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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

PETROLEUM RESOURCE RENT TAX ASSESSMENT BILL 1986

SUPPLEMENTARY EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer,
the Hon. P.J. Keating, M.P.)

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Introductory Note

An Explanatory Memorandum containing explanations of the Petroleum Resource Rent Tax Assessment Bill 1986 ("the Bill") and related Bills as introduced into the House of Representatives has been circulated.

Amendments of the Bill are proposed to be moved in the House on behalf of the Government during consideration of the Bills in Committee.

Those amendments will -

- make it clear that individual participants in a joint venture (and not the joint venture as a whole) are to be subject to petroleum resource rent tax;
- permit only parties having 50% or more equity in each of the relevant projects to apply for a project combination certificate;
- alter the basis for determining liability for the tax from a cash-flow basis to an accruals basis, so that it is consistent with the basis adopted for income tax purposes;
- make clear the circumstances in which costs of freight, demurrage etc., will be deductible;
- require the value of an unsold marketable petroleum commodity stored in an on-site storage facility to be brought to account only after the commodity has left that facility;
- authorise deductibility of expenditure on on-site storage facilities and other costs of selling a marketable petroleum commodity; and
- ensure that the value of a marketable petroleum commodity that is re-injected, flared-off or used on the project is not brought to account as an assessable receipt.

This Supplementary Explanatory Memorandum explains the amendments and should be read in conjunction with the earlier Explanatory Memorandum.

Financial Impact

The proposed amendments are essentially of an administrative nature or for purposes of clarifying the operation of provisions contained in the Bill. The only amendment likely to have any revenue consequences is that

to allow deductions for expenditure on certain storage facilities. It will result in a small, but unquantifiable, reduction in petroleum resource rent tax revenue.

More detailed explanations of the amendments are contained in the following notes.

PETROLEUM RESOURCE RENT TAX ASSESSMENT BILL 1986

Amendment (1)

This amendment will insert in clause 2 of the Bill a definition of "excluded commodity" - that is, a marketable petroleum commodity (as defined) that has been sold, further processed or treated after being produced, moved from the place of production otherwise than to an adjacent storage site or moved from a storage site adjacent to the place of production.

The term is used in clauses 19, 24 and 25, as proposed to be amended (see notes on amendments (7), (10) and (11)) to, in effect, ensure that the cost of facilities for storing a marketable petroleum commodity adjacent to the place of its production will be deductible and that the value of a marketable petroleum commodity stored in such a facility will not be brought to account as an assessable petroleum receipt until the commodity leaves that storage.

Amendment (2)

The term "re-inject", in relation to a marketable petroleum commodity (as defined), will be defined by this amendment to mean the return of that commodity either -

- in a case where a production licence in relation to the project has not yet come into force - to a natural reservoir in the eligible exploration or recovery area (see notes on clause 5 of the Bill); or

- in any other case - to a natural reservoir in the production licence area of any production licence in relation to the project.

The definition is relevant for the purposes of clauses 24 and 25, as proposed to be amended (see notes on amendments (10) and (11)), to ensure that the value of a re-injected marketable petroleum commodity is not brought to account as an assessable petroleum receipt or an assessable exploration recovery receipt.

Amendment (3)

By the operation of clause 13 of the Bill, an "unincorporated association" is to be treated as a person for the purposes of the Bill - one consequence of which is that a petroleum resource rent tax return may be required to be lodged on behalf of an unincorporated association. Amendment (3), by defining an unincorporated association as not including a joint venture, will make it clear that a joint venture will not itself be treated as a person for the purposes of the Bill. As a result, individual joint venturers will be responsible for lodging petroleum

resource rent tax returns disclosing their individual receipts and expenditures in relation to a petroleum project.

Amendments (4) and (5)

By these amendments liability for petroleum resource rent tax is to be determined on an accruals basis rather than a cash-flow basis. Consistently, where consideration under a transaction is liable to be given in the form of property, the monetary value of that property will be taken to have been liable to be given.

Amendment (6)

This amendment also arises from the proposed change to an accruals basis for determining a person's petroleum resource rent tax liability. The amendment will ensure that an amount is taken to be receivable by a person, although not to be actually paid over to that person, if it is to be re-invested, accumulated, etc., or otherwise dealt with on behalf of the person or as the person directs.

Amendment (7)

This amendment will extend a reference in the Bill to the operations, facilities and other things comprising a petroleum project to include operations and facilities for the moving or storage of any marketable petroleum commodity at a point before it becomes an "excluded commodity" (see notes on amendment (1)). The effect of the amendment will be to bring within the project boundaries any operations and facilities connected with the storage of a marketable petroleum commodity at a site adjacent to the place of production of that commodity. As a result, expenditure on such operations and facilities will, in terms of clause 38, qualify for deduction as general project expenditure.

Amendment (8)

Under clause 20 of the Bill, the Minister for Resources and Energy is authorised to issue a certificate specifying that 2 or more projects constitute a single petroleum project. The issue of that certificate may result from an application or request by a petroleum project participant or from the Minister's independent action.

This amendment will permit an effective application or request for the issue of a certificate to be made only by a participant (or participants together) having a 50 per cent or greater interest in each of the projects sought to be combined. The relevant interest will be determined by reference to a participant's entitlement to share in receipts from the sale of marketable petroleum commodities from the project.

If, for example, participant A has a 30 per cent interest in project X and a 75 per cent interest in project Y, an application for the issue of a project combination certificate in respect of X and Y could only be made by A in conjunction with another participant (or participants) having a 20 per cent or more interest in project X.

The terms of the amendment also make it clear that the making of a recommendation to the Minister by an officer (as defined in clause 2) - for example, in relation to a project participant's application - does not constitute an application or request for the purposes of the clause.

Amendment (9)

This is a technical amendment supplementing amendment (8) to the effect that where a joint application or request for a project combination certificate is refused, the Minister is required to serve notice of that refusal on each of the persons making the application or request.

Amendment (10)

Existing clause 24, which defines what is meant, for the purposes of the Bill, by a reference to assessable petroleum receipts derived by a person in relation to a petroleum project, is to be replaced by a new clause 24 to the same effect. The necessity for the amendment arises because of the proposed alteration (by amendment (1)) of the point at which unsold marketable petroleum commodities attract petroleum resource rent tax - broadly, from the point at which such commodities are produced to the point at which they leave initial on-site storage facilities. The terms of the new clause also reflect the change in the basis of assessment from a cash-flow to an accruals basis.

Paragraph 24(a) includes as an assessable petroleum receipt consideration receivable, less any expenses payable, in relation to the sale of processed or unprocessed petroleum (or a constituent of petroleum) before the production from it of any marketable petroleum commodity (as defined in clause 2). Expenses payable in relation to the sale would include, for example, freight charges, marketing costs and demurrage. For the purposes of the paragraph, "petroleum" has, by clause 2, the meaning given to it in the Petroleum (Submerged Lands) Act 1967 - broadly, any naturally occurring hydrocarbon or mixture of hydrocarbons including mixtures containing hydrogen sulphide, nitrogen, helium and carbon dioxide. The petroleum (or constituent of petroleum) referred to is that recovered from the production licence area or areas in relation to the project. Where a project relates to a single production licence, the area would be the area of that production licence. In the case of a combined

project, the areas would be those of the production licences specified in the project combination certificate (see notes on clause 20). The petroleum recovered from any particular area will include amounts which, by the operation of clause 3, are taken to have been recovered from that area. Clause 3 will apply, broadly, in cases where the boundary or boundaries of a production licence or licences straddle a petroleum pool.

By paragraph (b), assessable petroleum receipts are to include the consideration receivable, less any expenses payable, in relation to the sale of any marketable petroleum commodity (defined in clause 2 as including stabilised crude oil, sales gas, condensate, etc.) that becomes an excluded commodity by virtue of being sold. "Excluded commodity" is defined in clause 2 (see notes on amendment (1)) to mean, so far as is relevant, a marketable petroleum commodity that has been sold. The relevant marketable petroleum commodities are those produced from petroleum recovered from the production licence area(s) referred to in paragraph (a). Proceeds from the sale of stabilised crude oil directly from a stabilisation plant would thus be included as an assessable petroleum receipt by the operation of paragraph (b). Unsold stabilised crude oil that is stockpiled at a site adjacent to its place of production would not, at that point, be an excluded commodity and its market value would not be included as an assessable petroleum receipt.

Where paragraph (c) applies - for example, where a marketable petroleum commodity is moved away from its place of production other than to an adjacent storage site or is moved from that adjacent storage site - the market value of the petroleum commodity immediately before it thus became an excluded commodity will be included as an assessable petroleum receipt. Where there is insufficient evidence of that value, the amount will be such amount as the Commissioner of Taxation considers fair and reasonable. In cases where two or more persons are entitled to receipts from the sale of marketable petroleum commodities from the project, clause 26 will operate to apportion the notional amount between them on the basis of their respective entitlements to proceeds from the sale of marketable petroleum commodities.

Amendment (11)

As with the replacement of clause 24, existing clause 25 is being replaced to reflect both the alteration in the point at which assessable receipts are determined and the alteration in the basis for determining petroleum resource rent tax liability.

New clause 25 operates to determine assessable receipts in respect of petroleum, petroleum constituents or marketable petroleum commodities recovered or produced from

within the eligible exploration or recovery area (other than from a production licence area) in relation to a petroleum project. It will apply, for example, to petroleum recovered while drilling, for exploration purposes, in an exploration permit area from which a production licence is later drawn.

Paragraph 25(a) includes as an assessable exploration recovery receipt consideration receivable, less any expenses payable, by a person in relation to the sale, before a marketable petroleum commodity is produced, of processed or unprocessed petroleum (or a constituent of petroleum) recovered from the eligible exploration or recovery area in relation to a project. The eligible exploration or recovery area in relation to a project is determined under clause 5. Broadly, in the case of a production licence drawn from an exploration permit, the eligible exploration or recovery area is the area covered by the exploration permit including (by the operation of paragraph 5(2)(c)) the area of any production licences in relation to the project. Paragraph (a) excludes from its scope any petroleum (or constituent) recovered from a production licence area while the relevant production licence is in force. Proceeds from the sale of petroleum (or constituent) recovered from a production licence area while the production licence is in force are included as an assessable petroleum receipt by the operation of clause 24.

Because of the operation of subclause 5(2), where marketable petroleum commodities cease (except temporarily) to be produced from a project and recovery of petroleum continues in the exploration permit area (say, at a non-commercial level for testing purposes), receipts from the sale of such petroleum recovered after that time will not be taken to be assessable exploration recovery receipts in relation to that project. If subsequently a production licence drawn from the permit area comes into force, those receipts would be assessable exploration recovery receipts in relation to the subsequent project.

Paragraph (b) includes as an assessable exploration recovery receipt consideration receivable, less any expenses payable, for the sale of a marketable petroleum commodity produced from the recovered petroleum referred to in paragraph (a). The paragraph applies where that marketable petroleum commodity becomes an excluded commodity (as defined in clause 2 - see notes on amendment (1)) by virtue of being sold.

In a similar manner to paragraph 24(c), paragraph (c) of this clause will include a notional amount as an assessable exploration recovery receipt where a marketable petroleum commodity becomes an excluded commodity otherwise than by reason of its being sold, re-injected, destroyed or used on the project. That is, the paragraph will apply where the marketable petroleum

commodity has been further processed or treated, has been moved from its place of production other than to an adjacent storage site or has been moved from an adjacent storage site. The notional amount to be included will be, broadly, the market value of the commodity immediately before it became an excluded commodity or, in the absence of sufficient evidence to determine that value, such amount as the Commissioner considers is fair and reasonable.

Amendment (12)

Clause 26 operates for the purposes of clauses 24 and 25 in determining a person's entitlement to receipts. This amendment of the clause is a technical one, consequent upon the amendments of clauses 24 and 25 by amendments (10) and (11). Amendment (12) corrects references to those paragraphs of clauses 24 and 25 to which clause 26 will now have application.

Amendments (13-18), (20), (21)

These amendments reflect the alteration, from a cash-flow to an accruals basis, in the basis of determining the liability of a person to petroleum resource rent tax. Under the accruals basis, which accords with that applicable to project participants for income tax purposes, receipts are taken to have been derived when they are receivable rather than when actually received. The effect of the amendments is to alter the timing of the derivation of taxable receipts.

Amendment (19)

Assessable miscellaneous compensation receipts include, by virtue of clause 28, various amounts received by way of insurance, compensation and indemnity. This amendment will ensure that, as a consequence of the alteration in the point at which the value of a marketable petroleum commodity is assessable - see notes on amendments (10) and (11) - receipts derived by a person in respect of the loss or destruction of a marketable petroleum commodity before it became an excluded commodity (see notes on amendment (1)) will be treated as assessable miscellaneous compensation receipts.

Amendments (22), (24-30), (32), (33)

These amendments are also consequential on the alteration, from the cash-flow to the accruals basis, in the basis for determining a person's petroleum resource rent tax liability.

Expenditure under the accruals basis, as applicable for income tax purposes, is taken to have been incurred at the time at which the liability for such

expenditure arises, rather than when the amount is actually paid. The effect of the amendments is to alter the timing of the deductibility of such expenditure.

Amendment (23)

This amendment will insert new subparagraph (iiia) in paragraph (1)(b) of clause 37 to ensure that payments in respect of operations and facilities for the moving or storage of a marketable petroleum commodity before it becomes an excluded commodity (see notes on amendment (1)) are treated as part of a person's exploration expenditure. A condition is that the commodity was produced from petroleum recovered from an eligible exploration or recovery area, other than a production licence area. Expenditure on moving and storing a marketable petroleum commodity produced from petroleum recovered from a production licence area would constitute general project expenditure - see notes on amendment (7).

Amendment (31)

Amendments (13-18), (20-22), (24-30), (32) and (33) (see notes on those amendments) will together result in a person's liability for petroleum resource rent tax being determined on an accruals basis rather than on a cash-flow basis.

Amendment (31) is also consequent upon the proposed change from the cash-flow basis of assessment to the accruals basis. Under the accruals method, amounts will be included in the assessable receipts of a person when receivable, rather than when actually received. The amendment will insert new clause 39A to ensure that, where debts are not actually received and are written off as bad debts, a deduction is available for the amount so written off.

The deduction would ordinarily be allowable to the person in whose assessable receipts the amount was originally included. However, where a person's entire interest in a project has been transferred to another person (the purchaser), the amendment of clause 47 will ensure that the deduction is available to the purchaser (see notes on amendment (34)).

Paragraphs (a) and (b) of subclause 39A(1) outline the conditions which must be satisfied before the deduction for a bad debt will be available in any financial year. Paragraph (a) requires that there be a debt which is a bad debt and that the debt be written off as such during the financial year. The requirements parallel those under section 63 of the Income Tax Assessment Act 1936 which allows a deduction under that Act for certain "debts which are bad debts and are written off as such" during a year of income. It is not sufficient that a debt merely be characterised in the accounts as a doubtful debt.

By paragraph (1)(b) a deduction for a bad debt will only be available to a person where the debt has been brought to account, during a financial year in relation to a project, as an assessable receipt of one of the kinds referred to in clauses 24, 25, 27, 28 and 29.

The petroleum project against which a deduction will be available is determined by reference to paragraphs (c) and (d). Unless a project combination certificate has been issued under clause 20, the deductible expenditure will be deemed to have been incurred in relation to the petroleum project in respect of which the debt was included as an assessable receipt (paragraph (c)). Where the petroleum project is combined with another project by virtue of the issue of a project combination certificate, the amount of expenditure will be taken to be incurred in relation to the resulting combined project (paragraph (d)).

Paragraphs (1)(e), (f) and (g) of the new clause characterise the deduction for a bad debt as exploration expenditure (see notes on clause 37), general project expenditure (clause 38) or closing-down expenditure (clause 39) respectively.

Paragraph (e) will apply where the debt is written off before any general project expenditure or closing-down expenditure has been incurred in relation to the project (or, where paragraph (d) applies, the combined project). Where no such expenditure has been incurred before the time at which the debt is written off, the clause will operate to deem the person to have incurred, at that time, an amount of exploration expenditure equal to the debt.

Paragraph (f) will apply where the person has incurred general project expenditure but has not incurred closing-down expenditure in relation to the project or the combined project. The person will be deemed to have incurred (again, at the time the debt is written off) an amount of general project expenditure equal to the debt.

Where the person has incurred closing-down expenditure at the time the debt is written off, paragraph (g) will deem the person to have incurred, at that time, an amount of closing-down expenditure equal to the debt.

Subclause 39A(2) will apply where a debt has been brought to account in terms of paragraph (1)(b) and the debtor becomes bankrupt or executes a deed of assignment or deed of arrangement for the benefit of creditors. By paragraph (2)(a), where the Commissioner of Taxation is of the opinion that no amount will be paid on account of the debt, the full amount of the debt is deemed to be a bad debt. By paragraph (b), where the Commissioner forms the opinion that an amount less than the full amount will be paid on account of the debt, the balance is deemed to be a bad debt.

Subclause 39A(3) will operate to bring to account as assessable receipts amounts received in respect of debts to which subclause (1) applies. Accordingly, if an amount is allowed as a deduction for a bad debt and the debt is repaid in whole or in part, the amount so repaid is taken to be an assessable receipt derived by the person. The amount will be included as an assessable receipt in relation to the project in respect of which the debt was originally brought to account as an assessable receipt (paragraph (a)). Where that project has been combined with another project, the amount will be taken to be derived in relation to the resulting combined project (paragraph (b)). The receipt will be taken to be of the same kind (assessable petroleum receipt, assessable exploration recovery receipt, assessable property receipt, assessable miscellaneous compensation receipt or assessable employee amenities receipt) as was originally brought to account in terms of paragraph (1)(b).

Amendment (34)

Clause 47 applies where the whole of a person's interest (i.e., the vendor) in a petroleum project is transferred to another person (the purchaser). The effect of the clause is, broadly, to place the purchaser in the same position, for petroleum resource rent tax purposes, as the vendor would have been in but for the transfer of the interest.

This amendment of clause 47 to insert a new paragraph, paragraph (f), is consequent upon amendment (31) inserting clause 39A. Under clause 39A persons will be taken, broadly, to have incurred deductible expenditure where debts that have been brought to account as assessable receipts are written off as bad debts. The insertion of paragraph (f) in clause 47 will ensure that clause 39A operates where a bad debt is written off after the time at which the transfer of the interest in a project occurs and the debt was included in the assessable receipts of the vendor. By deeming debts brought to account as assessable receipts by the vendor to have been brought to account by the purchaser, the effect will be that, if such a debt is subsequently written off as bad by the purchaser, the purchaser will, under clause 39A, be taken to have incurred, at the time the debt is written off, expenditure of a kind determined in accordance with paragraph 39A(1)(e), 39A(1)(f) or 39A(1)(g) - see notes on amendment (31).

Amendments (35) and (36)

These amendments correct a technical flaw in clause 56 which operates in respect of transactions involving non-arm's length receipts. The amendments remove inappropriate references in that clause to receipts of a kind referred to in clause 26. Clause 26 operates to

determine a market value of petroleum or a marketable petroleum commodity for the purposes of clauses 24 and 25, but does not operate to deem a person to have derived receipts under clause 26.