



Policy costing

The PaRRTy is over	
Person/party requesting the costing:	Senator Richard Di Natale, Australian Greens
Date costing completed:	29 October 2018
Expiry date of the costing:	Release of the next economic and fiscal outlook report.
Status at time of request:	Submitted outside the caretaker period <input checked="" type="checkbox"/> Confidential <input type="checkbox"/> Not confidential
<p>Summary of proposal:</p> <p>This proposal would replace the existing petroleum resource rent tax method of uplifting excess expenditure to future years with the following two treatments:</p> <ul style="list-style-type: none"> • All excess expenditure recorded by the implementation date would be depreciated over 10 years to offset petroleum resource rent tax 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. <p>This proposal would also place a 10 per cent royalty of the wellhead value on projects subject to the petroleum resource rent tax, with these royalty payments creditable against petroleum resource rent tax 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 petroleum resource rent tax liabilities in a year would be carried forward, to be credited against petroleum resource rent tax liabilities in a later year.</p> <p>The proposal would have effect from 1 July 2019.</p>	

Costing overview

This proposal would be expected to increase the fiscal balance by \$8,100 million and the underlying cash balance by \$7,800 million over the 2018-19 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 petroleum resource rent tax 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 petroleum resource rent tax over the period to 2028-29.

Sensitive

The interaction between the components of this proposal would come from royalty amounts being creditable against final petroleum resource rent tax liabilities. This would reduce the overall petroleum resource rent tax that would have been expected to be collected in the absence of the proposed royalty. As more projects become liable for the petroleum resource rent tax, the amount of royalties would be expected to be fully offset against the petroleum resource rent tax. Over time the royalties would not be expected to change the overall impact of taxation on a project. The royalty amount would offset the petroleum resource rent tax 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 2028-29.

The proposal would be expected to have an ongoing impact that extends beyond the 2018-19 Budget forward estimates period. A breakdown of the financial implications of the proposal over the period to 2028-29 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 petroleum resource rent tax, royalty revenue and the company tax are recognised and when they are paid.

On 22 August 2018, the Government announced that it will not proceed with the unlegislated portions of the 2016-17 Budget measure *Ten Year Enterprise Tax Plan – reduce the company tax rate to 25 per cent.*¹ In addition, on 18 October 2018, the Parliament passed the *Treasury Laws Amendment (Lower Taxes for Small and Medium Businesses) Bill 2018* to fast track tax relief for small and medium businesses.² These changes do not form part of the current budget baseline, and instead would be expected to be included in the next economic and fiscal update. This will change the impact presented in this analysis.

There is a significant degree of uncertainty around the estimated growth in the value of offshore 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.³ As the changes to deductions of expenditure would increase the expected petroleum resource rent tax and reduce the post-tax return on projects, it is possible that this would also lead to some projects closing sooner or that some prospective projects may not proceed. 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 petroleum resource rent tax over the period to 2028-29.

¹ <https://www.financeminister.gov.au/media-release/2018/08/22/labor-abandons-australian-businesses-and-workers>

² https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6206

³ Report to the Treasurer, Australia's Future Tax System – Part 2 Detailed Analysis, December 2009, page 229

Table 1: The PaRRTy is over – Financial implications (\$m)^{(a)(b)}

	2018–19	2019–20	2020–21	2021–22	Total to 2021–22
Fiscal balance	-	3,700	2,000	2,500	8,100
Underlying cash balance	-	3,300	1,900	2,500	7,800

(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.

- Indicates nil.

Key assumptions

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

- Oil and gas production over the period to 2028-29 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 petroleum resource rent tax from the company tax.
- Companies would not vary pay-as-you-go instalments to allow for the company tax deduction in the first year.
- The average oil price would be US\$65 per barrel at the end of the 2018-19 Budget forward estimates period and its real value would be maintained over the period to 2028-29 by indexing it by the consumer price index.
- No new oil and gas projects will begin production over the period to 2028-29.
- 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 petroleum resource rent tax projects would continue to be primarily foreign owned over the period to 2028-29.

Methodology

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

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 global resources consulting firm, Wood Mackenzie.

Sensitive

Royalties paid by projects would be creditable against petroleum resource rent tax liabilities. The royalty revenue is grossed-up by dividing the value of the royalty expenditure by the petroleum resource rent tax rate to fully offset the petroleum resource rent tax. Where these grossed-up royalties could not be deducted against a petroleum project's assessable petroleum resource rent tax 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 petroleum resource rent tax that would become deductible from company tax.

Due to the majority of shareholders in companies that operate petroleum resource rent tax 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, 2018. *Budget 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.

The Treasury, 2009. *Australia's Future Tax System – Part 2 Detailed Analysis*, Canberra: Commonwealth of Australia.

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 – The PaRRTy is over – financial implications

Table A1: The PaRRTy is over – Fiscal balance (\$m)^{(a)(b)}

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	Total to 2021–22	Total to 2028–29
Revenue													
<i>Petroleum Resource Rent Tax</i>	-	1,300	1,800	1,400	3,700	4,900	8,500	10,300	11,600	9,600	9,100	4,500	62,200
<i>Royalties</i>	-	2,800	2,800	2,700	2,700	2,700	2,700	2,800	2,700	2,600	2,600	8,300	27,200
<i>Company Tax</i>	-	-	-2,000	-1,100	-1,400	-1,600	-2,200	-2,600	-2,800	-2,600	-2,300	-3,100	-18,500
<i>Interaction Petroleum Resource Rent Tax and Royalties</i>	-	-400	-600	-500	-1,200	-1,700	-1,900	-2,700	-2,700	-2,600	-2,600	-1,600	-17,000
Total	-	3,700	2,000	2,500	3,800	4,300	7,100	7,800	8,800	7,000	6,800	8,100	53,900

(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: The PaRRTy is over – Underlying cash balance (\$m)^{(a)(b)}

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	Total to 2021–22	Total to 2028–29
Receipts													
<i>Petroleum Resource Rent Tax</i>	-	1,000	1,700	1,500	3,100	4,600	7,600	9,900	11,300	10,100	9,200	4,200	59,900
<i>Royalties</i>	-	2,600	2,800	2,700	2,700	2,700	2,700	2,800	2,700	2,700	2,600	8,100	27,000
<i>Company Tax</i>	-	-	-2,000	-1,100	-1,400	-1,600	-2,200	-2,600	-2,800	-2,600	-2,300	-3,100	-18,500
<i>Interaction Petroleum Resource Rent Tax and Royalties</i>	-	-300	-600	-600	-1,000	-1,600	-1,800	-2,500	-2,700	-2,700	-2,600	-1,400	-16,300
Total	-	3,300	1,900	2,500	3,400	4,100	6,300	7,600	8,500	7,500	6,900	7,800	52,100

(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.