

Petroleum Resource Rent Tax Extension

On 2 July 2010, the Government announced new resource taxation arrangements to apply from 1 July 2012, encompassing a new Minerals Resource Rent Tax (MRRT) regime on the mining of iron ore and coal in Australia, and an extension of the existing Petroleum Resource Rent Tax (PRRT) regime to all Australian onshore and offshore oil and gas projects, including the North West Shelf of Western Australia. Presently, the PRRT only applies to offshore oil and gas projects, and does not include projects in the North West Shelf (NWS) and the Joint Petroleum Development Area (JPDA) between Australia and East Timor.

On 26 August 2011, Exposure Draft legislation for the PRRT extension was released. The following is an overview of the proposed PRRT extension.

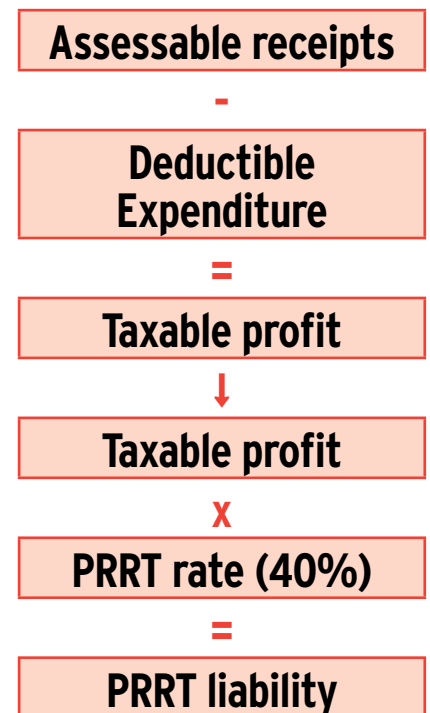
Overview of the PRRT

The PRRT currently applies to offshore oil and gas projects and is levied at a rate of 40% of taxable profits, but it is deductible for income tax purposes, reducing the net tax effect to 28%. PRRT applies to each project separately (incorporating each production licence area) but can be extended to related activities outside the production licence area. The taxing point arises when a 'marketable petroleum commodity' is sold, further processed or treated, or moved away from its place of production or initial storage. Marketable petroleum commodities include stabilised crude oil, condensate, sales gas, natural gas, LPG and ethane.

Calculation of PRRT Liability

Profit from a project is taxable for PRRT purposes to the extent that 'assessable receipts' exceed 'deductible expenditure'

for the period (including any carry forward expenditure transferred to the project from another project or group company). This can be represented diagrammatically as follows:



Deductible expenditure includes exploration expenditure, general expenditure or closing-down expenditure incurred in carrying on or providing

operations, facilities and other things comprising the project.

Certain excluded expenditure is not deductible for PRRT purposes. This includes interest payments, repayments of borrowings or equity capital, dividend payments, share issue costs, private override royalty payments, payments made under a cash bidding system, fees paid to obtain an exploration permit, retention lease or production licence, GST payments and indirect expenditure of an administrative and accounting nature.

Unused deductible expenditure of the current and previous years may be carried forward and is compounded to ensure that the value of the expenditure is retained. Whilst project losses generally cannot be offset against income of other projects, exploration expenditure can be transferred to other projects subject to various conditions.

PRRT extension exposure draft legislation

From 1 July 2012, the PRRT will be extended to apply to petroleum production, including coal seam gas and shale oil, sourced from petroleum projects located onshore and in territorial waters, as well as from the NWS Project area. However, the PRRT will not apply to the JPDA or taxable resources covered by the MRRT.

Various definitions are expanded to give effect to this extension, including:

- the definition of petroleum for PRRT purposes - to specifically include shale oil and coal seam gas not extracted from mining coal;
- the authority of the Resources Minister to combine projects - to extend to onshore projects (e.g. for onshore projects that are integrated downstream or that share a common processing hub); and
- the definition of excluded fees - to extend to fees paid to obtain an exploration permit, retention lease or production licence covered by the new PRRT extension.

Assessable receipts

Generally, the PRRT will start to assess receipts derived from onshore and NWS projects from 1 July 2012. Any prepayment of assessable receipts on projects covered by the PRRT extension are only taken to have been derived in the financial year in which the activity is undertaken.

PRRT will also apply to all revenue generated from incidental products and services that were recovered, extracted or produced in carrying on a petroleum project and sold (e.g. treated water from a coal seam gas project or excess electricity generated from the project). These are not currently subject to PRRT.

Deductible expenditure

The draft provisions will include the following clarifications relating to PRRT deductions:

- expenditure on environmental activities for projects will be deductible;
- resource tax expenditures (e.g. royalties, excise or other taxes imposed by Commonwealth, State and Territory governments) will be deductible, provided that it is incurred in relation to the same production licence area - the deduction is calculated by dividing the value of the expenditure by the PRRT rate (40%);
- undeducted expenditure cannot be transferred to other projects but it will transfer to the new holder of an interest; and
- native title payments are specifically carved out of the definition of excluded expenditure.

In addition, the '5 year rule' which determines the relevant rate at which undeducted expenditure carried forward is compounded, will be extended to onshore and NWS projects.

Transitioning projects

In order to recognise investments made prior to the Government's announcement of the PRRT extension, holders of interests in transitioning petroleum projects, exploration permits and retention leases that existed as at 2 May 2010 may either receive an additional deductible expenditure amount (a starting base amount), or can take account of past project expenditures in determining their PRRT liability. This



is a key transitional feature of the PRRT extension.

Starting base amounts

Holders of interests in transitioning projects existing at 2 May 2010 may choose to use either the market value or the book value approach to determine a starting base amount. The starting base amount as at 1 July 2012 will comprise:

- the value of starting base assets, using:
 - the market values of starting base assets (including rights to the resources) at 2 May 2010; or
 - the most recent audited accounting book values of starting base assets (excluding rights to the resources) available at that time; and
- interim capital expenditure incurred from the time that the value of starting base assets was determined to 1 July 2012 - this includes expenditure on depreciating or capital gains tax (CGT) assets, as well as mining capital expenditure relating to the project.

The starting base amount is reduced by:

- starting base assets that were not constructed or used for project purposes;
- expenditure on assets that would have been excluded expenditure; and
- starting base, depreciating or CGT assets partially or wholly disposed of prior to 1 July 2012.

To minimise compliance costs, an alternative valuation method for determining the market value of the starting base assets is available for coal seam gas project interests.

Where the book value approach is chosen, the value of both starting base assets and interim expenditure amounts will be uplifted each year by the Long Term Bond Rate (LTBR) plus 5 per cent over the interim period to 1 July 2012. Under the market value approach, starting base amounts are not uplifted during the interim period.

Look-back approach

Alternatively, holders of interests in transitioning projects can choose the look-back approach, under which there is no starting base amount. Instead, expenditures incurred in relation to the project interest from 1 July 2002 can be taken into account in determining PRRT liability, consistent with existing PRRT deductible expenditure provisions. The look-back rule is subject to certain substantiation requirements.

Where the project interest was acquired during the period 1 July 2007 to 2 May 2010, the acquisition price may also be taken into account under the look-back approach to the extent that it relates to the project interest. Apportionment rules have yet to be released.

Starting base and look-back amounts are immediately deductible against assessable receipts from 1 July 2012 where a production licence exists following the extension of the PRRT. Unused amounts are uplifted by the LTBR plus 5 per cent each financial year. Starting base amounts relating to interests in petroleum exploration permits and retention leases will become deductible when a related production licence comes into force.

Starting base amounts are not transferable between projects. Similarly, exploration expenditure that is taken to be incurred by a project before 1 July

2012 under the look-back approach is not transferable.

Finally, starting base and look-back amounts are subject to adjustment by the Commissioner within four years from the date of a valid choice, with no time limit if fraud and evasion is involved.

How can RSM Bird Cameron help?

1. Treasury is currently taking submissions on the Exposure Draft legislation, whilst the Resource Rent Tax Sub-committee of the Australian Taxation Office's (ATO) National Tax Liaison Group is in the process of consulting with industry and tax professionals. We can help you with this consultation process.
2. Holders of projects transitioning into the PRRT regime will need to assess the whether to choose a starting base for relevant assets or to apply the look-back approach. We can help you choose the best option and prepare the appropriate supporting documentation.
3. We can help you assess whether projects can or should be combined for PRRT.
4. We can work with you to design management systems to help you comply with your PRRT obligations.

Please contact RSM Bird Cameron if you require further assistance or information in relation to the MRRT or PRRT extension.

Further updates

RSM Bird Cameron will issue further PRRT updates as developments occur. Please email your contact details to prrt@rsmi.com.au to receive these updates.

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