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Submission Response: Papua New Guinea Tax Review – Mining and Petroleum Taxation

This submission has been drafted by Ernst and Young (EY) and summarizes EY's response to the relevant consultation questions noted in the Issues Paper No. 1 *Mining and Petroleum Taxation* (hereinafter referred to as the 'Issues Paper') for the Papua New Guinea Tax Review.

Purpose

The purpose of this report is to highlight the specific areas of mining and petroleum taxation that EY believes could be improved to make a more efficient and equitable taxation system in PNG. We note that our submission does not seek to answer all the questions posed within the Issues Paper. We have only provided responses to those questions where our particular expertise is most relevant.

We also note that our submission also provides some comments in respect to related mining and petroleum taxation issues not specifically addressed in the Issues Paper. Where we have considered issues not specifically addressed in the issues paper, we have done so whilst paying attention to the objectives of the review committee in undertaking the tax review, namely:

- Align PNG's revenue system with its development aspirations of being a competitive middle income nation in the Asian century;
- Improve the competitiveness and efficiency of PNG's tax system so as to encourage investment, employment and economic development;
- Enhance the fairness and simplicity of PNG's taxation system;
- Recommend practical options to change PNG's tax mix between the levels of taxation on land (including resources), capital and labour;
- Improve taxpayer compliance including considering options to enhance services to taxpayers and reduce the cost of compliance through the use of modern and user friendly technology; and
- Review PNG's non-tax revenues with the aim of ensuring that fees are appropriate and fair.

Discussion

In keeping in line with the focus of the Taxation Review Committee to make PNG an attractive destination for mining and petroleum investment, our commentary focusses on certain key issues where our expertise is relevant. Consequently, were have not considered nor commented on all the issues raised in the Issues Paper.

1. Investor Certainty and Transitional Regime

This issues paper raises a range of mining and petroleum taxation reforms that could have a significant impact on the PNG tax outcomes for existing explorers, developers, operators and owners of PNG mining and petroleum projects. Our key submission is that whatever course is decided on the various matters discussed in the issues paper, it is critical that clear transitional rules be introduced for all affected taxpayers so existing exploration, development and operating projects are not adversely affected.

The Australian Federal Government's recent proposals in respect to the Resources Super Profits Tax (RSPT) and subsequent introduction of the Mineral Resources Rent Tax (MRRT) and expanded Petroleum Resource Rent Tax (PRRT) are clear examples of the dramatic effect on investment certainty and perceptions of political risk that arise when resources tax changes occur without robust transitional rules.

Our suggestions in respect to the appropriate transitional rules are as follows:

- *New regime applicable to new projects* - One possible approach to transitional rules would be for the new resources tax regime to be applicable only to new projects. The existing regime would remain applicable to existing projects. Care would be needed to define what an existing project is. While this needs detailed consideration, we suggest that, as a starting point, all projects that arise out of existing exploration, retention and development resource rights should be regarded as grandfathered existing projects.

- *Optional elect in rule* - Consideration could be given to providing existing projects with the option of electing into any new resources taxation regime to be introduced. This would help manage compliance issues for taxpayers who are comfortable to transition to the new resources taxation regime.

- *Market value starting base relief* - The key political problems that arose for the Australian Federal Government in respect to the proposed introduction of the RSPT and the introduction of the MRRT and expanded PRRT related to the development of appropriate market value starting base relief to have regard to investments made and value created prior to these new regimes being introduced. As discussed below, this is a critical matter that needs detailed consideration.

2. Chapter 6: Design of a Resource Rent Tax

Other than the need for investor certainty and the need for a transitional regime for existing resource exploration, development and operating resource projects, in our view, the next most significant issue raised by the issues paper is the possible introduction in PNG of a broadly applicable resources rent tax (RRT). Our comments on RRT proposals are discussed below.

Design of a Resource Rent Tax

We have submitted below our views in relation to the design of a resource rent tax as outlined in Chapter 6 of the Issues Paper. In making our submission below, we have relied on our experience with the recent reform process in Australia which involved the introduction of the MRRT and expansion of the PRRT resources rent taxes. In our submission, we have sought to focus on the issues associated with the design and technical application of a resource rent tax. We have therefore chosen not to focus on the economic arguments which are generally relied upon to support a tax on resource rents.

Background to Australian Experience

Any reform process in PNG to introduce a resource rent tax must have regard to the recent Australian experience. As our experience with the Australian regime contributes heavily to the points raised in our submission, we have outlined a brief summary to the Australian regime.

Australia introduced a specific resource rent tax regime targeted at offshore petroleum projects in 1987. As part of the Henry Review into Australia's tax system, commissioned by the Federal Government and published in 2010, it was recommended that the resource rent tax be expanded to onshore petroleum and all other resources.

Acting upon the recommendation in the Henry Review, the Federal Government proposed the Resource Super Profits Tax (RSPT) in May 2010. The RSPT was proposed to be a broad ranging tax, applicable to all minerals. In addition, the RSPT did not include any material starting base for existing projects transitioning into the regime. A relatively low augmentation rate was applicable to unused expenditure but a cash refund was available for excess State royalties paid. The Federal Government was widely criticised due to a lack of consultation with affected stakeholders in relation to the design of the RSPT.

Following extensive political backlash and a change in Prime Minister, the Federal Government announced that the RSPT proposal would be discontinued. A working group was established, involving BHP Billiton, Rio Tinto and Xstrata to redesign the proposed resource rent tax in a manner that would be more politically palatable to the industry. Following extensive consultation, the Minerals Resource Rent Tax (MRRT) was announced in 2011 which was to be applicable from 1 July 2012 and only applicable to iron ore and coal. The expansion of the Petroleum Resource Rent Tax (PRRT) to onshore petroleum projects was unaffected by the political process surrounding the RSPT and MRRT.

Ultimately, with the recent change to a Coalition Government, the MRRT has been announced to be discontinued. The legislation for the repeal of the legislation has not yet passed both Houses of Parliament. The expanded PRRT will continue to apply.

We are of the view that PNG should take close interest in the political process surrounding the RSPT / MRRT and ensure that any design of a PNG resource rent tax reflects the learnings from the Australian experience. Our comments below reflect this accordingly.

Government Consultation with Affected Stakeholders

The key learning that can be taken from the failed RSPT in Australia is the lack of industry consultation that occurred in the key design process. As a result, the Federal Government was required to deal with significant political instability.

The Federal Government was criticised for not taking into consideration the ability, in a global economy, for miners to easily redirect their investment to other jurisdictions. To avoid this, PNG should ensure it consults with its key stakeholders at all stages through the policy and technical design process.

One Regime or Multiple?

The Australian MRRT and PRRT regimes, whilst based on the same policy considerations, are quite dissimilar in terms of their legislative drafting and technical application. This makes applying both regimes more difficult for taxpayers, advisors and the tax administration.

PNG already has the Additional Profits Tax (APT) which taxpayers, advisors and, in particular, the IRC are already familiar with. It could be a significant strain on the IRC's already limited resources to expect them to effectively and efficiently administer separate RRT regimes.

As such our suggestion would be that if PNG decides to proceed with the introduction of a broadly based resources rent tax, then it should consider expanding the APT rather than introducing a new broader ranging RRT regime. Whilst thought will need to be given to allow the APT to reflect the commercial differences between minerals projects and petroleum projects.

Rate of Tax

A decision will need to be taken as to PNG's preferred rate of tax for its resource rent tax. In Australia, the Federal Government originally announced that the RSPT would carry 40% rate. However, as part of the political process, this was reduced to 22.5% for the MRRT. The PRRT rate for both offshore and onshore projects is 40%.

It was difficult to reconcile the rate of tax for MRRT with that applicable to PRRT. We would recommend that PNG consider the merits of imposing a comparable rate of tax applicable for all of its resources. As a related matter, the total effective tax rate on projects should be considered from a global comparative perspective. Whilst many studies were produced by the various stakeholders in respect of the Australian MRRT, the general industry concensus was that the effect of the RSPT as originally announced would be to impose a total effective tax rate significantly higher than that experienced by industry participants in other resource rich jurisdictions.

The rate of tax will have significant impact on forecast profit for all PNG projects in the future. It will be necessary that the Government balance the rate between the country's revenue and a fatal impact on available profit from a project which could force miners and petroleum companies to send their capital to other jurisdictions.

Starting Base

A key issue with the RSPT was the lack of transitional relief for existing mining projects (an allowance equal to the accounting value of assets, excluding the resource was allowed but this was not considered significant in the industry). Following the political process, the MRRT included a 'starting base' which was provided to reflect the value of the project at the time of implementation of the regime. Prior to the inclusion of a starting base, a significant number of existing projects that were operating at a marginal profit prior to the introduction of a RSPT would have been required to discontinue operations at an earlier stage due to the unsustainable additional layer of tax.

We therefore recommend that PNG include a starting base in the design of any broader RRT to be introduced, or as a minimum some other form of transitional measure to ensure that industry participants who have made investments or capital commitments to projects are not penalised for decisions made under the current law.

A question will arise as to what stage a project should be at in order to be eligible for a starting base. It is not reasonable to require that a project be at a production licence phase in order to receive a starting base as this disadvantages those projects where exploration work has commenced but where a production licence has not yet been granted. Similarly, it is not uncommon for participants to have invested significant funds in acquiring exploration rights. In Australia all projects over which an exploration tenement was held was eligible for a starting base, regardless of the exploration spend that had occurred up to that point.

The other issue that will arise with starting base is the methodology for determining the quantum of the starting base shield. The MRRT included two main approaches being the book value and the market value method. PRRT provides for the same methods but also includes a look back method which allows the project to utilise the sum that has actually been spent on developing the project from a defined point in time (including the ability to attribute purchase prices for acquisitions of project assets or project companies). The PRRT also includes another method, specifically for Coal Seam Gas projects which is a shortcut method that allows the miner to utilise existing reported reserves and multiply that number by a price. In the PRRT case, the price was arrived at using a specified value that was used in a major transaction that occurred around the time of the introduction of the expanded PRRT regime. As a result, the shortcut is only available for assets that were subject to a transaction around a similar time.

In our view, the approach that PNG adopts for calculating a starting base needs to achieve a balance between simplicity and fairness. A market value methodology should be made available for those miners that choose to invest in obtaining a valuation. However, more simple options should also be available. Under both the MRRT and PRRT, the book value method excluded the value ascribed in the accounts to the project's resource which resulted in few projects using this option. PNG should consider allowing a book value, including the value of the resource and a look back approach as approaches resulting in simple yet fair outcomes. In addition, PNG should consider a similar shortcut approach to the CSG shortcut used for PRRT purposes.

Once determined, the starting base under MRRT and PRRT is used as the last class of allowance against calculated mining/petroleum profit. The starting base is generally written off over the project life but for MRRT purposes was capped at 25 years. PNG should also consider the starting base as the last available allowance in determining the tax payable and should generally allow the starting base to be written off over the project life.

Rate of Return

Under a RRT, it is necessary that the Government allows a rate of return to the resource project which can be earned on costs being recouped prior to the State taking its rent from the resource profit. A key issue that will need to be determined is what the rate of return should be.

Under the original RSPT proposal, the Government proposed a Government bond rate applicable to all baskets of expenditure. This was subsequently changed to a long term bond rate plus 7% once modelling developed by industry indicated that the Government bond rate was not a sufficient allowance to define a 'super profit' for a project.

We note that the original RSPT rate was justified on the basis that a cash refund of state royalties would be provided. Practically, this original regime was more closely aligned to the Australian Government "derisking" relevant projects to a degree. However, from an industry perspective, the strong preference was to self-manage resource project risk. Further, such considerations should be addressed in light of the PNG Government's existing ability to obtain an equity participation (and any proposed changes in relation thereto).

PRRT utilises different augmentation rates depending on the basket of expenditure. For general expenditure (including capital expenditure), the applicable rate is long term bond rate plus 7%. For exploration expenditure, to reflect the additional risk associated with long lead times to recoupment, the applicable rate is long term bond rate plus 15%.

In our view PNG should apply an approach similar to the PRRT in applying separate rates depending on the nature of expenditure. This provides the resources project developer with an appropriate incentive to engage in long term exploration activity, with the associated rewards to the PNG economy. In terms of the specific rate to be applied, we recommend that this be agreed based on discussion with affected industry stakeholders.

Breadth of Application

It will need to be determined how broadly the proposed RRT applies. In the RSPT case, it was proposed to apply to all major minerals. This was subsequently whittled down to just coal and iron ore following the political process.

Fairness and simplicity might dictate that the RRT would apply across the board with no exceptions. Inclusion of exceptions promotes inefficiencies in the tax. However, PNG would need to take care to ensure that it does not discourage investment in emerging resources.

Practically, any RRT is likely to impose a not insignificant compliance obligation on relevant taxpayers. As such, we recommend that de minimus provisions are contemplated to exempt smaller players from such onerous obligations. Such provisions were developed under the Australian MRRT.

Transferability of Attributes

A RRT is generally a project based tax with a strict project ring fence applicable to define a project's profit subject to tax. However, commonly, many resource companies will have an interest in multiple projects in the same jurisdiction. Where a taxpayer holds an interest in both a profitable and a loss making project, it may be economically inefficient for the taxpayer to continue to hold the interest in the loss making project unless it is able to offset losses against its profit making projects.

The MRRT contained a limited transferability of excess expenditure, but only within the same resource category (i.e. you could only transfer from a coal project to another coal project and not between coal and iron ore projects). The PRRT regime also incorporates the capability to transfer certain expenditure between petroleum projects.

We recommend that PNG give consideration to transferability of attributes between resource projects subject to the proposed RRT. Like the MRRT, this may only be limited to transfers between projects of the same resource category (e.g. gold project to gold project).

Similarly, the transferability of attributes on transfer of a project should also be considered. As a minimum, we would expect that historic attributes would transfer with a project as the underlying ownership of the project changes (whether by direct transfer or via an entity acquisition). The absence of an ability to transfer attributes under a change of ownership would likely be a disincentive to investment.

Refundability of Excess Royalties

Under Australia's Constitutional system, States have the right to tax resources contained in that State. This has historically been applied to give effect to a State Royalty regime operating in each Australian State. Double tax potentially applies where a royalty regime and a RRT apply to the same resource project. As a result, the original RSPT contained a mechanism by which State Royalties were to be credited against RSPT liability with the excess of State Royalties refunded by the Federal Government. Under the MRRT, the Federal Government removed the refundability of the State Royalty credits with unused royalty credits being augmented at the long term bond rate plus 7%.

PNG has a production royalty system administered at the provincial government level. In an ideal system, such a royalty regime would be replaced by a RRT with the provincial governments compensated through RRT revenues raised. Failing the ability to replace the royalty regime, the RRT would need to provide some form of relief for production royalties paid. This should be in the form of a credit against RRT liability or a grossed up deduction. In the event that the relief is not utilised against RRT in the year that the production royalty is paid, consideration should be given to either refunding the credit to the taxpayer or, if that is not economically viable, allow the ability to carry forward the royalty credit with an appropriate augmentation applied to the unused credit to preserve the real value of the credit once used.

Deduction for Income Tax

In order to mitigate the imposition of double tax on the same project profits, some form of income tax relief will need to be provided. This could be provided by way of a credit against income tax or an income tax deduction.

Australia provides an income tax deduction for PRRT and MRRT paid.

Treatment of Close Down Expenditure

An important consideration in designing a RRT is the treatment of rehabilitation or close down expenditure. The difficulty with such expenditure is that, due to a RRT being a project based tax, close down expenditure is generally incurred at a point too late to be able to be offset against project profits.

Options available for close down expenditure include a refundable credit or deduction for such expenditure. This option most closely reflects the policy of a RRT, being the State's contribution to the closing down expenditure of the project. A similar option could involve a 'carry back' of the expenditure to offset such expenditure against project profits in prior years. This would effectively result in a refund of RRT liabilities of prior years. The final option could include some form of transfer of such expenditure to other projects that the taxpayer has an interest in.

3. Chapter 5: Aligning Income Taxes

Aligning income tax rates of mining and oil and gas projects within resources taxation and also as compared to PNG's general corporate tax regime can be seen as logically pure where a broadly applicable RRT is applied. Pure textbook economic logic may support the view that the base level of taxation of all sectors of the PNG economy should be taxed consistently with any excess rents applicable to resources projects taxed through a RRT. However, we are of the view there are real risks with simplistically adopting such a textbook approach. Our key concerns are as follows:

- *Investor certainty and transitional measures* - Major changes to PNG's resources tax system without carefully designed transitional measures as discussed above involve significant political risk and capital flight risks.

- *Resulting complexity* - At the same time, it is acknowledged that transitional rules for existing exploration, development and operating resource projects result in significant complexity and compliance costs.

Chapter 5 of the Issues Paper discusses how the rates of taxation could be aligned between the Petroleum, Gas and Mining industries in PNG. The current rates of taxation which range from 30% for gas projects to 50% for existing petroleum projects is largely due to historical attempts to encourage investment in new exploration and maximize tax revenues during times of high commodity prices. As noted by the tax review committee in the background reading of this chapter, by aligning the income tax rates for Petroleum, Gas and Mining, it will help reduce the administrative burden faced by the Internal Revenue Commission and will simplify the income tax system thereby creating a better environment for potential investors.

In Questions 5.1 and 5.2 and 5.3 of the Issues Paper, it is broadly posed that provided a suitable rent tax is introduced for resource projects, should new resource projects continue to be subject to a 30 percent income tax rate with a dividend withholding tax ('DWT') rate of 10%. As noted in the background of the chapter, this is broadly equivalent to a 37 percent tax rate with no withholding tax.

Although we agree that rationalizing the tax rates would make sense, we are of the view that the benefits would be greater if the tax rates were rationalized further. Given that the tax burden faced by PNG taxpayers in non-extractive industries is 30% income tax with a DWT of 17%, consideration may also be given to reducing the DWT rate for these taxpayers to 10%.

The PNG government could then focus taxation of the resources industries at a layer above corporate income tax in the form of a resource rent tax. Doing so would align with the objectives of the tax review to:

- Improve the competitiveness and efficiency of PNG's tax system so as to encourage investment, employment and economic development; and
- Enhance the fairness and simplicity of PNG's taxation system.

The focus of resource taxation at a layer above corporate tax would enable the PNG government to design a more efficient mechanism to maximize the revenues from resource rents. We have separately discussed issues that the tax review committee should consider in designing a resource rent tax.

In addition, we note that wording of Questions 5.1, 5.2 and 5.3 singles out new resource projects. We have assumed from the emphasis of new in the questions that the tax review committee does not intend to recommend any retrospective changes. On that basis, our only concern is that consideration should be given as to how the changes to these rules are transitioned in over time. For example, at what stage would a resource project be considered to be new?

Much of the taxation economics of these projects have been modelled over the life of the project so for many exploration taxpayers the determination of the point at which a project falls under the old rules, the transitional rules or the new rules will be of great importance. Furthermore, should the new rules for resource taxpayers prove to be more favorable, consideration should be given as to whether an option should exist for existing taxpayers to elect into the new rules.

Dividend Withholding Tax credits

The background to Question 5.2 of the Issues Paper makes the comment that moving towards a company income tax regime that includes a DWT maximizes the creditability of PNG taxes for an international investor in their home jurisdiction on the basis that withholding taxes tend to be more creditable than underlying income taxes. We do not agree with this comment.

From our experience, investors typically look at investment returns on a post dividend withholding tax basis. In addition, many of the investors in PNG resources typically invest via branches of non-resident entities. For Australian investors (which make up a significant portion of foreign investors in PNG), branch profits are generally non-assessable, non-exempt income for Australian income tax purposes with no benefit being associated with foreign tax paid. Similarly, many investors may be able to access participation exemptions in respect of dividends received from a non-portfolio investment in a PNG company, such that DWT may also not be creditable.

Third Party Access Arrangements

The background to Question 5.3 in the Issues Paper makes the comment that underpinning the economics of any new gas project through third party access to the PNG LNG midstream and downstream infrastructure would arguably create less need for gas projects to receive income tax incentives greater than mining or petroleum projects.

Question 5.3 of the Issues Paper seeks to understand the views of stakeholders on ensuring that if there are third party access arrangements over the PNG LNG and any new gas project midstream and downstream infrastructure and what issues might arise with such arrangements. In the background to this question, the tax review committee recognizes the balance that must be struck between granting third party access arrangements (which would have the benefit of de-risking the commercialization of other gas projects) and ensuring that such arrangements are not sufficiently onerous so as to provide a disincentive for future gas projects.

We note from our experience that third party access agreements for existing infrastructure can be very complex to agree from a commercial perspective. Should consideration be given to imposing third party access arrangements on existing LNG infrastructure, then further consideration will need to be given as to the appropriate level of compensation that should be provided to the current owners for the risk they took in establishing the infrastructure. Any such proposal would also need to be carefully implemented or this may create a view that PNG has increased sovereign risk in the eyes of foreign investors.

Transfer of interests

One area of weakness in respect to resource taxation in PNG is the treatment of transferred expenditure. Question 5.5 seeks a view on whether the deduction for a buyer of a mining or petroleum interest be limited to the un-deducted allowable capital expenditure and allowable exploration expenditure of the vendor. As there is no capital gains tax in PNG such that tenements can be disposed of without taxation, it makes sense that ACE and AEE deductions for the acquirers of mining projects interests be capped at the un-deducted ACE and AEE balances.

We consider Section 155L should be reworded such that the Vendor has an obligation to enter into a section 155L transfer notice for the proportion of the mining right acquired. We are of the opinion that such changes will clarify the regime to new entrants.

Mine closure

Question 5.6 poses the question, in addition to the piercing of the ring fence, should taxpayers be allowed to make contributions to a mine closure trust to bring forward deductions for decommissioning expenses into the income producing phase of a ring fenced project?

We note that should ring fencing be removed completely then arguably the impact would only be felt by taxpayers with a single project. Be that as it may, we support this proposition.

Partial year depreciation

Question 5.9 considers whether depreciation deductions should be pro-rated in the first year of production for mining companies. Although the current rules would give a tax advantage to those projects that only commercially produced for a small part of the year, we view this as purely a timing difference and unlikely to significantly impact the tax revenues collected. However, any changes to the rules to pro-rate depreciation deduction would more intuitive.

4. Chapter 4: Exploration

Chapter 4 of the Issues Paper focuses on the exploration phase of a resource project. Exploration companies face a number of challenges. Broadly, it is during the exploration phase of a resources project where a taxpayer will incur expenditure and be subject to the most risk. Often the ability to offset exploration expenditure as tax deductions against assessable income is significant in determining the economic justification of a proposed exploration project.

In this chapter we have focused on:

- Restriction/limitation on deductions for exploration expenditure
- The project ring-fencing rules
- Restriction on deductions for interest expense incurred during exploration phase

Our discussion on this chapter focusses on the impediments and challenges presented by the current tax system and we offer our view on how the current tax system may be redesigned to improve the efficiency of the system. Our suggestions are based on our experience in servicing clients in the oil and gas, and mineral sectors in Australia and we also provide a comparison with some similar tax systems in other jurisdictions.

Exploration Expenditure Deduction Restrictions

Question 4.4 of the Issues Paper, raises a quite narrow question as to whether the 10 percent annual taxable income cap limitation on deducting exploration expenditure outside the project ring-fence rule should be adjusted. This question draws into light the broader question of whether the general project ring-fence approach adopted PNG resource taxation remains appropriate. We have provided some comments on this aspect below.

Section 155N allows an exploration pool to be created so AEE can be deducted outside the project ring-fence. This is a welcome measure and appropriately allows producers to claim tax deductions for failed exploration on one project against income on another successful project.

Question 4.4 asks for views on whether the 10% of annual taxable income cap in claiming Section 155N AEE pool deductions should be lifted. If this proposal proceeded the limit of 25% of the undeducted AEE pool balance limit would be applicable. We favour this approach as it more closely mirrors the treatment for AEE inside the project ring-fence.

Project ring fencing rules

One question not specifically raised in the issues paper is whether the project ring-fence approach that is broadly applicable to PNG should be removed.

Mining and petroleum taxation has a valid place in a modern tax system focused on encouraging the development of PNG's mineral and petroleum resources.

In our view, the project ring-fence concept is not consistent with modern tax law design. It has the potential to distort investment decision making and is seen as a disincentive to exploration and development expenditure investment. We submit that the review should look at the removal of the project ring-fence concept, particularly if some of the other measures in the issues paper proceed.

At the time of its introduction, project ring-fence taxation was required due to the differing tax rates applicable to gas, petroleum, mining and other industries. However, in the event the resources tax rules are aligned with the broader PNG tax regime applicable to non resource taxpayers, the project ring-fence concept is not required or appropriate.

Restrictions to the deduction of interest incurred during exploration phase

Another issue not discussed in the issues paper that we suggest be considered is the non deductibility of interest expenses during the exploration phase.

As the legislation is currently drafted, interest expense incurred by a taxpayer during the exploration phases (i.e. expenditure incurred under a Petroluem Prospecting License (PPL) or Petroleum Retention License (PRL) issued under the Oil & Gas Act or an Exploration License (EL) issued under the Mining Act) is not tax deductible and does not form part of AEE. Any interest incurred during the exploration phase does not qualify as AEE as is effectively lost as the cost of not able to be captured. This restricts taxpayers from obtaining AEE deductions for valid debt funding costs related to exploration. In our view, the cost of borrowing money should be capitalized, subject to the normal transfer pricing (where it is borrowed from related parties) and thin capitalization rules.

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If you have any queries in relation to the comments made please contact either Brent Ducker on +61 7 3243 3723 or myself on +61 7 3243 3691.

Yours sincerely

M Hennessey

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