bhpbilliton

Review of the Petroleum Resources Rent Tax

BHP Billiton Submission

Contents

Introduction

BHP Billiton welcomes the opportunity to share its views with the Federal Government's review of the Petroleum Resources Rent Tax (PRRT). As one of the largest taxpayers in Australia, and the single largest payer of PRRT, BHP Billiton has significant experience with the operation of the PRRT regime.

In making this submission, BHP Billiton has taken into account both:

- The Review's Terms of Reference, released by the Treasurer, the Hon. Scott Morrison MP, on 30 November 2016 and
- The Government's Issues Note released on 20 December 2016.

The Issues Note states that the purpose of the review is to 'Ensure that the PRRT provides an equitable return to the Australian community from the recovery of petroleum resources without discouraging investment in exploration and development that is vital to the industry.'

As then Treasurer Paul Keating said when he described the objectives of the PRRT, the regime seeks to balance "…the objectives of satisfying the interests of the community as a whole in sharing in the benefits of very profitable offshore petroleum projects, and of providing companies with adequate rewards in return for the risks that they accept in undertaking offshore exploration and development activities."

BHP Billiton believes there is a significant body of evidence that the PRRT continues to operate as intended. We expand on this point, and offer views on the importance of ensuring sound fiscal settings to encourage the continued development of Australia's petroleum resources, in our submission.

We endorse the submissions from the Australian Petroleum Production & Exploration Association (APPEA) and the Business Council of Australia (BCA) on behalf of industry.

Executive Summary

BHP Billiton is the largest single payer of PRRT in Australia. Our company has paid more than A$11.2 billion in PRRT and royalties/excise since 2000. In the past five years, our Australian Petroleum Assets alone have contributed a further A$5.7 billion in company income tax, resulting in an effective tax and royalty rate of 55-58%.

Our projects have delivered substantial benefits to Australia. For example, as a single project, our 50-50 joint venture with Esso[1] in the Bass Strait has contributed an average of 2.5% of all Commonwealth Government tax receipts, in excises, royalties and taxes and provided an average of 1,000 direct jobs per year since 1967, totalling more than A$220 billion in 2016 terms.

This significant source of taxation revenue represents one element of the total value of Australia's hydrocarbons for the Australian people and enables the Government to invest in infrastructure and provide essential services to the people of Australia**.**

In addition, over the last 10 years, BHP Billiton has invested A$23 billion in our Australian petroleum business. These investments have provided significant capital inflows to Australia and created high paying jobs within our operations and throughout the supply chains which support oil and gas development across the country. The jobs created by this level of investment are a valuable source of high wage, high skilled employment opportunities in Australia, as well as additional tax income.

BHP Billiton believes there is significant evidence that the PRRT, as a profits-based tax, is the most appropriate mechanism to maximise the value of Australia's offshore petroleum resources. By taxing profits, rather than value or volumes, the PRRT enables an equitable sharing of returns from petroleum resources between the Australian people and investors, while fully protecting the Australian people from the financial risks for investors in the petroleum sector. Furthermore, PRRT maximises revenue for the Government when prices are high and when fields reach maturity – keeping them profitable and paying tax longer than under other regimes.

BHP Billiton also believes the PRRT continues to operate as intended. The system has delivered significant tax receipts to Australia and been effective in stimulating investment in projects, such as our Stybarrow project, that would likely have not been feasible under a different fiscal regime.

BHP Billiton believes that companies must meet their tax obligations and do so in a transparent way – including through the PRRT. The Government already has powers to investigate and address any cases where an individual company is perceived to be not meeting these obligations. It is also critical that Australia maintains the integrity of its tax system, as well as its reputation as a stable and attractive investment destination. Any changes to the tax system should not be designed to address a specific company or project, nor should it negatively impact on existing projects.

Furthermore, BHP Billiton believes that any assessment of, or changes to, the PRRT must be viewed in the wider context of the broader investment climate. While Australia has competed successfully as an investment destination in the past, conditions have been changing as Australian basins have become mature and other supply regions with more attractive geology and fiscal terms have become more accessible to international investment. For example, in 2016 Canada's Fraser Institute ranked Australia's offshore petroleum environment as 26 out of 96 (2nd quartile) in terms of their overall attractiveness for investment[2]. IHSMarkit ranks Australia 4th quartile for "government take" in terms of the extent to which such take impacts project returns.

In this context, we believe that the underlying fiscal settings surrounding Australia's petroleum industry, including those relating to PRRT, should take into account the challenge of ensuring Australian

[1] Subsidiary of ExxonMobil

[2] https://www.fraserinstitute.org/studies/global-petroleum-survey-2016

competitiveness such that the economic benefits for the nation of further development of Australia's resources can be realised over the long term.

BHP Billiton's approach to tax and transparency

BHP Billiton is one of Australia's largest tax payers. Our company has paid approximately A$65 billion in taxes and royalties in Australia over the past 10 years.

We are also the single largest payer of PRRT[3], having paid A$11.2 billion in PRRT, royalties and excise since 2000. In the past five years, our Australian Petroleum Assets alone have contributed a further A$5.7 billion in company income tax resulting in a total effective tax rate of 55-58%.

We support transparency and disclosure of taxes paid. For the last two years, we have released our Economic Contribution and Payments to Governments Report, which outlines the taxes we pay on both a country-by-country and project-by-project basis. A copy of the report is attached to this submission and also available on our website at: http://www.bhpbilliton.com/investor-centre/annual-reporting-2016/economic-contribution.

Transparency is important in building community confidence and understanding of the economic contribution our company makes to Australia and the other jurisdictions in which we operate. It helps strengthen the integrity of Australia's robust tax administration and ensures the community can see the direct return they receive on the investments companies make.

Our approach to tax

Our approach to tax is underpinned by our global tax principles, which have been reviewed and endorsed by the Risk and Audit Committee of the Board of BHP Billiton. In 2016, we established six principles that govern our global approach to tax as set out below.

1. Transparency	We are transparent about the taxes and royalties that we pay to governments because we believe that openness allows our shareholders, employees, contractors, partners, customers and communities to understand the contribution we make and have a greater ability to assess the integrity of the tax systems in the countries in which we operate.
2. Corporate citizenship	We act with integrity when engaging with revenue authorities to support positive and sustainable relationships. Where possible, for the purposes of obtaining certainty of our tax positions, we engage with revenue authorities on a real-time basis regarding the application of the tax law and to identify and resolve any disagreements on a timely basis.
3. Risk management and governance	We are committed to strong governance. We seek to identify, assess, control and report tax risks in accordance with our global risk management framework. Risks identified as material are reported to the Risk and Audit Committee. We have internal standards which clearly set out our approach to tax planning, the level of tax risk that the Company is prepared to accept and escalation points and procedures. We have an adequately resourced Tax function staffed with appropriately qualified team members. The approval of the Tax function is required in the planning, implementation and documentation for all business or share acquisitions and disposals, corporate restructures, cross-border financing and trading arrangements and significant business transactions.
4. Business rationale	Our transactions have proper commercial purposes and economic rationale. We locate business activities where value is optimally created. We seek to have a tax charge that contributes to superior business performance and delivers long-term shareholder value. Accordingly, we do not engage in aggressive tax planning.
5. Compliance	We respect and comply with the laws of the jurisdictions in which we operate. We meet all of our tax compliance obligations on time. Our tax obligations include pricing transactions in our global value chain according to where value is created, and economic activity occurs, in compliance with the

[3] Source: ATO: 2013-2014 and 2014-2015: http://data.gov.au/dataset/corporate-transparency/resource/1e8c8ae0-81d1-4780-a669-9e4a2a6ba1a4

	Organisation for Economic Co-operation and Development (OECD) guidelines, and based on the arm's length principle. We conduct annual review and assurance over our compliance obligations.
6. Advocating reform	We support simple, stable and competitive tax rules and the principle that the taxing rights of countries should be commensurate with where the economic activity occurs. We engage in the reform process of international tax rules (including transfer pricing) and local tax rules in the jurisdictions in which we operate. We do this because we believe that tax systems should be effective, efficient and competitive, in order to support economic growth, job creation and long-term sustainable tax contributions.

BHP Billiton supports the measures the Government has introduced to improve transparency in tax reporting. We have signed up to the Australian Voluntary Tax Transparency Code and our reporting meets the Code requirements.

We also welcome the increase in transparency in Australian Government reporting, with the ATO's Corporate Tax Transparency reports released for 2013-14 and 2014-15 (see Appendix 1 for a comparison of the ATO and BHP Billiton's tax transparency reporting).

Tax Reform in Australia

While this review is focused on the PRRT, it is taking place at a time when there is significant debate about Australia's broader corporate tax settings and new measures to strengthen the integrity of the tax system as well as overall competitiveness and productivity across the economy.

We believe it is important to assess the effectiveness of the PRRT in this broader context.

Global benchmarking data indicates that Australia's investment climate for oil and gas exploration, development and production has become increasingly less competitive over the last several years:

- Wood Mackenzie ranks Australia 32nd in the world for undiscovered resources, suggesting that there are fewer large economically attractive fields waiting to be developed.
- Australia is ranked towards the bottom of the third quartile in its ranking of 130 countries in terms of fiscal attractiveness by IHSMarkit.
- Canada's Fraser Institute ranked Australia's offshore petroleum environment as 26 out of 96 in terms of their overall attractiveness for investment in 2016.

The PRRT is part of a suite of tax policy settings where the Government is balancing an appropriate return to the Australian community with the vital need to encourage investment, economic activity and job creation. Globally competitive tax settings are a significant factor in improving Australia's economic growth and competitiveness. In this regard, BHP Billiton supports the objective of putting Australia on a pathway to align the corporate tax rate to the OECD average.

PRRT is working as intended

PRRT objectives

The PRRT is a profits-based resource tax on oil and gas projects in Australia[4]. It is levied under the provisions of the *Petroleum Resource Rent Tax Assessment Act 1987* (the PRRT Act).

Since December 1983, when the then Hawke Federal Government released its first discussion paper that sought stakeholder comments in relation to the proposed introduction of a resource rent tax (RRT) for the petroleum sector in Australia, successive governments and policies have re-iterated that the purpose of a petroleum resource rent tax is effectively – as is noted in the Treasurer's Press Release on 30 November 2016 – to:

> *'Ensure that the PRRT provides an equitable return to the Australian community from the recovery of petroleum resources without discouraging investment in exploration and development that is vital to the industry.'*

Since 2000, BHP Billiton's Petroleum operations have paid more than A$11.2 billion in PRRT and royalties/excise. As the single largest payer of the PRRT and a major investor over many decades in developing Australia's oil and gas resources, we believe that there is a significant body of evidence to demonstrate that the PRRT has effectively met its objectives and works as intended.

BHP Billiton considers that our effective tax rate of 55-58% (including company taxes, royalties and excise) on our petroleum operations during the last five years represents a strong return to the Australian community – one that is substantially higher than the corporate tax rate.

Furthermore, changes in the level of PRRT revenue to Government in recent years reflect the way the PRRT is intended to operate. As a profits-based tax, the amount of revenue to Government will fluctuate over the long life of a project. Whether the project is delivering a profit depends on commodity prices, production costs, and the exchange rate, among other factors. The life cycle of an oil and gas project and the design features of the PRRT mean companies often make high risk up front investments that only deliver profits late in the project life cycle (see Appendix 2 for an overview of the lifecycle for offshore petroleum projects).

The PRRT was deliberately designed to provide an equitable return to the Australian community while providing investors with appropriate returns for the large financial risks involved in petroleum exploration and development. In this context, the uplift for exploration expenditure (15%) recognises the high risk associated with exploration[5], while the uplift rate that applies to general expenditure (5%) provides the investor with a modest return prior to PRRT becoming payable[6].

As in any other sector of the global economy, companies factor the tax and royalty regimes into their decision to invest in a petroleum project in a particular jurisdiction.

Australia possesses potentially significant undeveloped discovered resources and large potential undiscovered resources. We believe that the value of these resources for the Australian community will be maximised over the long term by ensuring that fiscal settings encourage the development of these resources in an efficient manner. This includes providing investors with confidence in fiscal stability by

[4] Royalty and excise regimes are government levies on per unit of output or percentage of gross value of output. Typically, the royalty or excise is levied irrespective of the costs of production and profitability of a project. Corporate or income tax are taxes on a company's business profits, broadly being gross revenue less business expenditure including interest expenditure and depreciation for capital investment. Rent based taxes such as the PRRT are taxation arrangements under which the government essentially collects a percentage of the project's economic rent.

[5] For example, over the past 10 years, BHP Billiton and our partners have drilled seven true greenfield or frontier exploration wells in Australia, none of which resulted in commercial developable resources.

[6] PRRT losses are preserved and carried forward and uplifted so that they can be used as a deduction against future assessable receipts from the project in later years. The uplift rate preserves the value of the project's PRRT losses, substituting for the lack of an immediate refund. The uplift rate also includes a premium to compensate for the risk that the project may never get to use its losses.

avoiding changes that would have the effect of retrospectively altering the basis on which investment decisions were made.

Australian assets

BHP Billiton has been a major participant in the Australian Petroleum industry for over 50 years. Australia is strategically important to BHP Billiton Petroleum's portfolio with existing long life assets and potential future developments.

Our Australian assets comprise long standing cornerstone assets (Bass Strait, North West Shelf), more recent developments (Macedon, Pyrenees), legacy assets transitioning to closure and decommissioning (Griffin, Stybarrow and Minerva), potential future developments (Scarborough, greater Exmouth, North West Shelf and Bass Strait) and significant exploration acreage off the coast of Western Australia. Appendix 3 provides further detail of BHP Billiton Petroleum's assets in Australia.

Australia is a core area for BHP Billiton Petroleum, contributing over 57% of BHP Billiton Petroleum's underlying EBITDA (17%of the Group) and 41% of Petroleum's revenue (~10% of the Group) in FY16.

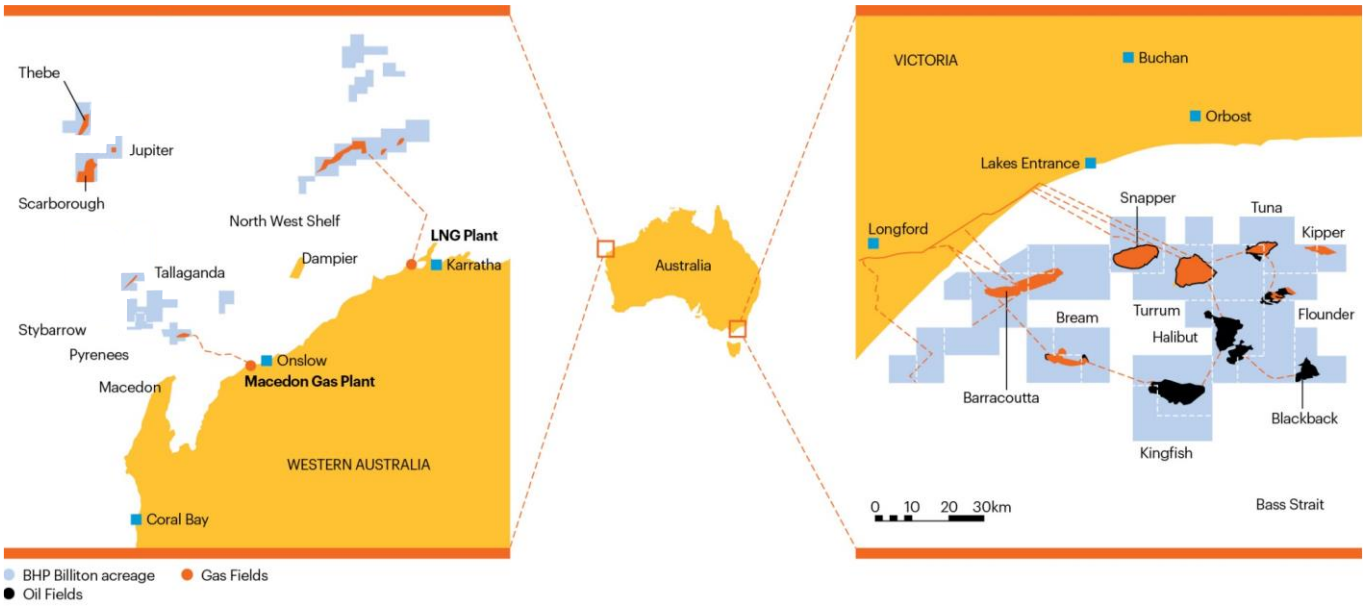

Figure 1: BHP Billiton's Australian petroleum assets

Overall performance of petroleum tax arrangements in Australia

BHP Billiton believes the PRRT, as a profits-based tax, is the most appropriate mechanism to maximise the value of Australia's offshore petroleum resources. The design of the PRRT is that it taxes profits ('economic rents'), rather than value or volumes. Profits occur only after the licensed producer has made a return in excess of its capital costs of development. When such profits are made, the PRRT applies at a fair rate (of 40%) – thus providing an equitable share of the returns from the development of petroleum resources between the beneficiaries: the Commonwealth (the Australian people) and the licensed producer.

As it is applied to profits, the PRRT maximises the potential revenue generated for Government when prices are high. In addition, the PRRT continues to maximise Government revenue on mature late life assets, which may be producing lower volume, yet at higher profits as the capital costs of the field have already been deducted. This has the added benefit of keeping fields operating, providing employment and paying tax for longer than fields otherwise would under a volume-based royalty regime. This is because

royalty regimes tax volume, not profit, thereby disincentivising petroleum production where the royalty level makes production sub-economic.

The system has been effective in stimulating investment in projects like Stybarrow (see case study below) that would likely have not been feasible under a different fiscal regime; and has delivered significant benefits to the community (through job creation, company income tax payments, and PRRT payments). Likewise, BHP Billiton's Bass Strait joint venture (see second case study below) demonstrates the potential of the PRRT to generate considerable taxation revenue for the Commonwealth ($9 billion since 2000) even as fields mature and their production capacity declines.

The annual profitability of oil and gas projects is affected by many factors. For example, in recent years, oil and oil-linked LNG prices have declined substantially (over 50% between 2014 and 2016), lowering many projects' profitability.

Oil and gas projects typically span several decades, and consist of a number of stages, including exploration, development, production and closure. The amount of production and expenditure, which determines profitability, will vary according to the different stages of the project lifecycle.

As Figure 2 illustrates, there has been a close relationship between the PRRT paid by BHP Billiton's Australian petroleum assets and the revenue generated by these assets.

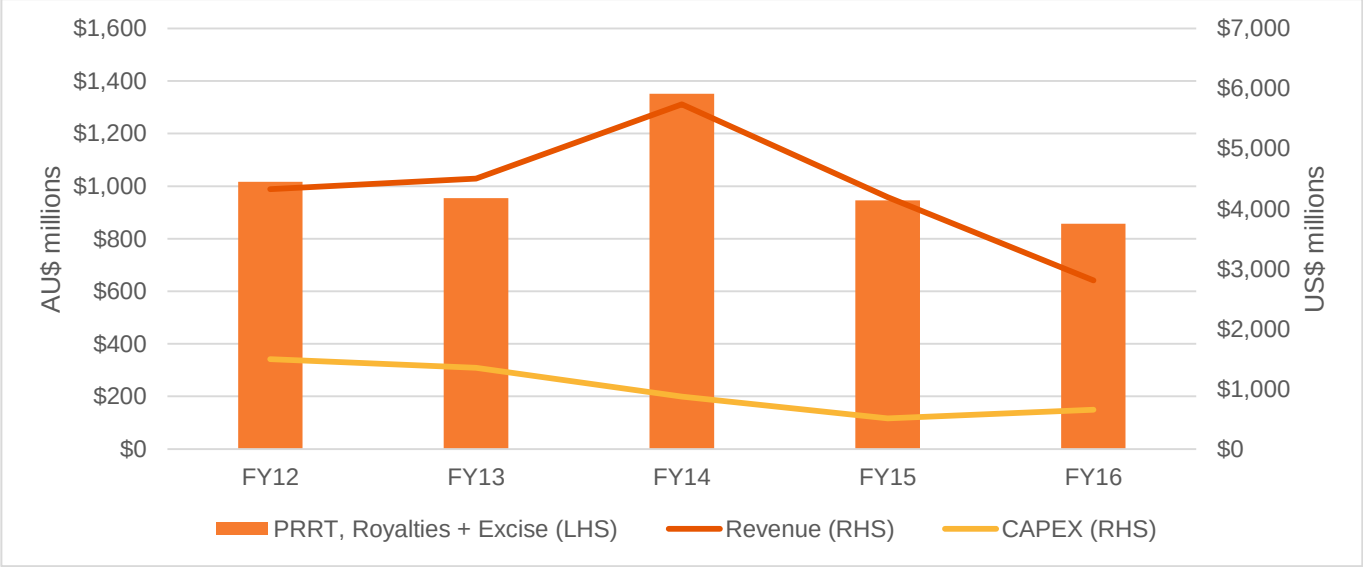

Figure 2: BHP Billiton's Australian petroleum assets, CAPEX, revenue, royalty, excise and PRRT

PRRT design – impact of commodity price: Stybarrow case study

When the Stybarrow oil field was discovered in 2003, with an estimated 70 million recoverable barrels of oil, it was considered a marginal project due to the low oil price and associated development cost of the field. The PRRT regime, however, was conducive to the viable development of this project. Petroleum taxation arrangements meant that the cost of the Greenfield exploration could be offset against the producing Griffin field, and that the cost of developing the offshore field could be offset once production commenced. If the design of the PRRT was such that it was not profits based and/or did not encourage exploration, this would likely have had the effect of directing capital to other projects outside of Australia.

BHP Billiton's investment decision for Stybarrow - at a time of low oil prices - incorporated a low capital expenditure infrastructure leasing arrangement due to expected low project returns based on the oil price at the time. The design of the PRRT – as it only taxes profits made after recovery of our capital costs - supported the investment being made, notwithstanding the project was marginal as a result of the oil price at the time.

As the project commenced production in 2007, oil prices unexpectedly increased significantly, to circa US$150 per barrel. As a result, the Stybarrow project's upfront capital expenditure was paid off within three months of start-up and the project began paying PRRT in the same year production commenced.

Stybarrow continued paying PRRT for the remainder of its production life. BHP Billiton's share of the Stybarrow project delivered A$856 million in PRRT revenue to the Australian Government. This project was made possible because the design of the PRRT provided BHP Billiton with the confidence to invest and resulted in windfall profits for the Australian people when prices where high.

In comparison, if BHP Billiton were to develop Stybarrow today, assuming the same development concept, cost, capital expenditure and production profile, the return to Government would be significantly lower due to the considerably lower oil price. Given the current low oil price environment, a less investment supportive taxation regime than the existing PRRT would effectively preclude the development of a Stybarrow equivalent today.

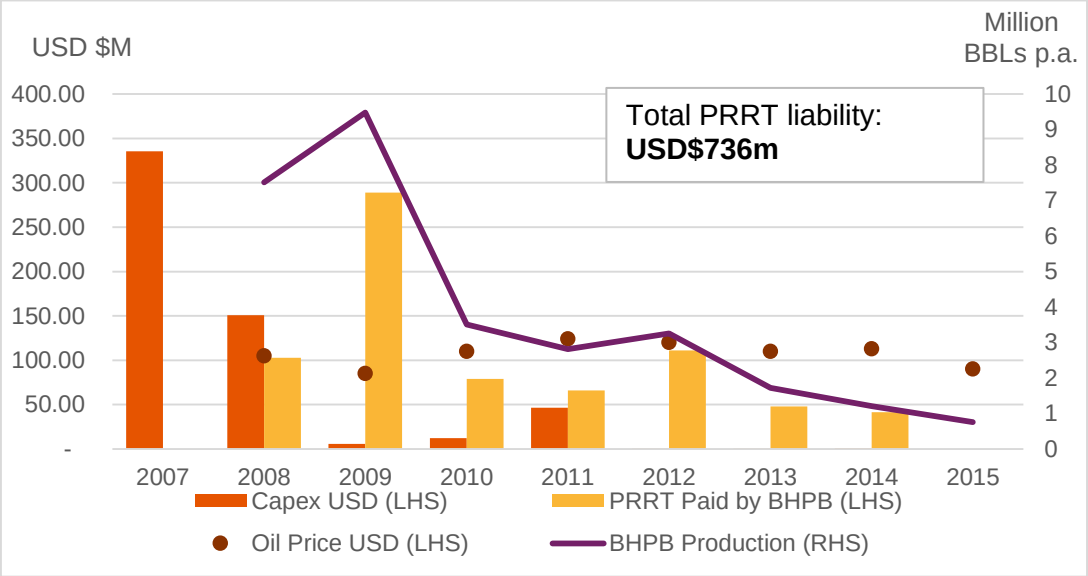

Figure 3 Stybarrow project - actual development and taxes paid[7]

[7] PRRT liability excludes exploration transfers.

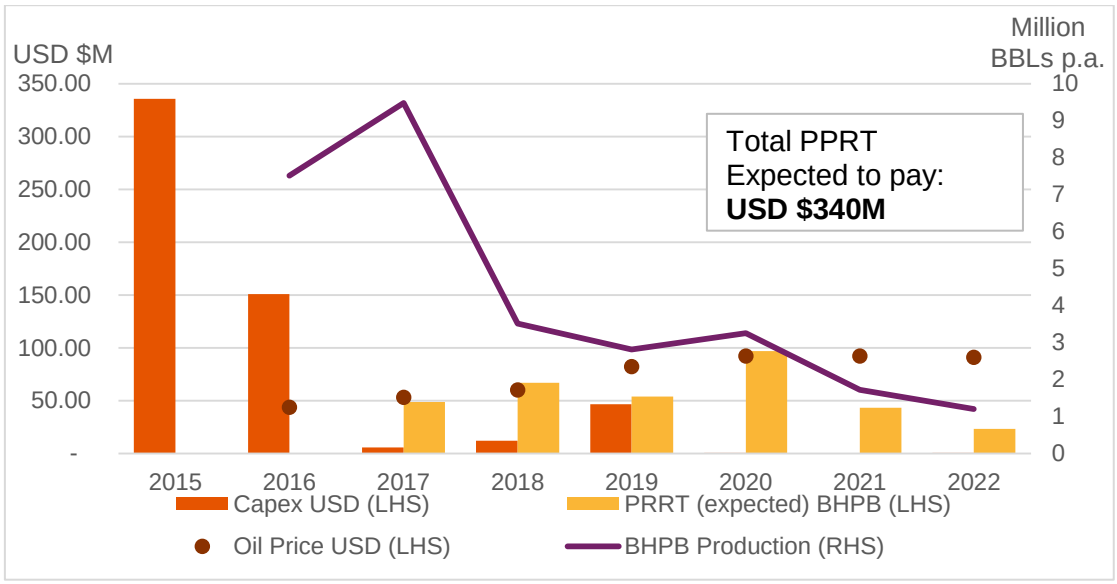

Figure 4 Stybarrow project simulation if it were commissioned at today's costs and oil prices[8]

PRRT design – Long-term PRRT contributor: Bass Strait

In 1965, with our 50-50 joint venture partner and operator, Esso Australia (a subsidiary of ExxonMobil), through the Gippsland Basin joint venture, we discovered hydrocarbons in the Bass Strait. Since the discovery 50 years ago, Bass Strait has provided significant economic benefits to Australia.

The Bass Strait fields are between 25 and 80 kilometres off the Gippsland Coast in south-eastern Victoria. Since discovery, the asset has been expanded significantly. There are currently 23 offshore platforms and installations in Bass Strait which feed a network of 600 kilometres of underwater pipelines to keep the oil and gas flowing, 24 hours a day. To date, more than four billion barrels of crude oil and around eight trillion cubic feet of gas have been produced from Bass Strait.

The majority of Bass Strait crude oil and condensate produced is sold to refineries along the east coast of Australia under spot and 12-month contracts with occasional export cargos. The steady and reliable supply of hydrocarbons has underpinned a significant level of industrial activity in Australia for decades.

Gas is piped onshore to the joint venture's Longford processing facility, from where we sell our share of production to domestic retailers and end users under contracts with periodic price reviews. Liquefied petroleum gas (LPG) is dispatched via pipeline, road tanker or sea tanker. Ethane is dispatched via pipeline to a petrochemical plant in western Melbourne.

Although the field was initially developed prior to the creation of the PRRT, Bass Strait was brought into the regime in 1990 under special circumstances due to the unique history of Bass Strait[9].

Since entering the PRRT regime, the profits-based nature of the tax has supported the continuation of the field's development. Specifically, by only taxing profits made after capital costs (including infrastructure development) have been recouped, the PRRT regime has supported major investments in Bass Strait in recent years.

The most significant new development is the A$4.5 billion (100%) Kipper Tuna Turrum (KTT) project. The KTT project includes the new Marlin B platform, new Turrum field wells, additional subsea pipelines, and the new Longford Gas Conditioning Plant.

[8] Notes for figures 3 and 4: Actual Development results are all actual numbers, with PRRT payments converted to USD. All numbers shown as BHP Billiton share. Figure $b has the same production and cost data, however is a simulation if the project were to start in FY16. Notably, the oil price and PRRT payments are less than half. Forward prices provided by WoodMackenzie.

[9] http://www.taxwatch.org.au/ssl/CMS/files_cms/186_MRRT%20Report.pdf

The KTT project was a significant boost for the economies of Gippsland, Victoria and Australia more broadly, with the Australian content of the project valued at approximately A$2.8 billion. At the peak of construction, around 1500 people in Australia were employed by the project.

Investments like KTT, which are supported by the existing PRRT system, will see Bass Strait continuing to supply energy, jobs, and PRRT revenue to Australian for decades to come. The KTT project also plays a major role in provided energy security to the people of Victoria, New South Wales and South Australia.

The Bass Straight operation is the largest payer of PRRT in Australia and has been paying PRRT since 1990. Over A$9 billion in PRRT has been paid by BHP Billiton since 2000.

Since 1967, Bass Strait's contribution to the Australian economy has been monumental. A 2015 study by ACIL Allen Consulting reported that over its life the project has contributed:

- More than A$31 billion (2016 terms) of ongoing operations expenditures.
- Over A$220 billion (2016 terms) of payment in Australian excises, royalties and taxes
- Generation of gross revenues of over A$330 billion (2016 terms).
- An average of 2.5% of all Commonwealth Government tax receipts since 1967.
- Over 40% of all of eastern Australia's natural gas and 54% of all of Australia's crude oil and liquids;
- An average of around 1,000 workers per year have been directly employed.

The legacy of Bass Strait when viewed over its 50-year life span provides a clear indication of the immense value Australia can derive from major long life offshore oil and gas projects. Projects such as Bass Strait have lifespans which outlive the swings of multiple commodity cycles. Their long-term nature requires a stable fiscal regime which recognises this, to ensure the people of Australia benefit from them for decades to come.

Maintaining Australia's Competitiveness

International Competitiveness

Australia's prospectivity

BHP Billiton considers that while Australia is an established oil and gas region, there are still significant undeveloped discovered resources and potential material undiscovered resources that represent future growth opportunities (see Figure 5 and 6). Discovery and development of these resources will be more challenging from a risk and cost perspective, and an unstable or uncompetitive tax system may result in these resources remaining undiscovered and/or undeveloped.

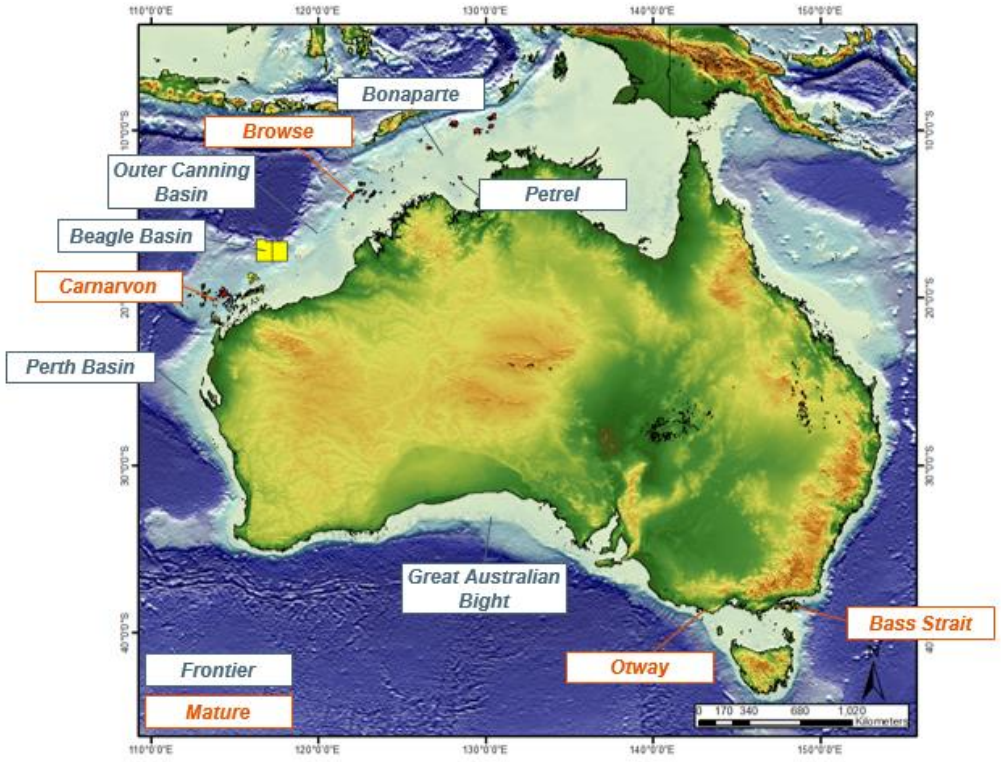

Figure 5: Key offshore basins. The Carnarvon and Browse mature basins have material discovered resource, albeit at high cost to develop. Other basins have potential, but are high geologic risk.

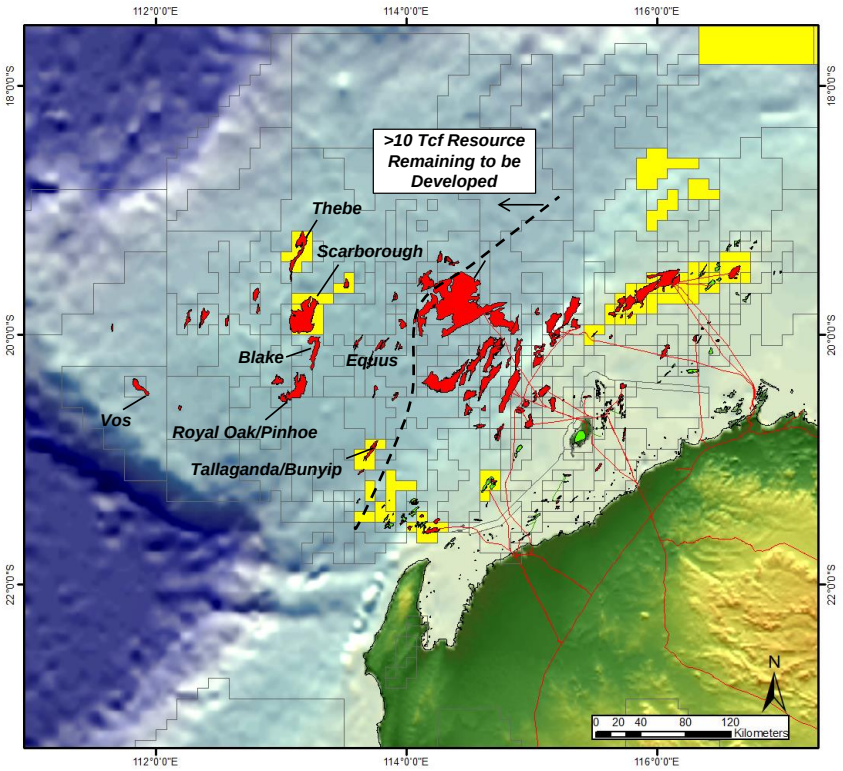

Figure 6: Significant resource in Outer Carnarvon Basin; Stable fiscal regime required for development

Fiscal policy settings and stability

In order to realise the long term benefits of Australia's petroleum resource endowment for the Australian community, a competitive fiscal regime is necessary to ensure that returns from growth and development opportunities are sufficient to attract global capital.

Given the current point in the resources cycle, global competition for increasingly mobile and scarce capital is likely to increase in the near and medium term. Capital will flow to the resources and investment opportunities which have an appropriate balance between risk and return.

For offshore resources development, many factors contribute to the risks and potential returns of investing in a particular country when companies are considering committing to different projects. These include dynamics that are beyond the direct control of governments (e.g. geology, existing infrastructure, and labour force skills and costs). This makes the fiscal regime one of the most critical policy levers available to increase a nation's attractiveness for resources investment.

To attract new capital, one of the critical factors is ensuring the fiscal regime under which the industry operates is globally competitive – which means a competitive tax system that is based on the principles of simplicity, stability, sustainability, transparency and fairness. The influx of capital investment to develop Australia's oil and gas endowment over the past decade provides clear evidence that the current taxation regime helps underpin Australian competitiveness over this timeframe.

We acknowledge the decline in PRRT revenues. Nonetheless, we do not believe that it is appropriate to amend a taxation regime such that it impacts current projects off the back of the short term commodity price swings which have driven this decline. We also recognise there has been comment from some groups regarding the differences between Australian PRRT revenues and the revenues generated by other oil and gas producing countries. When assessing such comment, it is vital to ensure that any comparison is made on a like-for-like basis, taking account of the full mix of tax, government investment and risk sharing in each jurisdiction.

We recognise the need for an informed debate around reform of the tax system. However, such reforms should be prospective in design and centred on the principles noted above.

International comparison

International oil and gas companies typically prioritise investment in exploration and development of new resources based on geological and economic attractiveness as well as "above-ground" political risk.

While Australia has competed successfully as an investment destination in the past, conditions have been changing. As Australian basins have become mature, other supply regions have become more accessible to international oil companies (e.g. Mexico, Iraq) and fiscal terms offered by other countries have improved (e.g. Brazil, Iran). An assessment of worldwide exploration spend by the top 40 oil and gas companies globally, based on data from Wood Mackenzie, indicates that Australia's share of investment has declined every year between 2009 and 2015, from about 8% at the peak to less than half that level (see Figure 7). At the same time, the share of exploration investment in other major petroleum provinces such as the US Gulf of Mexico or US onshore has held steady or increased.

Wood Mackenzie estimates that Australia has 0.5 billion barrels of oil equivalent (bboe) of undeveloped commercial resources. This ranks 21st out of 65 countries, behind the UK, Vietnam and Indonesia. Based on the average commercial field size, Australia ranks 32nd, suggesting that there are fewer large economically attractive fields waiting to be developed. BHP Billiton research suggests that there is at least 10 trillion cubic feet (tcf) or 2.5 Bboe of undeveloped resources in the Outer Carnarvon basin offshore Western Australia that is currently non-commercial.

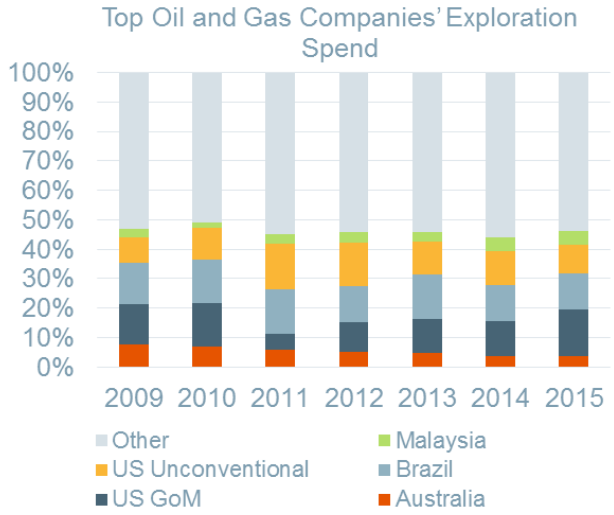

Figure 7: Top 40 oil and gas companies' global exploration spend

Fiscal terms are a key part of the economic attractiveness of different petroleum provinces. IHSMarkit maintains a ranking of fiscal attractiveness from an oil and gas perspective: Australia ranks towards the bottom of the third quartile in its ranking of 130 countries. The ranking uses a weighted score that is based on factors estimating government take and investor returns across a variety of field types in each fiscal regime. Australia is especially affected by the score for "government take", where it lies in the fourth quartile alongside higher risk but resource-rich countries such as Nigeria and Kazakhstan. In contrast, established oil regions such as the UK (first quartile – see Appendix 4 for additional details about the UK's recent experience regarding petroleum taxation), USA and Brazil (both second quartile) score more highly on this metric.

Likewise, the Canadian Fraser Institute[10] conducts an annual survey of petroleum industry executives regarding barriers to investment in oil and gas exploration and production in various jurisdictions around the world. The survey considers such factors as fiscal terms, regulatory barriers, labour availability and skills, and political and legal stability. In the 2016 edition of the survey, Australia's six oil and gas jurisdictions ranked from 26 to 90 (out of a total of 96 jurisdictions) in terms of their overall investment attractiveness (Figure 8). The top ranking jurisdictions are located in the US, Canada, Norway, the UK, New Zealand, the United Arab Emirates and Ireland.

Figure 8: Global attractiveness for investment rankings, Australia's oil and gas jurisdictions (Fraser Institute)

[10] https://www.fraserinstitute.org/studies/global-petroleum-survey-2016

Conclusion

As one of Australia's largest tax payers and single largest payer of the PRRT, we believe that the PRRT regime continues to fulfil the policy objectives for which it was designed by encouraging the development of Australia's petroleum resources while also providing a long-term return to the Australian community.

We recognise Government has a responsibility to continually assess fiscal policy to ascertain if existing settings are appropriate and are functioning as intended. In relation to PRRT, we believe this is the case.

Beyond PRRT, BHP Billiton believes it is important to consider a range of other factors that underpin the future development potential of Australia's petroleum resources, and their ability to support economic growth and employment over coming decades. These factors include the overall prospectivity of the Australian petroleum endowment and the broader competitiveness of Australia's economic and fiscal policy settings.

We welcome the opportunity to discuss these matters with the Committee in further detail, and look forward to sharing our perspectives on how best to maximise the contribution of Australia's petroleum sector to the national economy.

We will be pleased to engage further with the review committee on these matters.

Appendices

Appendix 1: Tax transparency reporting

BHP Billiton has a long-standing commitment to transparency. We first disclosed our aggregate payments of taxes and royalties around the world in 2000. Since 2015, we have disclosed our payments to government on a country-by-country and project-by-project basis through our *Economic Contribution and Payments to Government Report* series.

The table below summarises key outputs from our tax transparency reporting that relate to our Australian petroleum assets (for FY15 and FY16).

BHP Billiton	**FY16**		**FY15**	
Millions	*Corporate income tax*	*Royalty-related income taxes*	*Corporate income tax*	*Royalty-related income taxes*
Pyrenees and Macedon	US$0.4	US$172.6	US$23.6	US$469.0
Minerva	US$6.5	US$17.7	US$3.5	US$25.3
Bass Strait	US$73.1	US$143.4	US$123.2	US$430.4
North West Shelf	US$232.7	-	US$307.3	-
Non-Petroleum Businesses	US$322	-	US$1473.6	US$88.2
Total Payments to the Australian Federal Government	**US$634.7**	**US$333.7**	**US$1,931.2**	**US$1,012.9**

Appendix 2: Life cycle of offshore petroleum projects

The lifecycle of offshore petroleum projects can be divided in to four distinct phases: exploration, development, production, and decommissioning. Of these phases, only the production phase provides a return on investment, the other phases are all high financial risk activities.

Exploration – Offshore petroleum exploration is one of the highest financial risk activities a resources company can undertake given the potential that a commercial resource will not be discovered. The process entails locating a prospective region, identifying subsurface structures which may contain hydrocarbons and drilling exploration wells. This process can take many years and cost billions of dollars, particularly in frontier areas or in deep water. For example, the average cost of a well in Australia in 2014 was $130 million according to APPEA. In some instances a purpose built rig or drill ship may be needed due to local geological or oceanic conditions, the cost of these vessels can be many hundreds of millions of dollars. Under the design of the PRRT, the capacity to transfer exploration expenditure incurred on one project to a successful producing project recognises the high risk of exploration. Over the past 10 years, BHP Billiton and our partners have drilled seven true Greenfield or frontier exploration wells in Australia, none of which resulted in commercial developable resources. This design feature incentivises new investment, specifically exploration and furthermore, in doing so, it recognises that Australia will be a major beneficiary when exploration is successful.

Development – Once a commercial resource has been discovered, it will be developed. Development cost can be immense depending on the technical and geological complexities of the particular project.

Production – The capital cost curve for the development of an offshore hydrocarbon discovery is incomparable to many industries as the vast majority of capital costs are incurred upfront, prior to production commencing. Once development is completed and hydrocarbons begin to flow, the project becomes an asset and begins to provide cash flow. Once the eligible costs of the exploration and development are recouped and the asset becomes profitable, PRRT will begin being paid. While this may take many years for major projects, the long-term nature of these also enables long-term and significant PRRT contributions if the economics of the project are good.

Closure – This entails the plugging of wells and the decommissioning of production infrastructure once economically recoverable hydrocarbons have been exhausted. Under current environmental regulations, the specific requirements for removal of infield infrastructure are at the discretion of the regulator. Under the design of the PRRT, a portion of the costs for decommissioning can be deducted in computing the PRRT liability of the project, which can result in a refund of PRRT paid in earlier years in relation to that project. This design feature recognises the significant decommissioning costs which can be occurred once the project is no longer in production (and hence no revenue is being generated against which these costs can be offset). There is no guidance material available from the regulator on the expectations for decommissioning, as such there is no clarity for oil and gas operators or the government on the full liability decommissioning costs represent.

Appendix 3: Australia's petroleum assets

Bass Strait

In 1965, we, along with our 50-50 joint venture partner and operator, Esso Australia (a subsidiary of ExxonMobil), through the Gippsland Basin joint venture, participated in the original discovery of hydrocarbons. We have produced oil and gas from Bass Strait over the past 40 years. The Bass Strait operations are located between 25 and 80 kilometres off the South-Eastern coast of Australia.

We sell the majority of our Bass Strait crude oil and condensate production to refineries along the east coast of Australia under spot and 12-month contracts with occasional export cargos. Gas is piped onshore to the joint venture's Longford processing facility, from where we sell our share of production to domestic retailers and end users. Liquefied petroleum gas (LPG) is dispatched via pipeline, road tanker or sea tanker. Ethane is dispatched via pipeline to a petrochemical plant in western Melbourne.

Our share of production in FY16 was 35.3 million barrels of oil equivalent (MMboe), up from 31.2 MMboe in FY15.

Bass Straight is the largest payer of PRRT in Australia and has been paying PRRT since 1990. Over $9 billion in PRRT has been paid by BHP Billiton since 2000.

North West Shelf

We are a joint venture participant in the North West Shelf (NWS) Project, located approximately 125 kilometres northwest of Dampier in Western Australia. The North West Shelf Project supplies gas to the Western Australian domestic market, mainly under long-term contracts and liquefied natural gas (LNG) to buyers primarily in Japan, South Korea and China under a series of long-term contracts.

North West Shelf gas is piped from offshore fields to the onshore Karratha Gas Plant for processing. LPG, condensate and LNG are transported to market by ship, while domestic gas is transported by the Dampier-to-Bunbury and Pilbara Energy pipelines to buyers. We are also a joint venture partner in four nearby oil fields – Cossack, Wanaea, Lambert and Hermes. All North West Shelf gas and oil joint ventures are operated by Woodside.

Our share of production in FY16 was 27.5 MMboe, down from 28.7 MMboe in FY15.

North West Shelf has a distinctive fiscal regime due to its unique development history and the cross jurisdictional nature of the asset. Since 2012, NWS has paid A$492 million in excise and A$1.052 billion in royalties.

Pyrenees & Macedon

We operate six oil fields in Pyrenees which are located offshore approximately 23 kilometres northwest of Northwest Cape, Western Australia. We had an effective 62% interest in the fields as at 30 June 2016, based on inception-to-date production from two permits in which we have interests of 71.43%and 40%t, respectively. The development uses a floating, production, storage and off-take (FPSO) facility. The crude oil produced is sold internationally on the spot market.

Our share of production from Pyrenees in FY16 was 8.6 MMboe, up from 7.2 MMboe in FY15.

We are also the operator of Macedon (71.43% interest), an offshore gas field located approximately 75 kilometres west of Onslow, Western Australia and an onshore gas processing facility, located approximately 17 kilometres southwest of Onslow. The operation achieved first gas in August 2013 and consists of four subsea wells, with gas piped onshore to the processing plant. After processing, the gas is delivered into a pipeline and sold into the Western Australian domestic market under long-term and spot contracts.

Our share of production from Macedon in FY16 was 8.5 MMboe, up from 6.8 MMboe in FY15

The Pyrenees and Macedon assets produce from the same licences so are treated as the same field for PRRT purposes. Since start up in 2010, these projects have paid a combined total of A$1.35 billion in PRRT.

Minerva

We are the operator of Minerva (90%interest), a gas field located 11 kilometres south-southwest of Port Campbell in western Victoria. The operation consists of two subsea wells, with gas piped onshore to a processing plant. After processing, the gas is delivered into a pipeline and sold domestically under long-term contracts.

Our share of production in FY2016 was 2.3 MMboe, down from 3.1 MMboe in FY2015.

Minerva has paid A$139 million in PRRT since start up in 2005.

Appendix 4: Taxing North Sea Oil[11]

Context

Oil companies operating in the UK North Sea have paid three separate profit-based taxes since 2002: Corporation tax, Petroleum Revenue Tax (PRT) and a Supplementary Charge. The PRT is a windfall tax which only applies to certain older oil fields, and is treated as a deductible expense when calculating corporation tax and the supplementary charge.

In March 2011 there was a change in the fiscal regime when UK Chancellor of the Exchequer, George Osborne, increased the Supplementary Charge for oil companies from 20% to 32% of profits.

In addition, the government introduced a cap on tax relief for decommissioning activities (probably because it feared this would become too costly).

At the time, the corporate tax rate for oil companies was 30%, and the PRT rate was 50%. The top effective tax rate after applying all three taxes was 81%.

The changes took effect immediately. This was the third tax increase in nine years.

Consequences

Certain impacts were observed in the UK oil industry as a result of this change:

- In 2011, the largest year-on-year decline in production ever seen in the UK (19% down from 2010 levels) was reported.
- Exploration activity decreased dramatically in 2011, with the number of wells falling by half to the lowest level since the 1960s.
- Statoil announced it would suspend development work in two oil fields south-east of Shetland while it assessed the impact of the new regime.
- In 2014, Oil & Gas UK (the industry association) estimated that instead of the government gaining increased tax receipts from the UK Continental Shelf, tax revenues had actually fallen by two-thirds since the 2011 fiscal change.

Subsequent developments

In December 2014, the government announced the supplementary charge would be reduced from 32% to 30%, with the aim of reducing further to encourage additional investment.

In March 2015, it was announced the supplementary charge was to be reduced from 30% to 20%.

In March 2016, the Chancellor announced the supplementary charge would be further cut from 20% to 10%, in reaction to continually falling oil prices. In addition, the PRT was reduced from 35% to 0%.

As a result, the top effective tax rate became 40%. Most UK oil fields were not profitable at the time, so the change was not expected to have immediate negative impact on tax revenues.

The evidence suggests that tax instability in 2011 significantly discouraged investment (especially in exploration) and incentivised production declines which will take years – if ever – to recover. The UK must now offer some of the most competitive terms globally in order to attract the investment required to address the impact of the 2011 fiscal policy changes.

[11] http://researchbriefings.files.parliament.uk/documents/SN00341/SN00341.pdf

Appendix 5: Summary of Petroleum Australia Assets[12]

Asset	Location	Production Commenced	Product / FY16 Volume	Lifecycle	JV Partners	Tax Position
Bass Strait (50%)	Bass Strait, Victoria	1969	Crude Oil & Condensate - 6,852 Mboe NGL [13] - 6,684 Mboe Natural Gas – 131 bcf **TOTAL: 35.3 MMboe**	Operations	Exxon Mobil (Operator)	Largest payer of PRRT in Australia and has been paying PRRT since 1990.
North West Shelf (8.33 % - 16.67%)	Karratha and offshore facilities, WA	1984	Crude Oil & Condensate – 4,834 Mboe NGL - 962 Mboe Natural Gas – 130.2 bcf **TOTAL: 27.5 MMboe**	Operations	Woodside (operator) Chevron Shell MIMI BP CNOOC	PRRT extended to NWS in 2012. NWS Project pays significant Royalties and Excise.
Pyrenees (39.999-71.43%)	25km off Exmouth, WA.	2010	Crude Oil & Condensate – 8,617 Mboe	Operations	Quadrant Inpex	Macedon & Pyrenees combined - commenced paying PRRT 2011
Macedon (71.43%)	Onshore Gas Plant – 17km South of Onslow, WA	2013	Crude Oil & Condensate – 3.6 Mboe Natural Gas – 50.4 bcf **TOTAL: 8.5 MMboe**	Operations	Quadrant	Macedon & Pyrenees combined - commenced paying PRRT 2011
Minerva (90%)	Timboon, Victoria	2005	Crude Oil & Condensate – 34.6 Mboe Natural Gas – 13.6 bcf **TOTAL: 2.3 MMboe**	Late Life (cease operations 2017)	Santos	Commenced paying PRRT 2011
Stybarrow (50%)	Field ~45km off coast of Exmouth WA	2007	Crude Oil – no production FY16	Awaiting decommissioning (ceased operations 2015)	Woodside	Commenced paying PRRT 2008
Scarborough (25-50%)	300km off the coast of WA	-	Natural Gas	Potential future development	Exxon Mobil (operator) Woodside	-

[12] All production and payment numbers are net BHP Billiton Share

[13] Natural Gas Liquids