

New Zealand Petroleum Conference 2006

Fiscal Initiatives

Presenters:

Geof Nightingale - Ernst & Young

Spencer Smith – KPMG

Outline

- Review the 2004 Package
- Look at Govt policy settings for further initiatives
- Consider constraints on new initiatives
- Review what more could be done
- Outline current status of the tax policy work programme
- Consider some royalty issues
- Draw some conclusions.

2004 Gas Exploration Package

- New discoveries – 30 June 2004 to 31 December 2009
- AVR 5% reduced to 1% on gas
- Remove ring fencing of exploration costs for APR purposes
- Carry forward of exploration costs at interest
- APR 20% reduced to 15% on first \$750m/\$250m of sales

2004 Package cont

- \$15m Govt funded seismic mapping
- Tax policy review announced
- Non-resident offshore drilling rig operators and seismic survey vessel exemption
- Estimated cost over the period \$100m.

Why this package?

- Gas only – security of supply for electricity
- Design criteria
 - Rapid implementation
 - Material impact on project economics
 - Low compliance and administration costs
 - Lowest practical distortionary impact
 - Consistent with other Govt policy settings, particularly tax policy.

The result

- Direct funding too risky
- Infrastructure funding not considered to be required
- Tax measures less timely and flexible
- Royalties became prime focus.

Tax policy settings

- Broad base
- Lowest rate possible
- Minimise investment distortion
- Neutral behavioural response
- Generic Tax Policy Process

Political settings

- IRD's crowded work programme
- United Future/NZ First support agreements commit resources to business tax review etc
- Neutral tax system remains the policy setting
- More complex support negotiations
- Radical and rapid change to fiscal settings hard to achieve.

Is “Very Good” good enough?

- No new fiscal initiatives in Petroleum Sector since 2004
- No significant progress on tax issues highlighted at 2004 Petroleum Conference
- Oil prices have virtually doubled since 2004
- No significant new gas discoveries
- Post-Katrina competition for rigs and crews
- Limited uptake of recent offshore block offer

Are fiscal initiatives out of favour?

- Studies for 2004 gas incentives programme showed that reasonably substantial Government concessions may have only **marginal effect on project economics**
- Official scepticism – view that scrapping AVR at 1% or 5% would have **no significant benefit** except in marginal projects (which would not cure NZ's gas shortage problem)
- Government's **fiscal position is tightening**

Unfinished Business

PEPANZ

- Tax loss preservation
- Exploration Well clawback
- Immediate deductions for dry or depleted wells
- Changes to 7 year amortisation period
- Tax exemption for oil rig support vessels

Other Initiatives

- Clarification of demarcation between Onshore/Offshore
- Functional currency reform
- PAYE exemption for foreign crews on rigs
- More sensible PE rules
- Clarification of GST rules for JV's
- Loss Flow-through Shares

Status of Tax Initiatives

Functional currency reform	Part of IFRS project
Exploration Well write-back	Under consideration
Immediate deductions for dry or depleted wells	Under consideration
Changes to 7 year amortisation period	Under consideration
Tax exemption for oil rig support vessels	Rejected
Clarification of demarcation between Onshore/Offshore	Under consideration
Tax loss preservation/Flow-through shares	Not on IRD's radar
PAYE exemption for foreign crews on rigs	Not on IRD's radar
More sensible PE rules	Not on IRD's radar
Clarification of GST rules for JV's	Awaiting priority

Royalties

- Controversy around meaning of “new discovery”

Rewrite of Royalty Programme	no policy change intended
“Gross Sales”	affecting hedging policy?
Scrapping AVR	“fair financial return”? wider national interest?

Conclusions

- International competition for petroleum investment is intense.
- NZ needs to think about keeping existing companies as well as attracting new investors.
- NZ needs juniors as well as mid-large operators.
- Royalty rethink - Production is the lifeblood of exploration.
- If the Industry wants tax changes that are not revenue neutral, it will need the support of MED i.e.
 - a whole of government effort is required
 - IRD's job is revenue gathering, not giving it away
 - IRD has competing demands on its resources