Parliamentary Budget Office

Policy costing

Charge royalties for oil and gas and reform the petroleum resource rent tax	
Party:	Australian Greens

Summary of proposal:

This proposal would replace the existing petroleum resource rent tax (PRRT) method of uplifting excess expenditure to future years, with the following two treatments.

- All excess expenditure recorded by the implementation date would be depreciated over 10 years to offset PRRT profit. A minimum 10 per cent of existing expenditure would be used each year and be completely expired by year 10.
- For all expenditure, including general expenditure, incurred after the implementation date, the available deduction would be based on prime cost depreciation over 15 years so that 6.66 per cent of the expenditure would be available to be deducted each year. There would be no uplift factor applied to unused expenditure.

This proposal would apply to both offshore and onshore projects. This proposal would also place a 10 per cent royalty on projects subject to the PRRT, with these royalty payments creditable against PRRT liabilities on a one-for-one basis and treated as a deductible expense in calculating company tax liabilities. Any royalties paid that are not credited against PRRT liabilities in a year would be carried forward, to be credited against PRRT liabilities in a later year.

The proposal would have effect from 1 July 2019.

Costing overview

This proposal would be expected to increase the fiscal balance by $9,500 million and the underlying cash balance by $9,300 million over the 2019-20 Budget forward estimates period. This impact reflects a net increase in revenue.

The effect of the proposal would significantly alter the deductibility of expenses for PRRT purposes. The removal of uplift factors and the minimum expensing of existing expenditure mean that project expenditures would be used up much earlier, which will lead to more projects becoming liable for the PRRT over the period to 2029-30.

The components of this proposal would interact, as royalty amounts would be creditable against final PRRT liabilities. This would reduce the overall PRRT that would have been expected to be collected in the absence of the proposed royalty. As more projects become liable for the PRRT, the amount of royalties would be expected to be fully offset against the PRRT. Over time the royalties would not be expected to change the overall impact of taxation on a project. The royalty amount would offset the PRRT and would therefore bring forward the taxation point rather than change the amount of taxation over the life of a project. Changes in the taxation point for each project would be different and some of the net impacts would be expected to occur beyond 2029-30.

The proposal would be expected to have an ongoing impact that extends beyond the 2019-20 Budget forward estimates period. A breakdown of the financial implications of the proposal over the period to 2029-30 is included at Attachment A.

Departmental expenses for the proposal would not be expected to be material because it would not be expected to significantly alter the administration of the tax system.

The differences between the fiscal and underlying cash balance impacts reflect timing differences between when the PRRT, royalty revenue and the company tax are recognised and when they are paid.

There is a significant degree of uncertainty around the estimated growth in the value of oil and gas production and expected behavioural responses to the proposal, including uncertainty around future oil and gas prices. The proposed royalty would add to the production costs of affected projects and, consequently, it is possible that some more marginal projects would close sooner than they otherwise would have as a result of the proposal, or that some prospective projects may not proceed.[1] As the changes to deductions of expenditure would increase the expected PRRT and reduce the post-tax return on projects, it is also possible that this would lead to some projects closing sooner or that some prospective projects may not proceed. The 2018-19 Mid-Year Economic and Fiscal Outlook measure *Petroleum Resource Rent tax – changing the PRRT settings to get a fair return* changed the PRRT system. The effect of this change on behaviour has not yet been observed. Changes in assumptions relating to these factors could significantly reduce the revenue estimates. The estimates are also sensitive to assumptions around when affected projects would be expected to begin to pay the PRRT over the period to 2029-30.

Table 1: Financial implications ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Fiscal balance	3,300	2,000	2,300	2,000	**9,500**
Underlying cash balance	2,900	1,800	2,400	2,200	**9,300**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.

(b) Figures may not sum to totals due to rounding.

Key assumptions

The Parliamentary Budget Office (PBO) has made the following assumptions in costing this proposal.

- Oil and gas production over the period to 2029-30 would not significantly fall as a result of the proposal.
- The company tax rate for companies affected by this proposal is equivalent to the large company tax rate, and all affected companies would be taxable and able to deduct the PRRT from the company tax.
- Companies would not vary pay-as-you-go instalments to allow for the company tax deduction in the first year.

[1] Henry, Ken. & the Treasury. & Australia's Future Tax System Review Panel, 2010. *Australia's future tax system: report to the Treasurer.* Canberra: Australia's Future Tax System Review Panel: The Treasury. page 229.

- The average oil price would be US$58 per barrel at the end of the 2019-20 Budget forward estimates period and its real value would be maintained over the period to 2029-30 by indexing it by the consumer price index.
- No new oil and gas projects will begin production over the period to 2029-30.
- There would be no new transfers of exploration expenditure.
- Royalties would be paid monthly, consistent with company pay-as-you-go instalments.
- The majority of companies that are investors in PRRT projects would continue to be primarily foreign owned over the period to 2029-30.

Methodology

The PRRT impact was estimated by calculating the effect of changing the deductibility of existing expenses and estimated new expenses. These new deductions were offset against PRRT profit to calculate the overall new PRRT.

Royalty revenue was estimated by calculating the royalty rate against the wellhead value of the forecast production levels of projects that would be subject to the proposed royalty. As the North West Shelf project is currently subject to a Commonwealth royalty, it was excluded from the list of affected projects. Estimated production of offshore oil and gas projects that would become subject to the royalty was based on PBO analysis and data from the global resources consulting firm, Wood Mackenzie.

Royalties paid by projects would be creditable against PRRT liabilities. The royalty revenue is grossed-up by dividing the value of the royalty expenditure by the PRRT rate to fully offset the PRRT. Where these grossed-up royalties could not be deducted against a petroleum project's assessable PRRT receipts in a financial year, the excess was calculated and carried forward.

The company tax impact was estimated based on the estimated royalty amount and estimated increase in PRRT that would become deductible from company tax.

Due to the majority of shareholders in companies that operate PRRT projects being foreign based, the PBO has not calculated the dividend effect of this proposal or any impact on Australian resident shareholders under the dividend imputation arrangements.

Estimates have been rounded to the nearest $100 million.

The costing has taken into account the timing of tax collections.

Data sources

Australian Taxation Office, 2016. *Corporate tax transparency report for the 2015-16 income year*, Canberra: Australian Taxation Office.

Commonwealth of Australia, 2019. *2019-20 Budget,* Canberra: Commonwealth of Australia.

Commonwealth of Australia, 2018. *Mid-Year Economic and Fiscal Outlook 2018-19,* Canberra: Commonwealth of Australia.

Department of Industry, Innovation and Science, 2018. *Resources and Energy Quarterly, March 2018*, Canberra: Department of Industry, Innovation and Science.

Henry, Ken. & the Treasury. & Australia's Future Tax System Review Panel, 2010. *Australia's future tax system: report to the Treasurer.* Canberra: Australia's Future Tax System Review Panel: The Treasury.

The Treasury, 2017. *Petroleum Resource Rent Tax Review*, Canberra: Commonwealth of Australia.

Wood Mackenzie provided detailed project level information on oil and gas projects.

Attachment A – Charge royalties for oil and gas and reform the petroleum resource rent tax – financial implications

Table A1: Charge royalties for oil and gas and reform the petroleum resource rent tax – Fiscal balance ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	**Total to 2022–23**	**Total to 2029–30**
Revenue													
PRRT	*1,300*	*1,900*	*1,600*	*1,100*	*1,200*	*3,400*	*5,200*	*7,800*	*8,800*	*9,200*	*8,800*	***5,900***	***50,300***
Royalties	*2,400*	*2,500*	*2,400*	*2,300*	*2,300*	*2,300*	*2,200*	*2,200*	*2,100*	*2,100*	*2,100*	***9,600***	***24,800***
Company tax	-	*-1,800*	*-1,100*	*-900*	*-900*	*-1,200*	*-1,600*	*-2,100*	*-2,500*	*-2,700*	*-2,700*	***-3,800***	***-17,400***
Interactions between royalties and the PRRT	*-400*	*-600*	*-600*	*-500*	*-500*	*-1,200*	*-1,700*	*-2,000*	*-2,000*	*-2,100*	*-2,100*	***-2,200***	***-13,700***
Total	**3,300**	**2,000**	**2,300**	**2,000**	**2,100**	**3,300**	**4,100**	**5,900**	**6,400**	**6,500**	**6,100**	**9,500**	**44,000**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.

Table A2: Charge royalties for oil and gas and reform the petroleum resource rent tax – Underlying cash balance ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	**Total to 2022–23**	**Total to 2029–30**
Receipts													
PRRT	*1,000*	*1,700*	*1,700*	*1,300*	*1,200*	*2,800*	*4,800*	*7,100*	*8,500*	*9,100*	*8,900*	***5,700***	***48,100***
Royalties	*2,200*	*2,500*	*2,400*	*2,300*	*2,300*	*2,300*	*2,200*	*2,200*	*2,100*	*2,100*	*2,100*	***9,400***	***24,700***
Company tax	-	*-1,800*	*-1,100*	*-900*	*-900*	*-1,200*	*-1,600*	*-2,100*	*-2,500*	*-2,700*	*-2,700*	***-3,800***	***-17,400***
Interactions between royalties and the PRRT	*-300*	*-600*	*-600*	*-500*	*-500*	*-1,000*	*-1,600*	*-1,900*	*-2,000*	*-2,100*	*-2,100*	***-2,000***	***-13,200***
Total	**2,900**	**1,800**	**2,400**	**2,200**	**2,100**	**2,900**	**3,800**	**5,300**	**6,100**	**6,400**	**6,200**	**9,300**	**42,200**

(a) A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.