

History and provisions of New Zealand's petroleum exploration and mining tax regime

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Background

New Zealand's petroleum exploration and mining tax regime has been through four significant changes in the past 35 years.

Prior to 1971, the regime for taxation of mining companies was statutorily unlike the taxation of other companies, and the calculation of the quantum of tax was dissimilar to how other companies calculated their income tax. Mining companies calculated their tax based on the amount of dividends distributed to their shareholders.

Due to increasing attention to exploration and commercial discoveries, a new tax regime was introduced in 1971. Consequently, all income was now subject to tax and all related exploration expenditure was deductible in the year it was incurred.

Arising from the concessionary nature of the regime, the Government introduced major changes in 1979 which had significant impact on resident petroleum mining companies, in particular the treatment of development expenditure. The change was from immediate write-off of development expenditure to now capitalising such costs, and amortising the development costs over five income years from the date of commercial production. The treatment accorded to non resident petroleum miners was similar apart from the timing of the deduction for development expenditure, commencing from the time the expenditure was incurred.

Major changes were brought about from a comprehensive review of the tax regime in 1990 - 1991. The Government considered the previous regime to be very concessionary. The previous regime allowed exploration expenditure to be deductible when incurred, development expenditure was written-off over five years, and farm-out arrangements had no effect for tax purposes.

The reform process commenced with a consultative document prepared by Treasury. Petroleum miners made submissions in relation to this document, and policy issues were considered by officials from Treasury, Inland Revenue, and the Energy Division of the Ministry of Economic Development.

The new regime provided for special treatment for the deductibility of expenditure, sale of assets, insurance recoveries, and farm-out arrangements.

The regime discarded the long standing principle of immediate deduction. All the expenditure of the petroleum miner (with minor exceptions) was considered to be petroleum mining development expenditure (including exploration costs). The expenditure was subject to amortisation over ten years from the later of, either the first year of commercial production, or the year the expenses were incurred.

Other significant changes related to:

- Where the permit was relinquished, or an exploratory well plugged or abandoned, or the assets were disposed of to a non associated person, then all deductions for the exploration expenditure became immediately deductible.
- Where the sale of the asset was to an associated person, the deferred deductions could be applied in that year, up to the amount that was received as consideration for the sale.
- Consideration received from the sale of shares in a controlled petroleum mining entity is assessable to the person selling the shares or trust interests with the cost price of the shares being deductible in the same year. In determining the costs, the market value of the petroleum interest as at 1 October 1990 is used, the rationale for this provision being to prevent the owners of controlled mining entities from selling their shares rather than the underlying assets, and therefore avoid paying any tax on any gain made in New Zealand.

Present petroleum tax regime

Overview

In 1991, the Government introduced the new regime to tax petroleum companies based on the concept of tax neutrality. The regime was changed to be more concessionary, and consistent with the taxation treatment accorded in the past. The measure was designed to encourage petroleum exploration companies to make investment decisions based on commercial considerations, rather than tax.

The general features of the present regime are:

- Exploration expenditure is deductible in the year it is incurred;
- Development expenditure is capitalised and amortised over seven income years. The timing of the deduction is dependent on whether the development is onshore, or offshore.
- In relation to onshore expenditure the amortisation commences from the later of:
 - (a) The year the expenditure was incurred or
 - (b) From the date of commercial production.
- In relation to offshore expenditure the timing of the amortisation of the deferred deduction commences from:
the year the expenditure was incurred.
- It should be noted that any balance in the deferred deduction account is written off the income year that:
 - (c) The petroleum mining permit is relinquished;
 - (d) There is a disposal of the interest in a specific permit;
 - (e) Given disposal of a permit specific asset, any deferred expenditure relating to that asset is available to be deducted in the year of disposal (sale).
- The cost of land is not included in the definition of development expenditure and accordingly not deductible.

Disposition to an associated person

There is a unique set of rules relating to sale of permit specific assets to an associated person. Typically the petroleum miner sells a permit specific asset to an associated person, and in the event the deferred deductions exceed the consideration received from the associated person, the deduction available to the petroleum miner is reduced to the extent of the consideration received.

Where the associated person sells the permit specific asset to a person, and that person is not an associated person, the associated person, may deduct the balance of the deferred deduction not previously available.

Damaged assets

The cost of repairing any permit specific asset is allowed as a deduction. Any compensation or insurance recovery is income in the year it is derived.

Removal and restoration expenditure

The expenditure incurred in removal and restoration operations is allowable as a deduction in the income year the expenditure is incurred. Removal and restoration operations include:

- the removal of permit specific assets; or
- the restoration of any site at which petroleum mining operations have been carried on.

Further, if the deduction for removal and restoration operations occur in a year in which the petroleum miner has made a loss, then the expenditure can be spread over proceeding years where the petroleum miner has paid income tax and receive a refund.

Farm-out arrangements

Farm-in expenditure is typically treated as development, or exploration, expenditure as the case may be. This means the expenditure will be deductible according to its classification.

Any expenditure incurred by the farm-in party is not typically treated as income to the farm-out party.

Tax losses

Losses incurred by a petroleum mining company may be offset against the tax liability of other companies in the same group. A common 66% shareholding is required for such an offset.

Tax losses are not available to be carried forward where there has been a change in shareholding, in the ultimate parent company, by more than 49%.

Income

Any profit made on the sale of an asset by a petroleum miner is regarded as income in the year of disposition. Furthermore any proceeds from the sale of rights, or exploration material, is regarded as income.

Significant change post 1991 regime

Effective from 3 December 2001 the sale of shares in a controlled petroleum mining entity is regarded as non taxable.

Non-industry specific legislation

Company taxation

Petroleum mining companies undertaking taxable activities in New Zealand are required to furnish an income tax return. Petroleum mining companies are taxed at the same rate as other companies whether those companies are resident in New Zealand or elsewhere, or undertaking their operations through a branch structure. The current rate of corporate tax is 33 percent based on net income of the company.

Goods and Services Tax (GST)

GST is imposed on consumption of most goods and services in New Zealand at the rate of 12.5%.

Joint Venture operations

With the majority of joint venture operations reviewed by Inland Revenue, the permit operator (entity owning the majority of the shares in a petroleum exploration/mining permit) is registered for GST. The joint venture is regarded as an unincorporated body, and as such, the members themselves are not liable to be registered. The operator would seek recovery of expenses from the other members, net of GST. The operator would recover any GST input tax from Inland Revenue.

Where the individual member disposes of their interest in an exploration permit the holder is required to impose GST. The change in the members of the joint venture is regarded as having no effect for GST

Withholding taxes

Three types of withholding taxes that may relate to the oil industry are:

(a) Pay as you earn (PAYE)

Foreign employees working in New Zealand are subject to income tax where their presence in New Zealand exceeds 92 days, or 183 days in certain circumstances.

PAYE is required to be deducted, and accounted to, Inland Revenue on all applicable remuneration derived whilst working in New Zealand.

(b) Non resident withholding tax ((NRWT)

Withholding tax is required to be deducted at source from any interest, dividends, or royalty payments paid to a non resident.

(c) Non Resident Contractors Withholding Tax (NRCWT)

Contract payments made to a non resident for certain work undertaken in New Zealand is subject to NRCWT. The rate of withholding tax which the payer is required to withhold from contract payments to the non resident is 15% of the gross payments. Where the non resident contractor fails to provide an IRD number, the rate of withholding tax reverts to a “non declaration rate” of 20%.

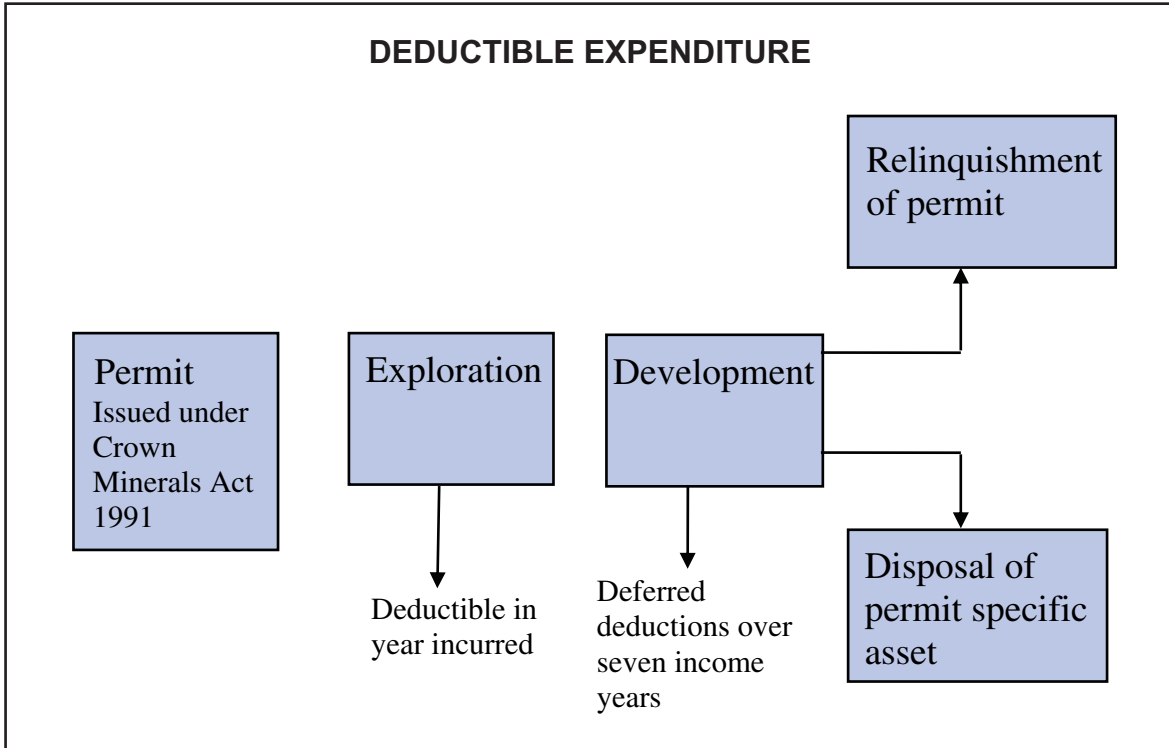
The NRCWT accounted to the Inland Revenue is an interim tax paid on account of any final income tax liability. If there is a reduced or nil, liability due to losses, the withholding tax maybe refunded to the non resident contractor.

Non resident contractors may be entitled to a special rate certificate, where the income tax payable is projected to be lower than the 15 percent withholding tax. The non resident contractor is expected to provide a projected profit forecast, which indicates that the expected profit will be less than the withholding tax which is going to be deducted from contract payments made to them. Alternatively, the non resident contractor may be entitled to an exemption certificate, resulting in a nil rate of withholding tax. This may arise from having a 24 month good history in New Zealand or other factors that are also considered under the relevant Double Tax Agreements entered into by New Zealand.

Author

Harsa Pancha is a senior investigator working in Corporates division of Inland Revenue. Harsa is presently working on the Resources sub-sector working with tax matters relating to upstream entities.

Appendix one



Appendix two

TAX RULES APPLICABLE IN FOLLOWING CIRCUMSTANCE

1. Tax rate

Resident 33 percent

Non resident 33 percent

2. Seismic

Write-off expenditure as incurred

3. Wildcat dry hole

Write-off expenditure as incurred

4. Discovery/Appraisal

Write-off expenditure as incurred

5. Development Wells

Offshore deferred deductions amortised over seven years

Onshore deferred deductions amortised the later of year expenditure incurred or commercial production begins

6. Field Development

Offshore deferred deductions amortised over seven years

Onshore deferred deductions amortised the later of year expenditure incurred or commercial production begins

7. Abandonment

Write-off balance of deferred development expenditure only when petroleum mining asset is sold or petroleum permit relinquished.

8. Removal and Restoration Expenditure

Immediate write-off. Petroleum miner who incurs a loss arising from claiming a deduction for removal and restoration expenditure can offset that expenditure against taxable income in previous year.

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PETROLEUM INDUSTRY DESK : Our role

- Initiate and maintain an excellent relationship with the Petroleum Exploration and Production Association of New Zealand Inc. (PEPANZ)
- Initiate and maintain an excellent relationship with the Crown Minerals group of the Ministry of Economic Development (MED)
- Develop and maintain expertise in relation to the petroleum industry



Our role continued...

- In consultation with PEPANZ set operational policy in relation to the industry to ensure clear, consistent and widely understood treatment
- Prepare and maintain an industry wide guide on what new entrants to the industry would like from Inland Revenue
- Identify industry taxation risk and co-ordinate compliance strategies to promote voluntary compliance

Our role continued...

- Interface with Policy Advice at IRD in relation to policy and legislative issues
- Undertake proactive advisory visits in relation to all major exploration and production operations.
- Provide timely educational material to Non Resident Contractors working in the upstream activities, including links to the NRCWT web page

Our role continued...

- Monitor and co-ordinate Service Delivery activity, especially audit activity
- Resourcing within Inland Revenue

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OPERATIONAL VIEWPOINTS FROM THE PERSPECTIVE OF THE INLAND REVENUE

Tax Compliance Issues Facing Participants Involved in the Upstream Oil and Gas Industry



Compliance Issues

- GST
- Income Tax
- PAYE

GST

- Registration
- Disposal of permit interest
- GST accounted in incorrect period
- GST must be recorded in NZ\$
- Transfers between taxpayers



Income Tax

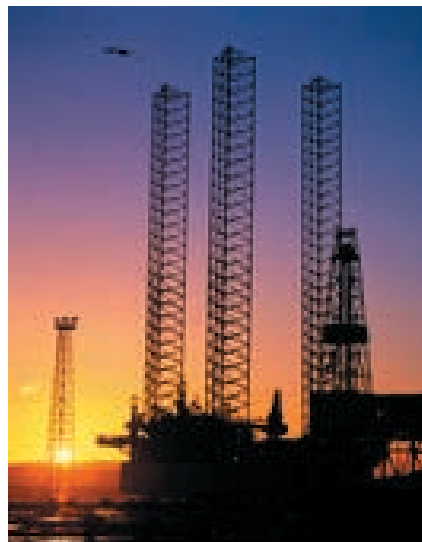
- Income tax returns
- Location of financial records
- Some Deductibility issues
 - Interest
 - Guarantee fees
 - Sale to related parties
- Change in parent company shareholding
- Reconciliation of expenditure

Income Tax continued...

- Exploratory well used for commercial production
- Timing for claiming deferred development expenditure
- Sale of permits/petroleum mining assets
- Distinction between off-shore and on-shore developments
- Non petroleum related issues

PAYE

- Registration of employees
- Accounting for PAYE
- Payments into an off shore bank account
- Taxation of world wide income



IRD Staff

- Experienced staff
- Timely responses
- Provide assistance

