

New Zealand Petroleum Conference 2008

Petroleum Industry Tax Reform

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Industry specific reforms



Foreign Branch Announcement

- From 4 March 2008 (date of press release)
- Expenditure on petroleum mining operations undertaken through a foreign branch cannot be offset against petroleum mining income from NZ
- Perceived as a “loophole” by Government

Foreign Branch Announcement (cont)

What the foreign branch announcement won't change:

- Income from petroleum mining operations undertaken through a foreign branch will still be taxable in NZ
- Other industries will still be able to offset expenditure, from operations undertaken through a foreign branch, against their NZ income

Process from March 2006 leading to the Consultative Paper

- June 2006, PEPANZ Fiscal & Taxation Sub-Committee meet with IRD and Treasury
- July 2006, formal written submissions by PEPANZ to IRD Policy Advice Division on petroleum mining tax issues
- September 2006, PEPANZ makes submission on the Business Tax Review Discussion Document

Process from March 2006 leading to the Consultative Paper (cont)

- October 2006, IRD advises that it has suspended work on reviewing the PEPANZ submissions in order to prioritise policy development in the wider Business Tax Review
- June 2007, IRD has progressed a draft issues paper, but has been asked to hold it pending further consideration in the context of the Government's energy strategy
- November 2007, Consultative Paper "Suggested changes to the petroleum mining expenditure tax rules" released

Proposals contained in the Consultative Paper

- Remove the onshore-offshore distinction and allow amortisation deductions for development expenditure to occur from the date that the expenditure is incurred
- Allow taxpayers to elect to amortise development expenditure under either the current seven-year straight-line method or apply a new depletion method based on P50 or probable reserves

Proposals contained in the Consultative Paper (cont)

- Allow a deduction for production well expenditure when that expenditure fails to produce an income earning asset
- Clarify that GST input tax credits are allowed on the costs of restoration associated with a past taxable supply

PEPANZ submissions on the consultative paper

- Support for removal of onshore-offshore distinction
- Support for the proposal to allow the option of seven year or depletion basis amortisation of development expenditure, but submit:
 - that amortisation is based on P90 or proved reserves
 - that different amortisation bases are available for different assets in the same permit
 - diminishing value amortisation is also made available

PEPANZ submissions on the consultative paper (cont)

- Support for the proposal to allow a deduction for unsuccessful production wells, but submit that clarification is needed on deductions for depleted production wells
- Support for the proposal to clarify the availability of GST input tax credits on restoration costs

Next steps

- Submissions closed on the Consultative Paper on 17 January 2008
- Policy Advice Division of IRD consideration of the submissions
- If legislation is going to be introduced on Budget night, 22 May, then it is likely that the Minister has already signed off on policy
- The Consultative Paper suggests implementation from 1 April 2008

Other initiatives proposed by PEPANZ

- Extending the current rules for deferral of research and development expenditure deductions (designed to prevent forfeiture of tax losses carried forward on a change of shareholding), so they also apply to petroleum exploration and development expenditure
- Eliminating the clawback of deductions relating to exploratory wells when a well is used for commercial production

New Zealand / Australia Double Tax Agreement Renegotiation



Relevant Provisions of the Current (1995) DTA

- An Australian resident carrying on business in NZ is only liable for income tax in NZ if it has a 'Permanent Establishment' in NZ
- Definition of Permanent Establishment includes:
 - Carrying on activities which are connected with the exploration for or exploitation of natural resources situated in NZ
 - Substantial equipment is being used in NZ by, for or under contract with the Australian resident
 - Neither of these definitions have any time thresholds

Relevant Provisions of the Current (1995) DTA (cont)

- The natural resources provisions were reportedly introduced into the DTA as a result of negotiations by the Australians who wanted to tax NZ contractors working in Australia's mineral mining industry
- Similar provisions exist in some of NZ's other DTAs, in some cases six month time thresholds apply (notably the natural resources provision in the NZ / USA DTA)

Effect of Current Provisions

- Most Australian oilfield services companies, contractors and technical consultants carrying out services physically in NZ will be subject to NZ income tax (excluding contractors / consultants operating as individuals without company structures)
- The operator (or principal contractor if the Australian resident is a subcontractor) will be liable to deduct non-resident contractors' withholding tax from payments made to the contractor

Effect of Current Provisions (cont)

- Many contractors will seek a 'gross up' of the income tax or withholding tax in order to pass this cost on to the operator
- The ability for an Australian resident contractor to obtain tax exemptions for employees working in NZ is restricted
- Compliance costs can be significant, particularly in the context of smaller contracts

Renegotiation of the Treaty

- In January 2007 the NZ Minister of Finance and the Australian Treasurer announced that a process of renegotiating the DTA would commence
- In January 2008 the Ministers of Finance and Revenue invited comment on matters to be raised in the forthcoming negotiation
- The deadline for comments is 22 March 2008 and the first round of negotiations is expected to take place between 31 March and 4 April 2008
- These types of negotiations are usually a long process

Comments

- PwC will be assisting PEPANZ with comments
- Other affected organisations still have time to make comments
- Submissions can also be made to the Australian Treasury by 21 March

Comments (cont)

- Extract from Australia's Treaty practice statement:
 - “In order to preserve source country taxing rights over real property and natural resources, the definition of permanent establishment applies to a wider range of activities (including...natural resource activities, the operation of substantial equipment,...) and adopts shorter, specified time thresholds than the OECD model.”

Research and Development Tax Credits



Application of the Regime

- A Government cash subsidy of 15% of eligible expenditure, delivered through the tax system
- Applies from the 2008 / 2009 income year to activities undertaken mainly in NZ
- Generally applies only to expenditure that is deductible for income tax purposes (ie not capital), but can apply to capital expenditure on intangible assets and prototypes

Eligible Activities

Core eligible R&D activities must:

- Be directed at acquiring new knowledge or creating new or improved materials, products, devices, processes or services
- Be systematic, investigative and experimental
- Either:
 - Seek to advance science or technology by resolving scientific or technological uncertainty; or
 - Involve an appreciable element of novelty

Eligible Activities (cont)

- Supporting activities undertaken mainly or wholly for the purpose of, required for, and integral to, carrying out core activities, may also qualify for the tax credit

Relevance to Upstream Oil and Gas Industry

- “Prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy.” Is excluded from being a core activity
- Developing technology related to oil and gas exploration and production may be included if it meets the eligibility requirements

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