example, an oil and gas interest owned by the same owner who has depreciated the oil and gas assets will have a different accounting carrying value compared with a purchaser of that same oil and gas interest who has fair valued project improvements in its accounts as a consequence of acquiring a producing asset.

Some taxpayers may have capitalised certain costs for accounts purposes, others not, for example interest costs during construction.

The book value of oil and gas assets will, almost invariably, not reflect the total capital invested and risk taken to date. No doubt during the initial consultation alternatives such as market value on indexed reconstructed cost will be raised.

Transitional expenditures

The treatment of expenditure incurred by companies between 2 May 2010 and 1 July 2012 needs to be clarified.

It appears from announcements that any transitional capital and exploration expenditure would be included in the capital account.





B. Technical issues

The taxing point

The determination of the appropriate taxing point for the RSPT is an important issue that has been identified by the Government and will be subject to intensive consultation with industry.

The Government paper indicates the preferred view is that the taxing point will be the point where the first saleable commodity exists. This will be at the earliest point that a world price or arm's length sale occurs. This is not dissimilar in concept to the PRRT. The issue of the taxing point for PRRT purposes still continues, however, to be a matter of real contention.

It is important that industry becomes heavily involved in the consultation process about the determination of the taxing point. In particular, the coal seam gas sector needs to evaluate and provide input on the implications for the proposed projects under consideration, and also the rules being developed by Queensland Treasury.

Variations in approach would add to the complexity of the proposed regime and overlap between the royalty and RSPT, for which there could be two separate and distinct rules for working out the taxable amounts.

Exploration expenditure

The Government paper provides that there will be an immediate deduction for exploration expenditure under RSPT for "exploration expenses currently immediately deductible under tax law". It needs to be confirmed that this is a reference to the income tax laws.

The definition of exploration expenditure is critical for the availability of the resource exploration rebate (RER) for taxpayers in a loss position.

Capital allowances

Another area in which the RSPT differs significantly from the PRRT is the proposal under the RSPT regime that project development expenditure is to be capitalised and depreciated, and the suggestion that the capital allowance rates used for income tax purposes could be used.

Under the PRRT, there is no revenue vs capital distinction, and all costs are deductible when incurred. The adoption of a capital allowance regime is likely to have a significant impact on projects and their RSPT profile.

Under the RSPT it is proposed that all expenditure that is deductible is eligible to be transferred, whereas for PRRT purposes general project expenditure is not transferable.

Augmentation

The RSPT proposes much less generous rates of augmentation compared with the PRRT, and so under the new regime tax is potentially payable earlier than under PRRT.

The issue of the reasonableness of the proposed augmentation rate needs to be raised as an important issue.

Foreign tax issues

It is unlikely that RSPT will automatically be recognised as a creditable income tax by some foreign jurisdictions' foreign tax credit regimes.

Some of Australia's double tax agreements (DTA) do recognise PRRT as a tax under the treaty (see for instance the Japanese, USA, UK, Chinese and Canada DTAs). A key issue is whether the RSPT will be regarded as substantially similar to the PRRT and therefore be covered by existing DTAs.

Alternatively, the Government may need to consider amending all treaties to make the RSPT a tax to which the treaty applies to ensure the availability of double tax relief for the RSPT.

Other issues

There are various other issues with the introduction of the RSPT that will need to be clarified during consultation. These include:

- (a) For LNG projects, the PRRT regime has complex gas to liquid (GTL) regulations to establish the amount of assessable receipts from the project. Will the RSPT contain similar rules for LNG projects? Will there be any grandfathering of the PRRT rules that cover this situation under the opt-in election? The implications on opting in to the RSPT are important given the long-term nature of such projects
- (b) As noted above, it is not clear why the Government is proposing to apply a capital allowance regime to development/general project expenditure, when the PRRT allows such costs to be deductible when incurred. The Government has also not stipulated the capital allowance rates
- (c) If a capital allowance regime is retained, the concept of tangible capital expenditure and cost of extracting resources – ‘tangible capital expenditure’ - appears to imply depreciable expenditure under Division 40 is covered. Presumably this includes both project pools and Division 43 expenditure

While the concept of ‘undepreciated tangible capital’ appears to relate to Division 40 concepts, it is not clear whether deductible expenditure “for the cost of extracting resources” to be used in RSPT is to follow section 8-1 income tax concepts or accounting concepts. If the latter, this could lead to mismatches with the concept of undepreciated tangible capital
- (d) The rules to identify revenue and expenses of the first saleable commodity from a project need to be made clear. This is a contentious issue in PRRT. As an example, the border between financial (out) and operational (in) hedging needs to be clarified
- (e) It is not clear how the proposed RSPT is intended to apply to site rehabilitation costs. Rehabilitation costs are generally only deductible toward the end of the life of project when incurred. To the extent they are not allowed as provided under the RSPT system, any resulting loss should be made transferable under the system or made ‘refundable’ (at 40%)
- (f) The Government announced in the fact sheet that RSPT would replace the crude oil excise. No further details have been provided
- (g) The Government release indicated that the treatment of private royalties is a matter requiring further consideration. This issue could be relevant to onshore activities such as coal seam gas where private royalties are common
- (h) If the states increase royalties under arrangements not recognised by the Federal Government, double taxation could arise
- (i) Details of the ‘ringfence’ rules have not been given, and how to identify non project expenses needs to be clarified. This has been a highly contentious issue for PRRT purposes for many years, and presents an opportunity to seek not only clarity but also a more reasonable approach in the actual legislation for the RSPT.

C. Tax administrative issues

The introduction of the RSPT will result in a further compliance burden for companies. There are various administrative issues that need to be addressed, including:

- Will the RSPT regime have a mandatory year end of 30 June, similar to that of the PRRT, or will there be scope for companies to adopt a substituted accounting period for their liabilities? This could cause practical difficulties for projects where the joint venture partners have different year ends
- The timing of RSPT payments and returns needs to be clarified
- Will functional currency elections, similar to those used in income tax, be permitted?
- Will quarterly transfers apply, as are allowed for PRRT, and will there be scope for quarterly refunds of royalties?



D. Accounting issues



Accounting for the proposed RSPT

- It seems likely that the proposed RSPT will be considered an income tax under Australian Accounting Standards, affecting effective tax rates reported in financial statements
- The refundable nature of state royalties and the carry forward RSPT losses in some cases may introduce elements of government grant accounting
- There is no need to directly account for the proposed RSPT until such time as it is “substantively enacted” within the meaning of the Australian Accounting Standards.

Impairment

- Under AASB 136 *Impairment of Assets*, the potential introduction of the RSPT may require the entity to perform a recoverable amount test of its Australian resources assets. If impairment charges arise, these may have flow on effects in areas such as dividend planning, banking covenant compliance and so on.

Disclosure requirements

- AASB 101 *Presentation of Financial Statements* may require resource companies to consider the nature of disclosures to be made at 30 June 2010 with regard to the proposed RSPT’s impact on the carrying value of assets and liabilities. Boilerplate disclosures should be avoided where possible
- AASB 136 *Impairment of Assets* also requires extensive disclosure about impairment losses in general and for cash generating units containing goodwill or intangible assets with indefinite useful lives
- For half-year reports, AASB 134 *Interim Financial Reporting* has numerous disclosure requirements, which may be triggered by the circumstances surrounding the RSPT. It would still be considered best practice for affected entities to make transparent disclosure about the impact of the RSPT in interim reports
- Finally, the various corporate governance disclosures required under ASX Listing Rules, *Corporations Act 2001* and so on may be affected.

RSPT transitional provisions

- An entity’s past accounting policy will affect the amount of the future RSPT deduction available for the accounting book value of existing project assets
- This may become a key area requiring clarification if the RSPT proposals are to proceed. It seems equitable to ensure all entities have a ‘level playing field’ regardless of past accounting policies.

These accounting issues are discussed in further detail in our Deloitte publication [Extracting Value, issue 8](#).

E. Commercial considerations

Debt covenants

The RSPT will be an additional cash flow burden before servicing debt, and may also give rise to earlier tax payments than income tax payments. As the RSPT is on the 'gross' margin of the first saleable commodity before interest expenses and indirect overheads, it may be payable by companies with income tax losses.

The dual system of state royalties and RSPT will also mean that there are cash flow and timing issues in claiming the state royalties. It would appear that the state royalties will need to be paid and will only be refunded on lodging the next RSPT return or statement.

The extra and earlier cash flow may be relevant to lending criteria such as interest cover.

Existing agreements

Companies should also review off take and other relevant agreements to determine if any change in law provisions are triggered, and resulting consequences, because of the introduction of the RSPT.

An important consideration is whether the agreements stipulate who bears the cost of any change in law and if the agreements provide for such costs to be passed on.

Transfer of expenditure between projects

It is proposed that the RSPT regime will allow transferability of expenditure between projects.

While this is a desirable design feature, many organisations may have projects involving many different types of commodities, which are run by separate business units or entities. Groups will need to consider the commercial implications of expenditure transfers to other projects and whether this will necessitate subvention payments, and any practical implications.

M&A activity – pricing transactions

The RSPT will affect cash flow from projects, and therefore their value. Given the uncertainty about the form of the RSPT (and indeed whether it will be legislated) it makes it difficult to price it into M&A models appropriately. It is possible to undertake an indicative analysis of the RSPT based on the information available to date (refer to the discussion of D-RSPT below) and to do sensitivities on refinements to the RSPT. Given the uncertainty, however, an issue will arise with RSPT in M&A about whether the vendor or purchaser takes the price risk.

As the proposed RSPT capital account is to be based on the original construction cost, an acquirer of a project will not be able to benefit from appreciation in the value of project and depreciable assets.

While there are a range of possible options for approaching M&A activity, as there is considerable uncertainty about the new regime and its future operation, as well as its impact on the value of assets and companies, there is a real risk that M&A activity will be adversely affected.

D-RSPT

Deloitte has produced a modelling tool, D-RSPT, which can be used to:

- (a) Model the indicative impact of the RSPT and project
- (b) Conduct sensitivities on inputs such as different RSPT allowance rates and starting base deduction values.

Please ask your Deloitte contact to demonstrate D-RSPT for you.

Appendix: RSPT overview and example

The RSPT will be introduced on 1 July 2012 at a rate of 40% on 'super profits' made from the exploitation of Australia's non-renewable resources.

The RSPT is a profits-based approach, broadly calculated as:

$RSPT\ profit = assessable\ receipts - deductible\ expenditure\ (after\ RSPT\ allowance)$

$RSPT\ tax\ liability = RSPT\ profit \times 40\%$

The 'taxing point' is the point at which revenues and expenses are determined for assessing RSPT. In brief, revenue is taxed at the first point of sale of a saleable commodity.

Assessable receipts will include receipts from the sale of the resource, but the proposed tax excludes receipts from the transfer of ownership of a resource project between owners.

In terms of deductible expenditure, the RSPT permits deductions for the cost of extracting resources including exploration expenditure, which will be deductible based on income tax concepts. Capital development expenditure will be included in the RSPT capital account and depreciated along principles of the income tax uniform capital allowance regime.

Similar to PRRT, the Government has indicated that these types of expenditure will be non-deductible:

- Interest and financing costs, including the cost of issuing shares, the repayment of equity, the payment of dividends, and financial hedging costs
- Payments to acquire an interest in an existing exploration permit, retention lease, development licence, production licence, pipeline licence or access authority
- Payments to acquire interests in projects subject to the RSPT
- Income tax, GST and state royalties (state royalties are to be refunded).

The 'RSPT capital account' is used to calculate the RSPT allowance and records the undepreciated tangible capital expenditure and unutilised losses.

The RSPT allowance is calculated on the closing balance of the RSPT capital account from the previous year. It is deducted from assessable receipts in calculating the RSPT profit equation above.

An 'uplift rate', referred to as 'RSPT allowance', will be applied to the capital expenditure included in the RSPT capital account. The RSPT allowance will be based on the ten-year government bond rate.

The payment of RSPT will not generate franking credits, but will be deductible in determining a resource entity's taxable income for income tax purposes.

A simple example – calculating the RSPT on a post-RSPT project

Assumptions:

- Company incurs tangible depreciable capital of \$50 million in years 1 and 2
- Assessable receipts from the sale of the commodity are \$60 million in both year 3 and 4
- Production costs are \$20 million in both years 3 and 4, which excludes depreciation, royalties interest, indirect overhead costs and sales costs
- Royalties are paid to the state government of \$2 million in years 3 and 4
- The company borrows \$50 million at 10% interest. The company has indirect overheads and sales costs not deductible under RSPT in years 3 and 4 of \$5 million
- Assume RSPT tax and book depreciation at 13% (eight years) prime cost.

RSPT calculation (\$m)	Year 1 \$m	Year 2 \$m	Year 3 \$m	Year 4 \$m
Revenue	-	-	60	60
Production costs	-	-	(20)	(20)
Depreciation at 13%	-	-	(13)	(13)
Less RSPT allowance at 6%	0	(3)	(6.2)	(5.2)
Less utilised or transferred losses	-	-	(3)	-
Net RSPT profit (loss)	0	(3)	17.8	21.8
Tax at 40%			7.1	8.7
Less refundable royalty rebate			(2)	(2)
Net RSPT payable	-	-	5.1	6.7
RSPT capital account opening balance	0	50	103	87
Additional investment	50	50	-	-
Carry forward losses		3	(3)	-
Depreciation	-	-	(13)	(13)
RSPT capital base closing	50	103	87	74

Income tax calculation (\$m)	Year 1 \$m	Year 2 \$m	Year 3 \$m	Year 4 \$m
Revenue	-	-	60	60
Production costs	-	-	(20)	(20)
Depreciation at 13%	-	-	(13)	(13)
Interest	(1)	(3)	(5)	(5)
Indirect Overhead/Sales costs	-	-	(5)	(5)
Accounting profit before all taxes	(1)	(3)	17	17
State royalties			(2)	(2)
RSPT tax at 40%	-	-	(5.1)	(6.7)
Taxable income/(loss)	(1)	(3)	9.9	8.3
Tax loss recouped			(4)	-
Adj. taxable income/(loss)	(1)	(3)	5.9	8.3
Tax at 28%			1.7	2.3

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