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Oil and gas taxation in Australia
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Tax professionals of the member firms of Deloitte Touche Tohmatsu Limited have created the Deloitte International Oil and Gas Tax Guides, an online series that provides information on tax regimes specific to the oil and gas industry. The Guides are intended to be a supplement to the Deloitte Taxation and Investment Guides, which can be found at www.deloitte.com/taxguides. For additional information regarding global oil and gas resources, please visit our website: www.deloitte.com/oilandgas

1.0 Summary

The principal Australian taxes and rates applicable to companies in the oil and gas extraction business are:

• Federal corporate income tax	30%
• Federal Petroleum Resource Rent Tax ("PRRT") (deductible as an expense for income tax)	40% 40%
• State royalties (varies by state, deductible as an expense for income tax and "creditable" against PRRT)	up to 12.5%

Australia does not operate a Production Sharing Contract ("PSC") system, except in respect of the Joint Petroleum Development Area ("JPDA") between Australia and Timor-Leste.

2.0 Corporate income tax

2.1 In general

Australian resident companies are subject to income tax on their worldwide income and gains, although foreign income of Australian residents is generally exempt from Australian tax. Where such foreign income is not exempt, foreign tax offsets are also provided to reduce the effect of income being subject to taxation by more than one country.

Non-resident companies that derive income from Australian sources are also subject to tax on that income, unless that income is subject to final withholding tax or treaty protection.

There are no special income tax regimes for oil and gas companies, such as project ring fencing. Accordingly, profits and losses from one project can be offset against another…

Residency is determined primarily based on place of incorporation or place of central management and control. Companies incorporated outside of Australia may still be regarded as tax resident in Australia if such companies carry on business in Australia, and either have their central management and control in Australia or if Australian-resident shareholders control their voting power.

Australian-resident companies which are 100% commonly owned may choose to form a tax consolidated group or multiple entry consolidated ("MEC") group.

There are no special income tax regimes for oil and gas companies, such as project ring fencing. Accordingly, profits and losses from one project can be offset against another, as well as against other business activities conducted by the oil and gas company, for income tax purposes.

2.2 Rates

Corporate income tax is imposed at a rate of 30%.

2.3 Taxable income

Taxable income is broadly assessable income less any allowable deductions. Assessable income includes ordinary and statutory income. Gains that are capital in nature may also be included in assessable income. Most ordinary and necessary business expenses of a corporation are deductible in arriving at taxable income.

2.4 Revenue

For an Australian-resident company, assessable income includes all worldwide income and gains (subject to certain exceptions). Non-residents are subject to tax on Australian-sourced income only and capital gains realized on certain Australian assets, subject to any tax treaty application.

An Australian-resident company conducting active oil and gas activities in a foreign jurisdiction through a permanent establishment should generally be exempt from tax on those profits in Australia.

2.5 Deductions and allowances

General deductions

Allowable deductions would ordinarily include expenses to the extent that they are incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, unless they are capital in nature or relate to exempt income derivation.

Leasehold costs

Generally, leasehold costs would be deductible where they were incurred in carrying on a business for the purpose of producing assessable income.

Resources taxes

A deduction is allowed for any PRRT paid or any other state or federal royalties and excise payments. The cost of permits under the Clean Energy Act (the "Carbon Regime") is allowed as a deduction.

Exploration costs

Exploration or prospecting expenditure is deductible in the year it is incurred where the taxpayer is carrying on mining operations for the purpose of obtaining petroleum, or the costs were necessarily incurred in carrying on a business of exploration or prospecting, or where it is reasonable to conclude that the taxpayer will carry on mining operations for the purpose of obtaining petroleum.

The government recently announced as part of the 2013-14 federal budget that it intends to remove the immediate deduction available for the cost of acquiring mining rights (including petroleum rights) and information first used for exploration (collectively referred to as 'mining intangibles').

Exploration or prospecting costs generally include:

- geological, geophysical and geochemical surveys;
- exploration drilling and appraisal drilling;
- feasibility studies to evaluate economic feasibility of mining petroleum once it has been discovered; and
- obtaining mining information relating to the presence, absence or extent of petroleum reserves in an area.

Up to 14 May 2013, where assets are acquired and first used for exploration, the acquisition costs can be claimed as a deduction in full at the time of first use. The government recently announced as part of the 2013-14 federal budget that it intends to remove the immediate deduction available for the cost of acquiring mining rights (including petroleum rights) and information first used for exploration (collectively referred to as 'mining intangibles').

Specifically, the immediate deduction is to be removed, and mining intangibles are instead to be depreciated over the shorter of:

- 15 years or;
- the effective life of the petroleum field that results from the exploration.

However, an immediate deduction would continue to be available for:

- expenditure to acquire mining rights under eligible farm-in/farm-out arrangements;
- costs of acquiring a mining right from a relevant government authority;
- costs of acquiring mining information from a relevant government authority; and
- costs incurred by the taxpayer itself in generating new information or improving existing information.

This measure (if enacted) would apply from 7:30 p.m. Australian Eastern Standard Time (AEST) on 14 May 2013, unless the taxpayer has committed to the direct or indirect acquisition of the mining intangible before that time or they are taken by tax law to hold the mining intangible before that time.

Development costs

Development costs are capitalized and deductible over the life of the project or the useful life of the asset. There are capped effective lives for certain depreciating assets in the oil and gas sector.

Rehabilitation costs

Costs incurred in rehabilitating the site of oil and gas project operations or in retiring the project assets are immediately deductible when actually incurred, not when accounting provisions are raised or funds are merely set aside to meet future rehabilitation and asset retirement obligations.

2.6 Losses

Income tax losses may, subject to specific loss-integrity rules, be carried forward indefinitely.

The government has recently introduced legislation to allow losses to be carried back, at the choice of the taxpayer, to two preceding years (but no earlier than the 2011-12 fiscal year). The amount of tax losses carried back to each earlier year is subject to a cap of A$1 million per year. Other conditions must be met, including a modified form of the loss integrity rules.

The loss integrity rules, for loss carry forward and loss carry back, include:

- A "continuity of ownership test" ("COT"), or failing this test.
- A "same business test" ("SBT").

There are certain concessions applicable to public or widely held companies in applying the loss-integrity rules.

Following the results of the federal election held on 7 September 2013, the new ruling Coalition party has indicated that it is considering abolishing the loss carry back rules.

2.7 Foreign entity taxation

Non-resident entities are subject to income tax at 30% on their Australian-sourced income, less allowable deductions, to the extent such income is not treaty protected or subject to final withholding taxes. Australia does not impose a branch profits tax.

Non-residents are only subject to capital gains tax ("CGT") on taxable Australian property ("TAP"), which broadly includes real property situated in Australia, such as land, including a lease, or mining or prospecting rights if the oil and gas is situated in Australia, or shares in an entity that is "Australian real property rich". Any asset used in carrying on a business in connection with a permanent establishment in Australia is also subject to CGT.

As part of future reforms announced by the government in its 2013-14 federal budget, various changes would be introduced to the non-resident CGT regime, which, if enacted, would apply to CGT events occurring after 7:30 p.m. (AEST) on 14 May 2013. These changes would affect non-residents disposing of interests held in Australian real property assets, including mining interests (refer to section 6.1 Capital gains below).

Non-resident entities are subject to income tax at 30% on their Australian-sourced income, less allowable deductions, to the extent such income is not treaty protected or subject to final withholding taxes. Australia does not impose a branch profits tax.

3.0 Other corporate income tax

3.1 Additional Profits Taxes – PRRT

Overview

PRRT is a federal tax payable on the upstream profits of a petroleum project. In its original form, PRRT only applied to petroleum projects undertaken in specific offshore areas that are under the jurisdiction of the Commonwealth of Australia. Specifically excluded are areas in the JPDA.

From 1 July 2012, the scope of PRRT was extended to the North West Shelf ("NWS") project, coastal and onshore oil and gas projects and coal seam gas projects. Coal seam gas extracted as a necessary incident of coal mining is not subject to PRRT, but is instead subject to the Minerals Resource Rent Tax ("MRRT").

PRRT is calculated on a project basis at a rate of 40% on taxable upstream profits. Projects generally exist where a production license has been issued. Individual projects can be combined for PRRT purposes if the relevant conditions are met. PRRT payments are deductible and refunds are assessable for income tax purposes. PRRT applies to the taxable profit arising from a project's upstream activities and is calculated by reference to the following formula:

Taxable profit = Assessable receipts – deductible expenditure – transferred exploration expenditure

Assessable receipts include the following in relation to a project, whether capital or revenue in nature:

- petroleum receipts;
- tolling receipts;
- exploration recovery receipts;

- property receipts;
- miscellaneous compensation receipts;
- employee amenities receipts; and
- incidental production receipts.

Special rules apply to integrated gas-to-liquids ("GTL") projects (e.g. Liquefied Natural Gas ("LNG") projects) to determine the deemed selling price (revenue) at the taxing point of the gas as it moves beyond the project ring-fence, where the upstream phase ends.

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Deductible expenditure includes expenses of both a capital and revenue nature. Expenditure is broadly categorized as exploration expenditure, general project expenditure or closing down expenditure, as well as resource tax expenditure from 1 July 2012. A starting base allowance is also available to transitioning onshore projects and the NWS project which were in existence at 1 May 2010.

A recent Administrative Appeals Tribunal ("AAT") decision reflected the AAT's view that the term 'exploration' for PRRT purposes takes on its ordinary meaning, which is the "identification of prospective oil or gas fields, and the appraisal of the potential size and quality of the reserve", but does not extend to assessing the feasibility of the field for future development and production. This view is broader than that held by the Australian Taxation Office ("ATO"). The ATO has since issued a draft ruling on the interpretation of the term 'exploration'. This draft ruling adopts a narrow understanding of the term 'exploration' which is broadly consistent with the recent findings of the AAT in the case referred to above. The ATO is expected to release further guidance on the way in which it would practically administer the PRRT law to address taxpayers' historical positions with respect to the treatment of exploration expenditure.

Specifically excluded (i.e. non-deductible) expenditure comprises:

- financing costs, payments of income tax or GST;
- payments to acquire (or acquire an interest in) an exploration permit, retention lease, production license, pipeline license or access authority, unless in respect of the grant thereof;
- payments to acquire interests in petroleum project profits, receipts or expenditures;
- indirect payments of accounting, administration and other work costs incurred in carrying on or providing project operations or facilities; and
- payments relating to land and buildings, which are not adjacent to the project operations, but which are used in accounting and administrative activities.

Another recent court decision has imposed a very narrow interpretation of the PRRT legislation with regard to circumstances where eligible expenditure can be considered to be incurred in relation to a project (and hence deductible against the income from that project), along with the treatment of indirect costs and contractor payments. In light of this development, the government has introduced changes to the PRRT legislation to ensure that the PRRT operates as a profit-based tax as intended, as well as providing for deductions for legitimate expenditures while preventing any abuse of the rules to gain unfair tax advantages in respect of related-party contract arrangements.

Where expenditures exceed assessable receipts, the undeducted expenditure is uplifted each year by rates of up to:

- exploration expenditure – generally, the long term bond rate (LTBR) + 15% per annum;
- general expenditure, resource tax expenditure and the starting base allowance (under the book or market value approach) – generally, the LTBR + 5% p.a.; and
- look-back starting base expenditure – generally, the LTBR + 15% p.a. for exploration expenditure or the LTBR + 5% p.a. for general expenditure (specific uplift rules apply for qualifying acquisition expenditure).

The augmentation rate for exploration and general project expenditure may differ if the expenditure was incurred more than five years before applying for a production license in relation to the project – in these circumstances, expenditure is generally uplifted at the nominal inflation rate. Excess closing down expenditure that is not offset against assessable receipts is not augmented – instead it may give rise to a PRRT refund to the extent PRRT was previously paid on the project.

Certain exploration expenditure incurred on a project (other than exploration inherited on acquiring an interest in a petroleum project from a third party) must be transferred to other projects of the same entity or of the same wholly-owned corporate group, where specific provisions are satisfied. The transfer rules contain a number of restrictions. Where transfers are made, they must be made to the project with the most recent production license and the oldest eligible expenditure must generally be used first.

Certain exploration expenditure incurred on a project (other than exploration inherited on acquiring an interest in a petroleum project from a third party) must be transferred to other projects of the same entity or of the same wholly-owned corporate group …

Project disposal

On the transfer or disposal of an interest in a petroleum project, the purchaser generally steps into the shoes of the vendor. The purchaser:

- will generally inherit any carried-forward expenditure of the vendor;
- is deemed to have derived the revenue actually derived by the vendor in the year of acquisition; and
- is deemed to have made any PRRT installment payments made by the vendor in the year of acquisition.

The extended PRRT regime

The extended PRRT will apply to onshore oil and gas projects and the NWS project from 1 July 2012. There are specific issues associated with this extension that require consideration. Some of the key issues include:

Starting base allowance

As a transitional measure for existing investments, an upfront deduction will be allowed on or after 1 July 2012 for the value of project assets, provided a production license exists. The valuation is to be performed as at 1 May 2010 (when resource taxation reforms for the onshore sector were first announced) and taxpayers have a choice of adopting a book value or market value approach. Alternatively, taxpayers can choose a 'look back' approach that enables expenditures incurred after 1 July 2002 ("look-back starting base expenditure") to be claimed as a deduction beginning from 1 July 2012. The choice of methodology needs to be made by lodging a starting base return within prescribed time periods. Alternative valuation methodologies may be available where interests in certain projects or entities were acquired in the period between 1 July 2007 and 2 May 2010.

The ATO has issued valuation guidance principles. However, the ATO does not mandate how to determine the market value of assets and generally refers to accepted valuation principles.

Any starting base amount (under the book or market value approach) which is unused and carried forward is uplifted at the LTBR + 5% p.a. Look-back starting base expenditure which is unused and carried forward is uplifted at a rate of up to the LTBR + 15% p.a. if the underlying expenditure is classified as exploration expenditure, or otherwise at a rate of up to the LTBR + 5% p.a. if the underlying expenditure is classified as general expenditure. However, the unused starting base amounts (whether determined under the book value, market value or look-back approach) cannot be transferred to other projects. Special rules apply when dealing with alternative valuation methodologies for acquisitions between the period 1 July 2007 and 2 May 2010.

Definition of a project

Specific rules have been introduced to facilitate the combination of onshore projects into one project where specific provisions are satisfied. This is particularly relevant for the coal seam gas-to-LNG projects in Australia specifically, and onshore projects more broadly. The NWS is deemed to be a single project.

PRRT consolidation

Australian companies in the same wholly-owned group may consolidate their interests in onshore projects for PRRT purposes, where a tax consolidated or MEC group has been elected for income tax purposes (this treatment is unavailable in respect of offshore projects).

Deduction for State or Commonwealth royalties

Onshore projects and the NWS project will still continue to be subject to royalties and other government resource taxes. To prevent effective economic double taxation, a "credit" against PRRT is allowed for royalties and other resource taxes paid. The "credit" is taken in the form of a deduction equivalent. Accordingly, the royalty or resource tax is translated into a deduction by grossing up the royalty or resource tax by the PRRT tax rate. Any royalty or resource tax deduction equivalent which is unused and carried forward is uplifted by the LTBR + 5% p.a., but cannot be transferred to other projects.

3.2 Federal crude oil excise

Crude oil excise is levied on eligible crude oil and condensate production from large oil fields situated in coastal waters, onshore areas and the NWS project in federal waters. The excise rate ranges progressively from 20% to 55% of the volume weighted average of the realized free-on-board price of crude oil sales, depending on the annual production rate, the date the petroleum reservoir was discovered and when production commenced. The first 30 million barrels of cumulative oil production from each field is exempt from crude oil excise. Fields which are subject to a state-imposed resource rent royalty are not subject to the crude oil excise regime.

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3.3 State

Wellhead royalties are administered at a state (or in some instances, federal) level (but royalties do not overlap with any resource rent royalty where imposed). The royalty rates vary between states, but are generally between 10% and 12.5% of the net value of petroleum produced at the wellhead. Royalties are payable to the state (or in limited instances, the federal government), but effective 1 July 2012, a "credit" is claimable against PRRT for any state (or federal) royalties paid. These costs are also deductible for income tax purposes.

A state may impose a resource rent royalty, similar to the PRRT, on a petroleum development project within its jurisdiction. In these cases, the revenue from that project is shared with the federal government and the project is then exempted from crude oil excise. As resource rent royalty payments are creditable against PRRT, there should not be any incremental PRRT liability where a resource rent royalty applies.

3.4 Municipal

There are no applicable municipal or equivalent taxes in Australia. Owners of property and land are subject to council rates and land taxes respectively, as imposed by the relevant local and State/Territory governments.

4.0 Tax incentives

4.1 Research and development ("R&D")

An R&D tax offset regime is in place, allowing an R&D entity to claim a tax offset for expenditure on defined 'core' or 'supporting' R&D activities. Eligible entities incurring eligible expenditure on core or supporting R&D activities can claim a tax offset as follows:

- a 45% refundable tax offset if aggregate turnover is < A$20 million; or
- a 40% non-refundable tax offset if aggregate turnover ≥ A$20 million.

The refundable tax offsets may be accessed on a quarterly basis with effect from 1 January 2014.

Non-refundable tax offsets can be carried forward to be used in future income years, subject to certain tests similar to the loss integrity tests.

Prospecting, exploring or drilling for minerals or petroleum for one or more of the following purposes are specifically excluded from being core R&D activities, but may be claimed as "supporting R&D activities" if undertaken for the dominant purpose of supporting core R&D activities:

- discovering deposits;
- determining more precisely the location of deposits; or
- determining the size or quality of deposits.

The government has proposed to limit the ability of large Australian businesses to access the R&D tax incentive with effect from 1 July 2013. Specifically, if the proposed measure is enacted, multinational companies and groups with income assessable in Australia of A$20 billion or more would no longer be eligible to make a claim for the R&D incentive after the fiscal year ended 30 June 2013, removing access to an additional 10 per cent net tax benefit available in respect of eligible R&D expenditure.

4.2 Manufacturing

There are no specific incentives for the manufacturing industry.

4.3 State

There are generally no specific state-based incentives for oil and gas activities. The State of New South Wales ("NSW") does currently have a tax holiday for up to five years for coal seam gas projects; however, this is currently being reconsidered by the NSW state government.

5.0 Payments to related parties

5.1 Transfer pricing

In practice, Australia broadly applies the Organisation for Economic Cooperation and Development ("OECD") principles with respect to transfer pricing. There are no special rules for the oil and gas sector. In addition, tax returns require certain disclosures in relation to international related-party transactions, and the methodologies adopted in supporting an arm's length price.

In practice, Australia broadly applies the Organisation for Economic Cooperation and Development ("OECD") principles with respect to transfer pricing.

The Australian federal government has recently introduced retrospective legislation which allows the transfer pricing articles in Australia's tax treaties to be used to make transfer pricing adjustments. The government has also recently introduced new legislation aimed at further reforming the transfer pricing regime to formally bring Australia's rules more into line with international best practice and help Australia protect its tax base. The new legislation includes:

- rules to ensure the amount taxable in Australia as a result of cross-border conditions between entities reflects the arm's length contribution made by Australian operations;
- rules to reconstruct transactions based on commercial realism; and
- rules on contemporaneous transfer pricing documentation.

The PRRT also contains arm's length rules that apply to domestic transactions as well as international related-party transactions.

5.2 Thin capitalization

The funding of oil and gas companies in Australia is subject to the same thin capitalization rules as any other Australian entity.

The thin capitalization regime limits the deductions relating to the total debt, not just related party debt. Currently, the Australian safe harbor rule broadly allows up to 75% of the net assets of a company to be funded with tax deductible debt. For the purpose of this test, assets and liabilities are broadly determined in accordance with accounting standards.

There is also an arm's length debt test that broadly requires an analysis to determine what would reasonably be expected to have been the entity's maximum arm's length debt funding.

However, the government recently announced as part of the 2013-14 federal budget that the thin capitalization safe harbor debt limit would be reduced to 60% of net assets. Other changes to the regime include:

- the increase in the *de minimis* exemption threshold to A$2 million of debt deductions annually (up from A$250,000);
- the extension of the worldwide gearing test to inbound investors (allowing Australian operations to be geared at the same level as the worldwide group, even if that exceeds the safe harbor debt limit);
- improvements to the arm's length debt test (as an alternative to the safe harbor debt limit); and

- removal of the ability to claim debt deductions in respect of debt used to fund foreign equity investments which generate exempt income.

If enacted, these changes would apply to fiscal years starting on or after 1 July 2014.

5.3 Interest deductibility

There are no unique interest deductibility rules or limitations that apply specifically to oil and gas companies. The deductibility of interest paid or accrued by a domestic company to a foreign related company (or to a third-party on debt guaranteed by a foreign related company) will depend on the debt/equity classification of the relevant instrument for tax purposes (Australia adopts an economic substance test to determine if a financing instrument is debt or equity) and can also be limited if the thin capitalization limits are breached or interest is paid to a related party in excess of an arm's length amount. As noted above, it has been proposed that interest on debt used to fund foreign equity investments which generate exempt income would cease to be deductible from fiscal years starting on or after 1 July 2014.

6.0 Transactions

6.1 Capital gains

Gains from a CGT event may be subject to CGT. A capital gain or loss is determined by deducting the cost base of an asset from the capital proceeds. Net capital gains are taxed at 30% for corporate taxpayers.

Capital losses are only deductible against future capital gains. Normal trading losses are deductible against capital gains.

Capital losses are only deductible against future capital gains. Normal trading losses are deductible against capital gains. Net capital losses not utilized can be carried forward indefinitely and used in subsequent years, subject to satisfying the loss integrity tests.

Depreciating assets acquired after 19 September 1999 are not subject to the CGT provisions. Gains and losses on disposals of depreciating assets are treated as balancing adjustments under the depreciation rules and are regarded as being on revenue account. Specifically, oil and gas exploration permits, production licenses and retention leases acquired after 30 June 2001 are treated as depreciating assets and any gain or loss is treated as a balancing adjustment and on revenue account. Permits, leases and licenses acquired on or before 30 June 2001 will remain subject to CGT.

Capital gains or losses derived by an Australian resident company in respect of the disposal of shares in a foreign company may be reduced under a participation exemption. For the participation exemption to apply:

- the Australian company must own at least 10% of the foreign company;
- the ownership stake must have been held for at least 12 months; and
- the foreign company must have at least 10% of its asset base (measured either using market or average book values) comprising "active assets" (as defined).

Where the value of the foreign company's active assets (as defined) is 90% or more of its total assets (as defined), the gain is reduced to nil. A pro-rata reduction is allowed where the active asset ratio is 10% or greater, but less than 90%.

Australian companies with foreign branches conducting an active business may also qualify for an exemption from CGT on the disposal of foreign branch assets.

Non-residents are only subject to CGT on TAP assets. TAP includes:

- taxable Australian real property such as land, fixtures to land and mining and prospecting rights over minerals and petroleum situated in Australia (including in Australia's territorial waters);
- indirect holdings in real property where the membership interest is 10% or more, and greater than 50% of the market value of the company's assets, is attributable to taxable Australian real property, whether held directly or indirectly. The company need not be an Australian resident – CGT can apply to the disposal of shares in non-resident companies which hold interests in companies which ultimately own taxable Australian real property;
- the assets of a permanent establishment in Australia; and

- any derivative, right or option to acquire any of the assets described above.

As part of future reforms announced by the government in its 2013-14 federal budget, various changes will be introduced to the non-resident CGT regime, which, if enacted, would apply to CGT events occurring after 7:30 p.m. (AEST) on 14 May 2013. These changes are largely aimed at improving the integrity of the 'principal asset test', which compares the value of land and non-land assets to determine whether a disposal of interests in an entity is subject to CGT.

The government has also announced as part of the 2013-14 federal budget the introduction, from 1 July 2016, of a 10% non-final withholding tax on gross proceeds payable to non-residents on disposals of certain taxable Australian property. The withholding obligation would apply irrespective of whether the relevant assets are held on capital or revenue account. Residential property transactions under A$2.5 million and disposals by Australian residents would be excluded from the proposed measure.

6.2 Asset disposals

Asset disposals are dealt with under the CGT regime, the capital allowance provisions or may be treated as ordinary income. The disposal of a petroleum permit, production license or retention lease acquired after 30 June 2001 will give rise to an assessable balancing adjustment if the proceeds received on disposal exceed the asset's written-down tax value, or a deductible balancing adjustment where the proceeds are less than the written-down tax value. There are various specific rules to be considered, including arm's length requirements.

Asset disposals are dealt with under the CGT regime, the capital allowance provisions or may be treated as ordinary income.

For PRRT purposes, the purchaser effectively 'steps into the shoes' of the vendor and inherits the history of the vendor as set out in section 3.1.

6.3 Like-kind exchanges and involuntary conversions

There are specific CGT and balancing adjustment rollovers available for taxpayers to the extent the same assets are exchanged, or for certain transactions occurring, within wholly-owned groups.

The government is currently in the process of consulting with industry and taxpayers on the appropriateness of providing concessional tax treatment to mining interests acquired through exchanges of mining rights (including via interest realignments or tenement swaps).

6.4 Abandonment

For income tax purposes, abandonment is a disposal for CGT with no proceeds. However, where the asset is a depreciating asset, the uniform capital allowance rules apply and a balancing adjustment would arise.

6.5 Sharing arrangements and farm-outs

The treatment of farm-in and farm-out transactions is contentious for income tax, goods and services tax ("GST") and PRRT purposes. Some key points to note are:

- the farmor could also be subject to CGT where they have also disposed of rights;
- the ATO has issued tax rulings which outline their views on how both parties are treated for income tax and GST purposes. These provide some guidance, but there are still many uncertainties that remain and they are fact specific; and
- ultimately, from a PRRT perspective, the terms of the farm-in agreement will affect who is entitled to the deductions for the amount of expenditure outlaid or spent.

6.6 Inbound structures

Various structures can be adopted for an investment in an Australian oil and gas project. The issues can be complex and will depend on the particular facts and circumstances of the investor and the project. In broad terms, investors typically invest in a project through either an unincorporated joint venture structure or an incorporated joint venture structure. Most inbound companies tend to invest via a wholly-owned Australian subsidiary, except in cases where the home jurisdiction allows a deduction for foreign exploration expenditure incurred in Australia through a branch. The subsequent conversion of a branch into an incorporated Australian structure can have significant ramifications, so this decision needs to be carefully considered at the outset.

7.0 Withholding taxes

7.1 Dividends

Dividends are 'franked' to the extent that income tax has been paid by the company on the profits being distributed as a dividend. The 'unfranked' portion of dividends (i.e. dividends paid out of untaxed profits, other than exempt foreign source income) paid to non-residents is subject to 30% withholding tax. This rate is reduced where a double tax treaty applies and the reduced rate generally ranges from 0% to 15%. However, franked dividends paid by Australian-resident companies (i.e. dividends paid out of taxed profits) or dividends paid out of exempt foreign source income, are not subject to withholding tax.

Dividends are 'franked' to the extent that income tax has been paid by the company on the profits being distributed as a dividend.

7.2 Interest

Interest paid or credited to non-residents is subject to the domestic withholding tax rate of 10% unless reduced under a double tax agreement or another domestic exemption applies – for example, interest paid in relation to a qualifying loan arrangement which satisfies a public offer test. Where withholding tax does apply, no deduction can be claimed by the taxpayer for interest incurred for income tax purposes until the withholding tax is paid.

7.3 Rents and royalties

Royalties paid or credited to non-residents or Australian permanent establishments of non-residents are subject to a 30% withholding tax. Where the business profits article of a double tax treaty applies, the applicable Australian tax is 30% of the net taxable income in respect of the royalty attributable to an Australian permanent establishment, rather than a final royalty withholding tax rate applicable on the gross royalty amount. The 30% rate of royalty withholding tax may be reduced where a double tax treaty applies and is generally reduced to 10% or 15%. Most treaties specifically include payments for the use of "substantial equipment" as a royalty. However, many treaties also treat payments for the use of substantial equipment as giving rise to a permanent establishment and to the extent the royalty is attributable to the permanent establishment, these payments would be subject to the business profits article of the treaty and royalty withholding tax should not apply.

Where withholding tax does apply, no deduction can be claimed by the taxpayer for a royalty incurred for income tax purposes until the withholding tax is paid.

7.4 Other

Non-resident contractors' withholding tax ("NRCWT") of 5% applies to the gross payments made to foreign residents where the services provided in Australia are considered "works" or related activities, unless an exemption or variation is obtained. The term "works" includes the construction, installation and upgrading of buildings, plant and fixtures, and would normally include work relating to pipelines, oilfield and gas field development, but generally excludes activities in the exploration stage. NRCWT is an advance payment of tax.

Payments made to non-residents carrying on a business in Australia without an Australian Business Number (ABN) can be subject to tax being withheld at 46.5%, unless they can provide a declaration to the payor that no ABN is required.

Any payment which is made to a non-resident, where the payment is determined wholly or partly by reference to the value or quantity of natural resources produced or recovered in Australia, is subject to a withholding tax at a rate that is prescribed by the ATO.

The government proposes to introduce, from 1 July 2016, a 10% non-final withholding tax on gross proceeds derived by a non-resident in respect of the disposal of certain taxable Australian property.

7.5 Tax treaties

Australia has a large number of double tax treaties entered into with other jurisdictions, allowing for a reduction in withholding tax rates in certain circumstances.

8.0 Indirect taxes

8.1 Value added tax, goods and services tax, and sales and use tax

GST is a broad-based consumption tax on supplies of goods or services within Australia and in some offshore areas. GST is also levied on taxable imports into Australia.

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Suppliers of goods and services (residents and non-residents alike) are required to register for GST and levy GST on taxable supplies made by them. The registration for GST is subject to a minimum turnover threshold of A$75,000 within a revolving 12-month period, although a voluntary registration may be made below the threshold. This is common practice in the oil and gas industry where input tax credits will exceed any GST on supplies given the largely export-oriented nature of the industry, and particularly during the exploration and development stages.

GST is levied at each step in the supply chain at a standard rate of 10%. There are certain “GST free” supplies such as exports of goods and services to non-resident entities, and other transactions where GST is not applicable as they are “input-taxed supplies” (e.g. financial supplies). Where goods or services are exported, and a GST-free status is sought, goods must generally be exported within 60 days. Ordinarily, this would be supported by the customs documentation.

A transaction involving the sale of a project as a going concern can also be supplied on a GST-free basis, where the parties to the transaction agree to do so. This can result in savings in stamp duty and/or the offshore petroleum title registration fee.

The importation of products and equipment into Australia for domestic consumption will attract GST, and is payable at the time the goods clear customs. The GST paid may then be eligible to be recovered by claiming an input tax credit. Often, oil and gas entities operating in Australia will apply for the GST deferral scheme, which alleviates the up-front cash flow stress as the GST payable at the time of importation is deferred, and generally offset by an equivalent claim for input tax credits on the import, when the relevant GST return is filed.

A GST-registered entity may recover input tax in respect of the GST paid on certain goods or services that it acquires. These inputs would be offset against the GST on the supply of goods or services. GST is accounted for on a business activity statement (BAS), which is generally submitted every quarter. Where the turnover in a 12-month period exceeds A$20 million, or if a taxpayer is seeking to qualify for a GST deferral, the BAS will need to be submitted electronically and on a monthly basis.

8.2 Import, export, and customs duties

Customs duty is levied on the dutiable value of goods imported into Australia. Duty rates of up to 5% may be payable, but vary depending on the tariff classification of imported goods. Customs duty may be reduced or exempted under a tariff concession order. Alternatively, customs duty may be waived on goods imported for use in major projects under the Enhanced Project By-law Scheme (EPBS). The EPBS reduces the customs duty from 5% to 0% on goods imported into Australia as part of a project worth more than A$10 million. The EPBS extends to machinery, equipment and components in qualifying industries, such as the oil and gas industry. To be eligible for an EPBS grant, the applicant must demonstrate that the goods are either not produced in Australia or that the imported goods are technically superior to those produced locally.

In addition, the applicant must prepare an Australian industry participation plan that demonstrates the applicant’s commitment to provide full, fair and reasonable opportunity to Australian industry to participate in all aspects of the project. All applications must be lodged with AusIndustry before the eligible goods are imported.

8.3 Excise tax

Excise duty is a tax on certain types of goods or services produced or manufactured in Australia, including alcohol, tobacco and petroleum products. Excise duty is not generally levied on goods to be exported, particularly where oil or condensate is subject to PRRT (refer to section 3.2 Federal crude oil excise above). Excise duty on refined petroleum products which are not exported is generally A$0.38143 per litre.

Fuel used in certain eligible activities (such as mining) may be eligible for a fuel tax credit to offset the fuel excise duty. With the introduction of a carbon-pricing mechanism in Australia from 1 July 2012, the maximum amount of fuel tax credits claimable is reduced by the carbon charge.

8.4 Stamp duty

‘Stamp duty’ is imposed by states and territories and varies (with rates up to 6.75%) on the acquisition of real property and other business property. This would include tenements and rights to extract. There are anti-avoidance provisions, which include indirect transfers such as buying the shares in an entity which holds real property.

The treatment of onshore tenements may vary between the various states or territories. The treatment may again vary depending on whether the permits are onshore or offshore. Some states may waive stamp duty in favor of a registration fee. Western Australia would be an example of this where a stamp duty is waived on onshore petroleum tenements, but a registration fee of 1.5% of the value of the petroleum permit, or consideration paid (whichever is the higher) is levied.

Generally, offshore petroleum tenements situated in federal waters and any transfers are subject to a 1.5% federal registration fee.

8.5 State and municipal

States will tax real property transactions (as discussed above under section 8.4 Stamp duty). In addition, payroll taxes at rates of up to 6.85% on salaries and wages is payable by employers where the applicable wages threshold is exceeded. The rates vary from state to state.

The JPDA is an area off the North West coast of Australia. There are specific tax implications for operating in this area, which are not covered in this guide. In general, the taxing rights in the JPDA are split between Australia and Timor-Leste on a 10%:90% basis respectively.

9.0 Other

9.1 Choice of business entity

It is common for exploration and production activities to be conducted in an unincorporated joint venture ("UJV"). In these circumstances, the UJV is normally regarded as transparent for tax purposes. Accordingly each party is taxed in their own right.

It is common for foreign companies to enter into joint ventures ("JV") when engaging in engineering, procurement and construction ("EPC") contracts. Broadly, there are two types of JV that are common, a UJV and an incorporated JV (i.e. company). EPC UJVs are often considered to be a partnership for tax purposes. Partnerships are required to file an income tax return; however, they are fiscally transparent and the income or loss flows through to each partner (except in the case of a limited partnership, which is generally taxed like a company).

It is common for exploration and production activities to be conducted in an unincorporated joint venture ("UJV"). In these circumstances, the UJV is normally regarded as transparent for tax purposes.

9.2 Foreign currency

An entity in Australia may calculate its taxable income in a foreign functional currency where its accounting records are kept predominantly in that currency. Otherwise, taxable income must be calculated in Australian dollars (transactions denominated in foreign currencies will need to be translated into Australian dollars in accordance with applicable translation rules).

No specific treatment applies to the oil and gas industry in respect of the treatment of foreign currency gains or losses. Subject to an election, realized gains and losses on foreign currency will be accounted for in taxable income, while unrealized gains and losses will not. Under the Taxation of Financial Arrangements rules, the taxpayer can elect to align the tax treatment with the accounting treatment. In that case, gains and losses may be subject to tax on an unrealized basis.

9.3 Australia's *Clean Energy Act* ("Carbon Regime")

From 1 July 2012, every tonne of carbon dioxide equivalent ("CO2-e") produced will be priced at A$23/tonne for a large emitter (i.e. where direct CO2-e emissions exceed a threshold of 25,000 tonnes p.a.). The carbon price will be fixed for three years from 2012 to 2015 (and indexed annually by 2.5%). From 1 July 2015, a floating market-based Emissions Trading Scheme ("ETS") will commence whereby the Australian government sets the emissions level cap for Australia and the market determines the price of permits.

During the fixed-price period, large emitters will be required to buy a fixed-price permit from the government in exchange for every tonne of CO2-e produced. Once the floating ETS commences, the carbon price will be subject to a ceiling price of A$20 above international carbon prices, rising annually at 5%. From 30 June 2018, the cap will fall away, and the price will be dictated entirely by the market.

Between 1 July 2015 and 30 June 2020, liable entities are able to satisfy up to 50% of their annual liabilities by purchasing eligible international emissions units. However, there is a 12.5% cap on the amount of eligible units created under the Kyoto Protocol that can be surrendered to meet an entity's annual liability. In addition, from 1 July 2015, Australia will begin 'one-way linking' with the EU Emissions Trading Scheme ("ETS"). Subject to formal negotiations, by 1 July 2018 at the latest, this will become a full two-way link. The Australia-EU linking mechanism will enable Australian businesses to use EU units to assist in meeting up to 50% of their annual liability.

All direct emissions except for emissions from transport fuels or synthetic greenhouse gases will count towards the threshold of 25,000 tons referred to above. The scheme will cover four of the six greenhouse gases under the Kyoto Protocol – carbon dioxide, methane, nitrous oxide and perfluorocarbons (PFCs) from aluminum smelting. Other synthetic greenhouse gases are excluded.

Certain assistance is provided for selected industries, referred to as "emissions-intensive, trade-exposed industries" to facilitate those operators that are involved in exports to remain internationally competitive. Free units are to be issued, generally based on a certain percentage of the industry average cost of carbon. In addition, LNG projects may be entitled to receive a supplementary allocation to ensure that they receive an effective rate of assistance of 50% or above in relation to their LNG production each year. There is a formal application process for obtaining this assistance.

The cost of carbon units will be deductible for income tax purposes to the extent they are used or sold. Essentially, any unused units would be treated broadly in a manner similar to trading stock. The cost of units which are acquired to offset carbon emissions from upstream operations should also be considered deductible expenditure for PRRT.

Following the results of the federal election held on 7 September 2013, the new ruling Coalition party has indicated that it is considering abolishing the current carbon regime.

9.4 Proposed reform

Australia is in a continuing state of taxation reform, as evidenced by some of the reforms currently being implemented that are outlined above and as a result of the recent change in the political party ruling the federal government. Potential modifications to certain tax treatments currently applicable to the oil and gas industry, such as the definition of exploration expenditure, are still being discussed and future developments in relation to these matters should continue to be monitored. The new ruling Coalition party has also indicated that over the coming two years, it would consult publicly to produce a comprehensive white paper on tax reform, which will set the longer term fiscal policy direction for Australia.

Potential modifications to certain tax treatments currently applicable to the oil and gas industry, such as the definition of exploration expenditure, are still being discussed and future developments in relation to these matters should continue to be monitored.

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