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Oil & Gas industry Budget response

Tax changes included in tonight's Budget that affect exploration costs and thin capitalisation rules will hurt the oil and gas industry's international competitiveness. As such, they are short-sighted given the current debate regarding debt, deficit, and the need to map a credible path back to surplus.

The resources boom has provided successive Australian Governments with windfall tax revenues for much of the past decade. Governments have spent up big in the good times. But rather than reining in an expanding government sector (now 25.5% of GDP), the Federal Government has tonight come back to the well in a bid to source new revenue streams and the tax changes flagged risk curtailing the investment needed to drive growth and fund future surpluses.

The oil and gas industry is today responsible for more than 30 cents in every dollar of Australian private sector investment. The industry is currently investing around $200 billion over five years (that is more than $1,200 per second) on new projects that will pay billions every year to governments and create more than 100,000 new jobs.

The industry also has tens of billions of dollars' worth of projects under consideration and Australia's competitiveness and attractiveness as a place to do business will determine whether they proceed.

It is noteworthy that while Budget Paper No.1 says: **"..*a substantial pick-up in liquefied natural gas exports in the second half of the decade will support growth for years to come,*"** the tax changes within the Budget actually hamper the growth of this industry and its ability to fulfil its potential contribution to the Australian economy.

APPEA Chief Executive David Byers said: "The decisions announced this evening continue the recent trend of fiscal and regulatory changes that reduce investor confidence and our global competitiveness.

"Short-term revenue goals pursued at the expense of long-term nation building investments are short-sighted and do little to position our economy to benefit future generations."

Exploration Costs

The changes in tonight's Budget directly increase costs associated with developing oil and gas resources in Australia because they increase the costs associated with trading and/or buying into exploration permits. This will make it more costly for companies to align or roll-over their interests in exploration permits; an important step in enabling the commercial alignment that allows projects to proceed on a timely basis.

"The changes will have a particular impact on small or medium sized-exploration companies who are wishing to sell an interest to larger, better-resourced or more experienced companies on a full or partial cash basis. Changes to the deductibility rules mean that a purchasing company will be unable to obtain a timely deduction for the acquisition cost. There will therefore be less incentive for the purchase to take place and the proposed (safe-harbour) write-off period of 15 years does not reflect commercial reality.

“While the decision to maintain the existing treatment for non-cash farm-in/farm-outs arrangements is welcome, overall, tonight’s announcement continues the trend of policies which make it harder for explorers to invest in Australia. This includes the failure to proceed with a flow through share scheme, the introduction of cash bidding, and the imposition of significant compliance and administrative costs associated with extending PRRT onshore.”

Thin-Capitalisation rules and Cash Bidding

“The changes to thin-capitalisation rules will directly impact the after tax return for very large oil and gas projects reliant on debt funding and will create further complexity in the tax system for both inbound and outbound investors.

“In the Budget papers, the Government has also identified the potential revenues associated with the proposed introduction of cash bidding for nominated offshore exploration acreage, which APPEA believes to be both premature and likely to be overly-optimistic.

“APPEA remains opposed to cash bidding as it reduces the funds available for future exploration.

“The industry faces challenges in competing both in domestic and global markets and the decision to put further lead in the industry’s saddle-bags will further erode investor confidence.

“The contribution made by the oil and gas industry in terms of both tax payments and the investment of hundreds of billions of dollars in risk capital must not be taken for granted by either side of politics.

“The challenge for the Federal Government is to rein in spending, search for expenditure savings and impose the discipline that any new expenditure must be offset by savings in existing programs. According to analysis by Macroeconomics, resource sector revenue contributed around $160 billion to the Commonwealth budget from 2003-04 to 2011-12. Over the same period, growth in public spending has expanded on the basis of unrealistic forecasts of continued revenue growth.

“Increasing revenue by targeting productive sectors entrenches rather than addresses an ever expanding government sector.”

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