8 May 2023

Australia 2023/08

Tax Insights

Proposed reforms to the Petroleum Resource Rent Tax

Snapshot

On 7 May 2023, the Treasurer advised of significant changes to the design of the Petroleum Resource Rent Tax (PRRT). The package of proposed changes, which include integrity reforms, is expected to increase tax receipts by $2.4 billion over the forward estimates.

The key announcements are:

- The Government has released the *Petroleum Resource Rent Tax: Review of Gas Transfer Pricing Arrangements* final report (GTP review) prepared by Treasury, together with the Government's response. The Government will proceed with 8 of 11 recommendations by the GTP Review.
- One significant recommendation accepted is that from 1 July 2023, the Government will limit deductible expenditure to the value of 90 per cent of PRRT assessable receipts in respect of each project in the relevant income year (applied after mandatory transfers of exploration expenditure).
- Further the Labor government's response to the Callaghan Review, in respect to recommendations that were accepted but not implemented by the previous government has been released. The Government will proceed with 8 recommendations made by the Callaghan review.

The Government will consult on final design and implementation details for the deductions cap and on the draft GTP rules later this year. Consultation on other policy changes (recommendations from the Callaghan Review and anti-avoidance rules) will occur in early 2024.

The implementation of these reforms will finalise the Government's response to the Callaghan Review and the GTP Review. The Government has advised it will continue to monitor the operational aspects of the PRRT and address any integrity issues that emerge, as well as undertake standard care and maintenance of the PRRT as appropriate.

What is the PRRT?

The Petroleum Resource Rent Tax is a tax on oil and gas projects located offshore in Australian Commonwealth waters. PRRT is levied at the rate of 40% on the taxable profits derived from the petroleum project in a year of tax. The taxable profit derived from a petroleum project in a year of tax is the excess of assessable receipts over the deductible expenditure and transferred exploration expenditure.

If deductible expenditure exceeds the assessable receipts derived during the year, the excess is uplifted and carried forward so it can be deducted against assessable receipts derived in future years.

Background to the review of the PRRT

- On 30 November 2016, the former Treasurer Scott Morrison announced the independent expert Michael Callaghan would lead a review into the design and operation of the Petroleum Resource Rent Tax, crude oil excise and associated Commonwealth royalties to provide advice on the extent to which they are operating as intended.
- On 28 April 2017, the former Treasurer Scott Morrison released the report of the Petroleum Resource Rent Tax review here. The Review found that, while the PRRT remained the preferred way to achieve a fair return to the community without discouraging investment, 'changes should be made to PRRT arrangements to make them more compatible with the developments that have taken place in the Australian oil and gas industry.'
- On 2 November 2018, the former Treasurer Josh Frydenberg released the Government's final response to the report of the Petroleum Resource Rent Tax Review provided by Michael Callaghan AM PSM.
- On 14 December 2018, Treasury released exposure draft legislation to implement some of the recommendations, which was ultimately introduced as Treasury Laws Amendment (2019 Petroleum Resource Rent Tax Reforms No. 1) Bill 2019.
- On 5 April 2019, Treasury Laws Amendment (2019 Petroleum Resource Rent Tax Reforms No. 1) Bill 2019 received Royal Assent. Broadly, from 1 July 2019:
  - The uplift rates that applied to certain categories of carried-forward expenditure were reduced.
  - Onshore projects were removed from the scope of the PRRT.
- On 5 April 2019, Treasury issued a Consultation Paper on gas transfer pricing arrangements.
- On 30 June 2020, the Coalition Government announced the start date for compliance and administration changes around the PRRT were revised from 1 July 2019 to the income year commencing on or after 3 months after the date of Royal Assent. This was due to the result of the reprioritization of government resources and the shortened parliamentary sitting period in 2020 due to the COVID-19 pandemic.
- In November 2022, the new Labor Government advised that Treasury was recommencing work on this measure at Treasurer's request.

Key changes: Proposed cap on deductions

From 1 July 2023, the Government will limit deductible expenditure to the value of 90 per cent of PRRT assessable receipts in respect of each project in the relevant income year (applied after mandatory transfers of exploration expenditure).

Unused denied deductions would be carried forward and uplifted at the Government long term bond rate (LTBR). This option would only apply to projects that produce LNG.

To minimise the impacts of upfront payments on project economics, projects would not be subject to the cap until 7 years after first production.

The cap would not apply to certain classes of deductible expenditure in the PRRT: closing-down expenditure, starting base expenditure and resource tax expenditure. This change will bring forward PRRT revenue from LNG projects.

We note that PRRT is deductible for income tax and so the 10% assessable receipts now taxed earlier will be at an effective rate of 28% (i.e., 40% x (1 - 30%)) assuming the taxpayer is taxable.

Transfer pricing changes

As indicated above, the Government has released the *Petroleum Resource Rent Tax: Review of Gas Transfer Pricing Arrangements* final report (GTP review) prepared by Treasury, together with the Government's response.

The 8 recommendations (out of 11) which the Government has accepted are listed below.

Treasury recommendation	Government response
Recommendation 1c: Limit deductible expenditure to the value of 90 per cent of PRRT assessable receipts in respect of each project in the relevant income year (applied after mandatory transfers of exploration expenditure).	The Government will implement option 1c of the recommendation and introduce a measure to cap the use of deductions to offset assessable receipts earned by LNG producers under the PRRT. The Government notes that Treasury has consulted industry on the three options in Recommendation 1, and that the recommended design for the deductions cap takes into account stakeholder feedback to minimise impacts on new investment in current and future projects. This policy change will commence from **1 July 2023.**
Recommendation 3: Require projects to make an irrevocable election to use the shorter or longer asset life formula to remove the integrity risk that projects change the operating life of capital projects to benefit from higher rates of return allowable under the shorter asset life formula.	The Government agrees with this recommendation. This change will better reflect the contribution of the upstream part of LNG production to the integrated operation. This will address an integrity risk that projects change the operating life of capital projects to benefit from higher rates of return allowable under the shorter asset life formula. This policy change will commence from **1 July 2024.**
Recommendation 5: If the RPM is retained, equalise the treatment of the notional upstream and downstream entities between loss situations and profit situations.	The Government agrees with this recommendation. This is an integrity measure which removes the asymmetry in the current rules which means that profits are split 50:50, but losses are attributed 100:0 to the upstream – meaning all the downside is effectively borne by the taxpayer. Losses will now be shared 50:50. This policy change will commence from **1 July 2024.**

Treasury recommendation	Government response
Recommendation 6: Update the comparable uncontrolled price (CUP) rules to align with the OECD guidelines. In particular, the analysis for the CUP should be broadened to consider all reasonable conditions of a comparable transaction. Reasonably accurate adjustments would continue to be permitted.	The Government agrees with this recommendation. This will ensure the GTP rules are fit for purpose if CUPs become available in the future. This policy change will commence from **1 July 2024**.
Recommendation 7: Modify the Advance Pricing Arrangement (APA) rules to provide guidance to industry and the Commissioner of Taxation on the principles that the Commissioner must have regard to in agreeing an APA. If the RPM is retained, the use of an APA should be limited to circumstances where it is required to give practical effect to the statutory residual profit split.	The Government agrees with this recommendation. The Government will limit the use of APAs to circumstances where they are required to give practical effect to the statutory residual profit split. This will provide greater certainty on the circumstances in which an APA can be used. This policy change will commence from **1 July 2024**.
Recommendation 8: Update the regulations for tolling arrangements to support the effective operation of the RPM and to ensure that arm's length/commercial transactions for parts of the LNG production chain (that reflect the underlying resource ownership and risks to parties) are used as far as possible as a reference for establishing a gas transfer price.	The Government agrees with this recommendation. This clarifies the way tolling arrangements interact with the gas transfer pricing rules and ensures that commercial tolling arrangements are reflected in the way the gas transfer price is calculated. This policy change will commence from **1 July 2024**.
Recommendation 9: Update both the PRRT general anti-avoidance rule and the arm's length rule to clarify that they apply to the GTP Regulation. This follows a recommendation made by the Callaghan Review that the Government amend the PRRT anti-avoidance rules to be in line with the income tax anti-avoidance rules.	The Government agrees with this recommendation. This ensures anti-avoidance provisions operate across the PRRT in a consistent fashion and will help ensure that companies cannot enter into artificial tolling arrangements to reduce PRRT liabilities. This builds on recommendation 12 of the Callaghan Review. This will better enable the Commissioner of Taxation to pursue tax avoidance arrangements. This policy change will commence from **1 July 2023**.
Recommendation 11: Update the GTP Regulation to ensure that where an LNG facility enters the PRRT regime (either solely for the purposes of the GTP Regulation or for broader PRRT calculations) for the first time for backfill or tolling purposes, the value of the plant for use in PRRT calculations is the historical cost of the LNG facility, uplifted by the GDP deflator to the date of first production for PRRT purposes.	The Government agrees with this recommendation. This provides certainty for how assets should be valued in these circumstances and removes potential disputes about which valuation method would be appropriate. This policy change will commence from **1 July 2024**.

Decisions and implementation of Callaghan Review recommendations

As mentioned above, the Treasurer has followed up with the Labor government's response to the broader recommendations of the Callaghan Review, in respect to recommendations that were accepted but not implemented by the previous government. The Government will proceed with 8 recommendations made by the Callaghan review.

A summary of the Callaghan Review recommendations and the resultant actions are listed below.

Recommendation	Coalition Government response	Action/Albanese Government response
Recommendation 1 a) Changing the arrangements for the uplift rates for all deductible expenditures so that they are more commensurate with the risk of losing PRRT deductions, taking into account transferability and that this risk will vary over the life of a project.	Broadly the Coalition Government accepted the recommendations to lower uplift rates. For example, the uplift rate on exploration expenditure was to be reduced from Long Term Bond Rate (LTBR)+15 percentage points to LTBR+5. Existing investments were to be respected.	Changes to the uplift rates were legislated in Treasury Laws Amendment (2019 Petroleum Resource Rent Tax Reforms No. 1) Act 2019
b) Ensuring that classes of expenditure with the highest uplifts are deducted first having regard to how deductions can compound in large, long-life projects	No reordering of deductions was required to ensure those with the highest uplifts are deducted first.	Not applicable
c) Examining the rules for the transferability of deductions between projects in a company to ensure they produce a consistent set of outcomes; and	The Government will retain an interoperable PRRT regime with transfers of exploration expenditure allowed between existing and new projects. As part of accommodating this change, the treatment of exploration expenditure incurred before 1 July 2019 will also change when it is transferred or deducted within a project at the uplift rate of LTBR+15 percentage points.	Changes to the uplift rates were legislated in Treasury Laws Amendment (2019 Petroleum Resource Rent Tax Reforms No. 1) Act 2019
d) Examining the gas transfer pricing arrangements to identify possible changes that would achieve greater simplicity and transparency, ease of compliance, and fair treatment of the economic rent from each stage of an integrated petroleum operation.	The Government has asked Treasury to lead a review of the gas transfer pricing arrangements. Treasury will consult and report back within 12 to 18 months.	On 5 April 2019 Treasury issued a Consultation Paper on gas transfer pricing arrangements. The Albanese Government has completed this review above.

Recommendation	Coalition Government response	Action/Legislation/Albanese Government response
Recommendation 2: Prohibit onshore projects transitioned into the PRRT in 2012 with 'starting base' credits from combining with future onshore projects that don't currently have a starting base.	From 1 July 2019, the Government will remove onshore projects from the PRRT regime.	Changes to the uplift rates were legislated in Treasury Laws Amendment (2019 Petroleum Resource Rent Tax Reforms No. 1) Act 2019
Recommendation 3: The review into the legislative framework for decommissioning of projects currently being undertaken by the Department of Industry, Innovation and Science should take into account the impact of decommissioning expenses on PRRT revenue.	Coalition government response: This recommendation is being considered in the context of the review into the legislative framework for decommissioning of projects being undertaken by the Department of Industry, Innovation and Science.	
Recommendation 4: Recognise partial closing down expenditure as a legitimate deduction	Coalition Government response: This recommendation has been addressed by the ATO through publication of guidance. This recognises partial closing down expenditure as a legitimate deduction[1].	
Recommendation 5: Allow PRRT taxpayers to lodge annual returns after they start holding an interest in an exploration permit, retention lease or production lease rather than having to wait until they receive assessable receipts from the project.	The Government supports this recommendation. Consultation on exposure draft legislation will ensure no unintended consequences arise from implementation.	Never legislated. The Albanese Government will proceed with this measure.
Recommendation 6: Grant power to the Commissioner of Taxation to treat a new project as a continuation of an earlier project, where it would be reasonable to do so.	The Government supports this recommendation. The legislation will outline criteria that the Commissioner must take into account in for determining whether a new project is a continuation of an existing project.	Never legislated. The Albanese Government will proceed with this measure.
Recommendation 7: Grant discretion to the Commissioner of Taxation to recognise more than one project from a production licence area where there are genuinely separate and independent petroleum operations.	The Government supports this recommendation. The legislation will outline criteria that the Commissioner must take into account in determining whether there are multiple projects in a production licence area.	Never legislated. The Albanese Government will proceed with this measure.

[1] TR 2018/1 Petroleum resource rent tax: character of expenditure incurred in relation to abandonment, decommissioning and rehabilitation activities undertaken on a part of a petroleum project

Recommendation	Coalition Government response	Action/Legislation/Albanese Government response
Recommendation 8: Extend to offshore projects, the option to have all interests held by a group taken together and reported as a single PRRT return.	The Government supports this recommendation. Treasury to seek comments and views on this proposal as part of the options paper it will release.	Never legislated. The Albanese Government will proceed with this measure.
Recommendation 9: Allow PRRT taxpayers to adopt a substituted accounting period for PRRT so it can align with their choice to use a substituted accounting period for income tax.	The Government supports this recommendation. Treasury to seek comments and views on this proposal as part of the options paper it will release.	Never legislated. The Albanese Government will proceed with this measure.
Recommendation 10: Allow PRRT taxpayers operating with a Multiple Entry Consolidate (MEC) Group to make a functional currency choice for PRRT purposes that aligns with the functional currency choice made for income tax purposes.	The Government supports this recommendation. Treasury to seek comments and views on this proposal as part of the options paper it will release.	Never legislated. The Albanese Government will proceed with this measure.
Recommendation 11: Grant power to the Commissioner of Taxation to administratively exempt projects from PRRT obligations where they are clearly unlikely to pay PRRT in the foreseeable future.	The Government supports this recommendation. Treasury to seek comments and views on this proposal as part of the options paper it will release.	Never legislated. The Albanese Government will proceed with this measure.
Recommendation 12: Amend PRRT anti-avoidance rules to be in line with the income tax anti-avoidance rules	The Government supports this recommendation. Treasury to seek comments and views on this proposal as part of the options paper it will release.	Never legislated. The Albanese Government will proceed with this measure.

Legislative and industry support

The Treasurer has stated that the change “strikes the best balance between getting a fairer return for Australians sooner, but also being cognisant of investment and supply and our international relationships”. The modest changes will provide greater certainty for the industry after a long period of review.

For the relevant legislation to pass it will be critical for a bipartisan approach, and industry bodies have called for the government to work constructively and cooperatively with the opposition. The Coalition has not yet committed to supporting the measures.

8 May 2023

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