



Submission

Review of the Petroleum Resource Rent Tax

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Chevron in Australia

Chevron is currently developing two of Australia's largest resources projects in Australia's history. The Chevron-operated Gorgon and Wheatstone projects represent over \$80 billion of investment, delivering vast benefits to the Australian economy – 19,000 workers employed; 1,000 contracts with local industry; and over \$45 billion in Australian content.¹

Projects the size and scale of Gorgon and Wheatstone have long lifecycles. The Gorgon field was discovered in 1982. The final investment decision was made in 2009. Construction commenced in December 2009 and full production capacity will not be realised until at least the second half of 2017. It is expected Gorgon, a legacy project, will produce LNG for over 40 years.

Profits-based taxation

A key consideration in Chevron's final investment decisions for Gorgon and Wheatstone was the stability of the Australian fiscal regime. As a profits-based tax, PRRT allows investors to recover their capital before the tax is payable. Chevron and its partners elected to invest their capital in Australia, rather than competing destinations, explicitly on the basis that the PRRT did not adversely affect project economics.

The fiscal benefit for Australia is that once PRRT is payable, it is levied at a high rate of 40%, ensuring that the long-term return for the nation can be substantial.

This trade-off between the quantum and timing of tax payments was an explicit design feature of the PRRT when introduced in the 1980s.

In reviewing the PRRT, the 2010 Henry Tax Review strongly endorsed a profits-based tax regime, stating:-

“...output-based royalties discourage investment and production because they are levied irrespective of the costs of production. Consequently, investors receive a lower post-tax return from a more expensive operation because costs are not recognised for tax purposes. This is particularly important for risky projects. Output-based royalties can therefore result in some economically viable projects not proceeding.”²

The Henry Tax Review acknowledged the political issues with the timing in tax payments:-

“However, a rent-based tax has the longest delay before the government collects revenue because tax is only collected once receipts cover expenses including a normal return to investment. The delay in collecting tax could create a public perception that the resource sector is not paying for its exploitation of non-renewable resources, as projects could be generating significant operating profits but not yet paying tax.”

The Parliamentary Secretary to the Prime Minister, Andrew Leigh MP, defended the timing of tax payments in 2013:-

“When you look at the Petroleum Resource Rent Tax over its 25 year history, if you'd analysed the PRRT one year in, you would have said, “well this tax isn't raising what we wanted it to raise”. But over the course of the last quarter century, the PRRT has bought in, I think, around \$25 billion. The Minerals Resource Rent Tax depends on commodity prices and it also depends on the deductions that mining companies are making, and that will change with the point of the cycle. But anyone who says going back to the old royalties regime is better than a profits based mining tax has got rocks in their head. There's no sensible economist that would argue that.”³

¹ http://www.acilallen.com.au/cms_files/ACILAllen_Chrevon2015.pdf

² Henry Tax Review, Chapter C1–1 The community's return from the exploitation of its resources

³ <http://www.andrewleigh.com/4197>

Making material changes to the PRRT regime to bring forward revenue would not only be counter to the design intentions of the tax but would also represent a retrospective change in tax law. For major investors, this would be a further dent in Australia's reputation for fiscal stability.

As Garnaut has written, one of the virtues of the PRRT is that its long-term stability will encourage greater investment.

“And where efficient resource tax regimes have been introduced, and that includes offshore Australia and about a dozen other countries now have taxes of this design based on the work that Anthony Clunies-Ross and I did back in the '70s, the general practice is that once in place there has not been pressure to change them. They are self-adjusting. When profits are very high they generate a lot of revenue, when profits are low they don't, and so they end up having political support and so are a basis for stable arrangements. And stable arrangements reduce the supply price of investment and encourage investment.”⁴

Other taxes

The debate about the timing of PRRT payments ignores the range of other taxes which the community receives from LNG projects.

Since 2009, Chevron has paid almost \$4 billion in federal and state taxes, as set out below:-

Chevron Australia - Taxes Paid 2009 to 2015								
Description	2009	2010	2011	2012	2013	2014	2015	Total
Income Tax	-	-	123,077,424	304,498,403	-	-	-	427,575,827
Fringe Benefits Tax	13,386,384	14,435,627	26,263,732	22,919,282	35,724,920	76,574,626	63,628,694	252,933,265
Royalties	151,019,164	239,102,006	227,944,551	236,110,707	254,393,169	261,681,528	169,843,617	1,540,094,742
Excise	174,266,496	116,391,411	140,908,603	137,764,767	130,135,364	109,651,414	62,730,740	871,848,795
Pay-roll Tax (Western Australia)	14,317,349	16,735,076	23,567,839	33,588,307	41,131,258	56,764,038	59,004,155	245,108,022
Interest Withholding Tax	5,287,776	12,528,009	56,737,913	86,527,818	112,330,979	162,194,916	199,395,364	635,002,775
Foreign Resident Withholding Tax	-	-	-	2,418,696	2,150,281	3,468,682	4,238,042	12,275,701
Royalty Withholding Tax	-	-	3,127,993	100,258	80,133	74,936	1,089,329	4,472,649
GST - Denied Input Tax Credits	-	-	-	-	46,574	1,348,854	3,245,272	4,640,701
TOTAL	358,277,169	399,192,129	601,628,054	823,928,238	575,992,679	671,758,994	563,175,213	3,993,952,476

Once Gorgon and Wheatstone are in full production, independent analysis from Acil Allen has forecast Chevron will pay \$2 to \$3 billion a year in company tax to 2040⁵.

Critics have attacked Chevron for not paying company tax in the past three years. This criticism ignores the fact that the oil-linked gas price has fallen, that Gorgon only commenced production in 2016 and Wheatstone will not start up until later in 2017. It is entirely appropriate that projects in the start-up phase have not yet generated company tax.

PRRT and future investment

The PRRT will be a key factor in future investment decisions by Chevron.

Chevron currently has two major future opportunities for investment in Australia:

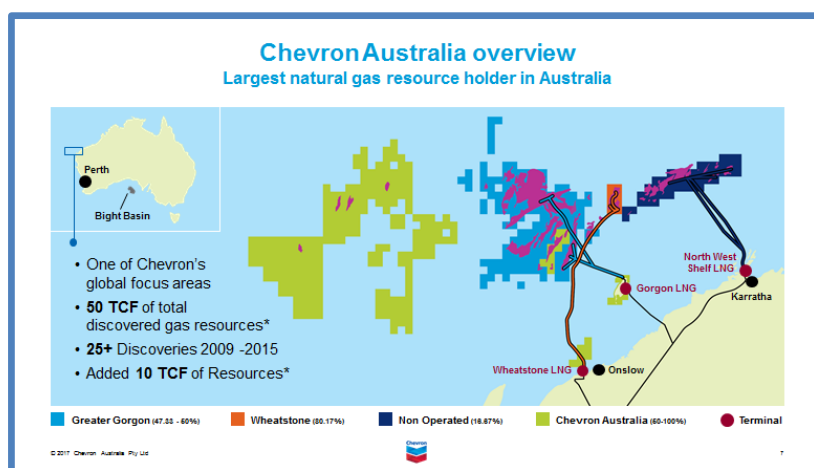
- the next wave of LNG infrastructure in Western Australia; and
- exploration and potential development in the Great Australian Bight.

⁴ https://grattan.edu.au/wp-content/uploads/2014/05/518_transcript_cities_melb_MRRT.pdf

⁵ <http://www.acilallen.com.au/projects/3/energy/163/a-snapshot-of-chevrons-realised-and-forecast-economic-benefits-in-australia>, based on January 2015 parameters.

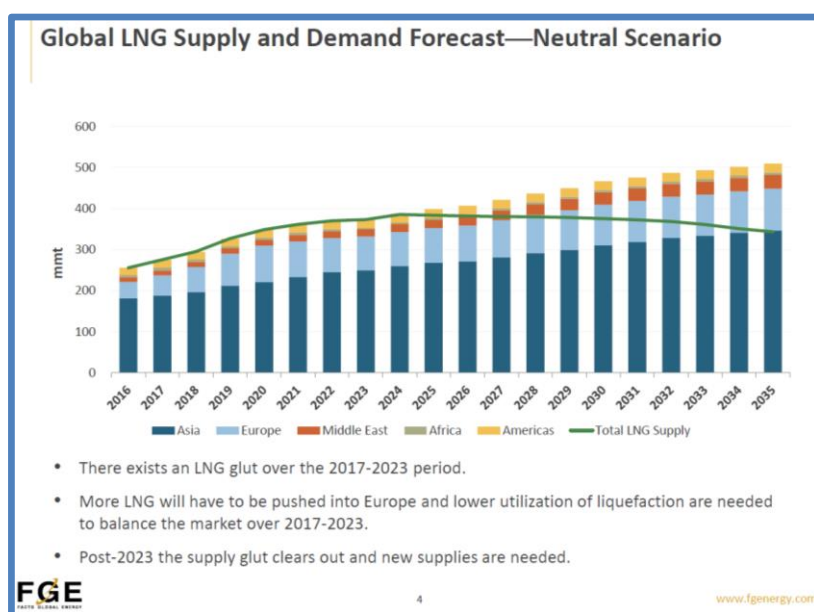
Western Australia

Chevron is the largest holder of natural gas resources in Australia. Since 2009, Chevron has made over 25 new gas discoveries off the north-west Western Australian coast. With Gorgon and Wheatstone nearly complete, Chevron is moving to plan the development of these additional fields. All options for developing these resources are being assessed, including processing through existing Chevron-operated plants and third-party processing through emerging spare capacity in the North West Shelf and Pluto plants.



Such developments would generate billions of dollars of new investment in upstream infrastructure and ensure the ongoing utilisation of existing liquefaction capacity. But these projects require comprehensive economic analysis to evaluate potential costs and revenues, and the supply and demand outlook in the region. These Australian projects must compete for capital against other potential projects around the world.

Chevron remains optimistic about long-term demand for gas in the Asia Pacific. Global demand for LNG is expected to almost double by 2025. Most of this growth will occur in Asia - primarily China and India, but other customers are entering the market. A report commissioned by the Australian Energy Market Operator⁶ determined that LNG demand would exceed supply after 2023.



⁶ https://www.aemo.com.au/-/media/Files/Gas/National_Planning_and_Forecasting/NGFR/2016/LNG-Supply-Demand-Price-Forecasts-and-Risk-Analysis-September-2016.pdf

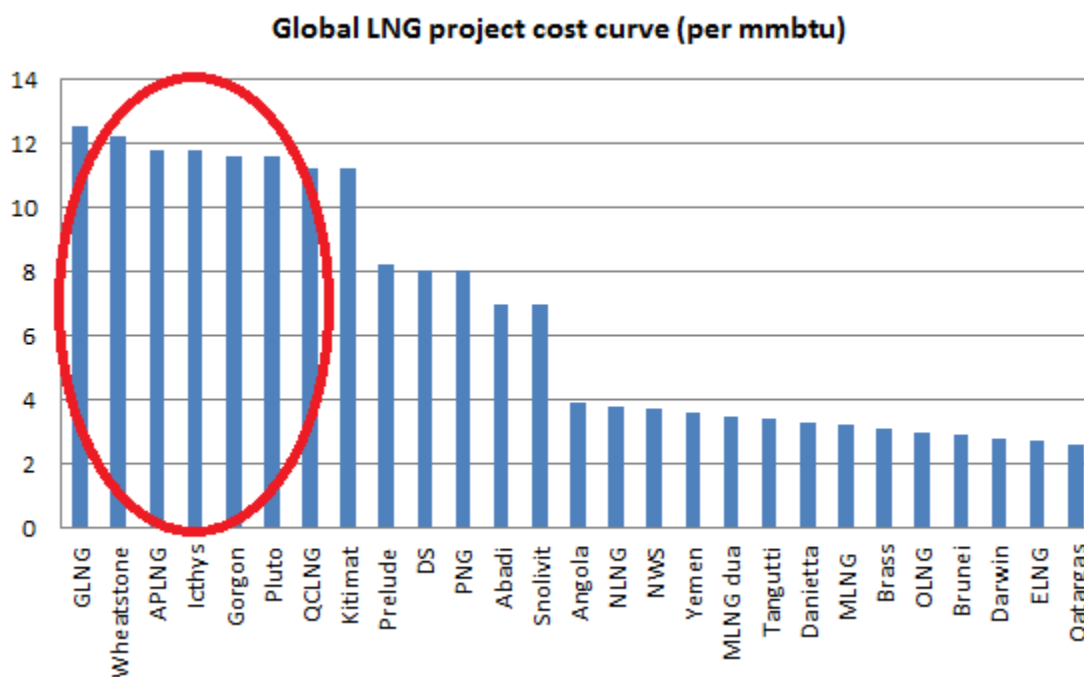
Australia is well positioned to take advantage of the growing Asia Pacific market, with an historical competitive advantage selling to Asian customers. However, that competitive advantage is being eroded by several factors.

First, abundant low-cost shale gas from the US is already entering the Asian market. Six additional LNG plants are under construction in the US, with a capacity of 60 mmtpa – the equivalent of four Gorgons. Other projects in Russia, Malaysia, Canada and Africa will be coming on stream.

Second, Australia's proximity to Asian customers has historically provided a shipping cost differential compared to US and Middle East suppliers. However, low US gas prices, lower charter rates and the widening of the Panama Canal have eroded this differential. Any policy changes by the Trump Administration which further cheapen US gas will exacerbate this problem.

Third, Australia's fiscal and regulatory regimes are increasingly uncompetitive. The Australian company tax rate is globally high, while other jurisdictions, particularly the US, are proposing tax cuts. Petroleum investment is facing noisier activist resistance, leading to regulatory over-reaction. Future climate policy changes could add additional cost imposts not faced by major LNG competitors.

Fourth, Australian construction costs are excessive. Global studies, such as by Macrobusiness⁷ set out below, show the manifest gap between Australian and competitor costs.



As a result, projects such as Browse and Scarborough have failed to proceed, and liquefaction expansion proposals have been shelved. Australia can work around increased construction costs through greater collaboration between projects to make greater use of existing liquefaction facilities. However, new developments still require multi-billion dollar investments in new wells, subsea equipment, platforms and pipelines. These investments must offer an adequate return to proponents. Global petroleum company capital budgets have fallen with oil prices, and investment is being targeted at a narrower range of lower-risk, higher-return investments.

For Australia to be competitive at attracting constrained capital, it needs to offer a more globally attractive fiscal regime, not adverse changes to the PRRT.

⁷ Macrobusiness, March 20, 2014

South Australia

Chevron is currently undertaking a major oil exploration program in the Great Australian Bight. Two seasons of seismic surveys have been completed. They provide early but promising evidence that the Bight represents a tremendous opportunity, possibly on the scale of the Bass Strait.

Chevron is proposing to drill four exploration wells in 2018/19 and 2019/20. Future options for development are highly conditional on the nature of any discovery.

Exploration is a high-risk venture with long lead times. The indicative cost of drilling in the Bight is \$100 million per well. Historically in Australia only 14 percent of exploration wells drilled lead to production. As with LNG investments, companies have global choices as to where to undertake exploration. BP demonstrated this starkly in October 2016 when it withdrew from the Great Australian Bight, not due to a lack of prospectivity, but due to changing global priorities.

If the Bight did prove to be of a Bass Strait scale, research conducted for Exxon Mobil⁸ highlights the benefits from the 50 years of the Gippsland Basin Joint Venture, particularly over \$220 billion in Australian excises, royalties and taxes.

For any future high-risk investment in the Great Australian Bight to achieve funding by a major oil company, the fiscal terms on offer must be competitive and stable. If deleterious changes to the PRRT regime were to drive major explorers from the Bight, these potential benefits would be lost.

Summary

Chevron submits the case for major changes to the PRRT has not been made.

The PRRT is working as designed. It has contributed to major investments in Australia by Chevron and others and it can underpin a further wave of oil and gas investment.

The contribution of fifty year projects cannot be measured by the revenue from their start-up phases. Their fiscal and economic benefits must be assessed over the lives of the projects.

PRRT should be viewed as a form of Future Fund, delivering large returns at a time in the future when Australia's demographic challenges will be at their sharpest.

Chevron encourages the Committee to agree the PRRT is working as intended and designed. If the Committee determines otherwise, any proposed changes must meet a strict test that ensures future investment is encouraged, existing project economics are not retrospectively undermined and Australia's international competitiveness is not further compromised.

⁸ http://www.acilallen.com.au/cms_files/ACILAllen_GBJV_2016Factsheet.pdf