Submission Number: 002

TOTAL
COMMITTED TO BETTER ENERGY

TOTAL GLNG AUSTRALIA

13th April 2015

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13 April 2015
Finance and Administration Committee

The Research Director
Finance and Administration Committee
Parliament House
George Street
Brisbane Queensland 4000

Dear Sir/Madam

Finance and Administration Committee
Inquiry into the Payroll Tax Rebate, Revenue and Other Legislation Amendment Bill 2015

Total E&P Australia (***Total***) welcomes the opportunity to provide comments and submissions to the Finance and Administration Committee (the **Committee**) in response to the *Payroll Tax Rebate, Revenue and Other Legislation Amendment Bill 2015*, which was introduced into Parliament and referred to the Committee on 27 March 2015 (the ***Bill***).

Our submissions on the Bill are directed at the proposed amendments to the *Duties Act 2001* to give legislative effect to a duty concession for eligible farm-in agreements relating to exploration authorities, and transfers of interests in exploration authorities under such farm-in agreements.

Total has previously made comments and submissions to the Committee in response to the *Revenue and Other Legislation Amendment Bill 2014* (the ***Predecessor Bill***). As the amendments proposed by the Bill remain, in all material respects, the same as those that were proposed under the Predecessor Bill, we request that the Committee consider our submissions on the Predecessor Bill as submissions in response to the current Bill. For convenience, we **enclose** a copy of our previous submissions.

If the Committee would like us to elaborate on any of the issues raised in our submissions, we would be pleased to do so. In the first instance, please contact Sean Jermy on [redacted]

Yours sincerely

David Mendelson
Managing Director

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17 December 2014

The Research Director
Finance and Administration Committee
Parliament House
George Street
Brisbane Queensland 4000

Dear Sir/Madam

Finance and Administration Committee
Inquiry into the Revenue and Other Legislation Amendment Bill 2014

Total E&P Australia (***Total***) welcomes the opportunity to provide comments and submissions to the Finance and Administration Committee (the ***Committee***) in response to the *Revenue and Other Legislation Amendment Bill 2014*, which was introduced into Parliament and referred to the Committee on 26 November 2014 (the ***Bill***).

Our submissions on the Bill are directed at the proposed amendments to the *Duties Act 2001* (the ***Act***) to give legislative effect to a duty concession for eligible farm-in agreements relating to exploration authorities and transfers of interests in exploration authorities under such farm-in agreements.

About Total

Total is a wholly owned subsidiary of Total S.A., a French company listed on the Paris, London, Brussels and New York stock exchanges. It is the 5th largest international oil and gas company, operating in more than 130 countries, including Australia. The Total group is a major participant in Australia's oil and gas industry. It holds a 30 per cent interest as a participant in the Ichthys LNG Project, off the northwest coast of Western Australia, and a 27.5 per cent interest in the Gladstone LNG project. In late 2012, the Total group formed a joint venture with Queensland based, ASX listed company, Central Petroleum Limited to explore for oil and gas reserves in the Southern Georgina Basin, a region that extends from western Queensland into the Northern Territory. Total is also continuing to seek out other exploration opportunities throughout Australia, including Queensland

General comments on the Bill

As a general comment, Total welcomes the introduction of the Bill which provides much needed certainty as to the scope and administrative aspects of the duty concession which was first announced in the 2012-13 State Budget.

However, Total is concerned with particular aspects of the Bill that, unless addressed, are likely to mean that the concession falls short in achieving its intended policy objective of encouraging exploration expenditure in Queensland, as a means of reinvigorating growth in the mining and petroleum industries, and maintaining Queensland's international reputation as a stable and certain investment environment

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In summary, our concerns in relation to the Bill fall into two broad categories:

- For the concession to achieve its policy objective, the commercial context in which farm-in agreements are entered into needs to be properly understood and taken into account in the design of the concession. As outlined below, we have concerns that the Bill, in its current form, does not reflect this.
- In order to preserve Queensland's reputation for minimal sovereign risk and regulatory stability, the proposed amendments must be fully consistent with the administrative arrangement under which concession has been administered by the Office of State Revenue for the past 18 months.

We expand on both issues below.

1 Giving effect to the intended policy objectives

1.1 Key objectives

In the 2012-2013 State Budget, the Queensland Government announced that the transfer duty base was being expanded to impose duty on direct and indirect transfers of exploration permits and authorities to prospect (***ATPs***) in Queensland. Historically, such transfers were exempt from duty.

At the same time, it was announced that eligible farm-in agreements relating to exploration authorities and transfers of interests in exploration authorities under eligible farm-in agreements, would qualify for concessional duty treatment to ensure that duty would not be imposed on exploration and development expenditure under those agreements.

It is clear that the introduction of the farm-in concession is in direct response to, and evidence of, the government's commitment to encourage mining investment in Queensland.

1.2 Farm-in agreements in industry

In order for the concession to fully achieve its intended aim, the design and scope of the concession must align with the broader commercial context in which agreements of this kind are negotiated.

Farm-in agreements are most attractive to smaller exploration companies (who generally assume the role of farmor), as a mechanism to share the costs of exploration, and partition the high degree of risk generally associated with exploration activities. In the absence of farming out their mining or petroleum authority, the commercial reality for these companies is that it is often uneconomical to progress the exploration with any degree of certainty. Their lack of financial and technical resources can mean that proceeding to develop a project following a successful exploration is also generally not feasible.

The farmee, on the other hand, is typically a well-resourced and technically capable entity.

Against this background, it is common for the farmor to secure the involvement of the farmee as early in the exploration project as possible, often prior to the farmor becoming the registered holder of the authority (ie, while the authority is in the application phase). Generally, the farm-in agreement remains non-binding and conditional upon the grant of the authority.

Securing the early involvement of the farmee allows the farmor access to a broader technical and financial resource base. The technical capability of the farmee assists in the development of a project plan which, practically, increases understanding of the resourcing requirements of the exploration program, and allows parties to commence the tender process for procurement of those resources. For farm-in agreements entered into during the application phase of a project, this preliminary (often complex) planning and scoping work allows the parties to commence the exploration project promptly once the authority has been granted.

The involvement of the farmee at this earliest possible stage (eg, during the application phase) also reduces the perceived risk of the exploration project and increases market confidence in the project's potential success. This is the market's recognition of the farmee's experience in successfully completing comparable projects in the past, and the additional technical capability and financial security brought about through its involvement.

For the farmor, a reduction in the perceived risk of a project expands its capacity (by making it less expensive) to raise capital from debt and equity markets, and positions the farmor more favourably to meet their financial obligations under the farm-in agreement. Ordinarily, while the greater expenditure burden is borne by the farmee, the farmor retains a certain percentage of the project's overall exploration commitment under the farm-in agreement. If the farmor is able to secure its share of funding prior to the grant of the exploration authority, the project may commence without undue delay once the authority is granted.

Overall, the timely introduction of the farmee into the project accelerates exploration investment. It is from this investment that the government is able to realise the tangible benefits from these type of projects. For Queensland, these benefits include, increased:

- investment in the State;
- demand in employment;
- state royalty income; and
- supply of the resource for local and international markets.

The early involvement of the farmee into an exploration project is therefore directly aligned with achieving the policy objectives of the Queensland Government. The proposed farm-in concession to be introduced by the Bill should therefore facilitate obtaining the benefits that flow from the involvement of the farmee. But, in doing so, the design of the concession needs to properly recognise the resourcing constraints under which smaller exploration companies in the market operate, and the broader commercial context in which farm-in agreements are entered into. Any other approach would result in undue delay to exploration investment, and has the potential to encourage behaviours which are at odds with the policy objectives for which the concession was designed.

1.3 Implications for the Bill

Under the Bill, one of the requirements for the concession to apply is that the farmor must have been granted an exploration authority, even if the person is not yet registered as the holder. The relevant time for testing this is the time when the farm-in agreement is entered into. According to the explanatory notes to the Bill, where the farmor has applied for, but not been granted, an exploration authority at the time the agreement is entered into, the agreement will not qualify for the concession (even if the application is subsequently granted). The policy rationale for limiting the concession in this way is unclear.

Limiting the concession in the manner currently proposed essentially requires parties to defer entering into a farm-in agreement until after an authority has been granted, and prevents prospective farmors from securing exploration funding during the application phase. This undermines the commercial benefits outlined above, which include a farmor being able to enter into a farm-in agreement as early as possible.

We urge that consideration be given to expanding the Bill to enable agreements entered into during the application phase to qualify for the concession. This change could be accommodated by amending the definition of 'farmor' in section 84A to include a person who has applied for, but not yet been granted, an exploration authority. The definitions of 'upfront farm-in agreement' and 'deferred farm-in agreement' in sections 84B and 84C respectively should not require any amendment and, as currently drafted, would ensure that the concession only applies to dealings in the actual exploration authority (once granted) and not to dealings in the application for the authority.

In any case, the duty benefit of the concession only applies to monies spent on 'relevant exploration and development' (which can only apply to expenditure incurred after the exploration authority has been granted). Therefore, expanding the concession to enable the agreements to be entered into during the application phase will not have any consequential impact on the type of expenditure that qualifies for relief from duty.

It is relevant to note that other Australian jurisdictions that have sought to encourage exploration expenditure through a farm-in duty concession have also recognised the importance of a farmee's involvement in the early stages of an exploration project. The duty exemptions in South Australia and Northern Territory are designed to focus on the actual conveyance of the exploration authority, rather than the status of the exploration authority at the 'date of the agreement'. In doing so, it allows prospective farmors to secure exploration funding during the application phase, and reduces delay in exploration investment.

2 Consistency with existing administrative arrangements

2.1 Background to existing administrative arrangements

While the legislative design of the concession was being settled, the Office of State Revenue has been administering the concession under an administrative arrangement on the terms set out in public ruling DA000.12.1.

Since June 2013, the ruling has operated as a tool used by the Commissioner of State Revenue to anticipate the form of the proposed concession. In doing so, the Commissioner has confirmed that the payment of duty will not be required for transactions that fall within that identified scope.

In order to preserve Queensland's reputation for minimal sovereign risk and regulatory stability, the proposed amendments must be fully consistent with the administrative arrangement under which concession has been administered for the past 18 months.

2.2 Implications for the Bill

The Bill distinguishes between two different types of farm-in agreements – an 'upfront farm-in agreement' and a 'deferred farm-in agreement'.

The difference between the two types of agreements relate to the point in time at which the specified interest in the exploration authority is transferred by the farmor to the farmee.

- Under an upfront agreement the transfer is made subject to a condition that the farmee will incur a specified amount of exploration expenditure and, if the farmee fails to do so, the interest is transferred back to the farmor.
- Under a deferred agreement the transfer occurs only once the agreed amount of exploration expenditure has been incurred.

The explanatory notes to the Bill adopt the position that a farm-in agreement must be either an upfront farm-in agreement or a deferred farm-in agreement and that 'hybrid' agreements that allow for multiple transfers consisting of both up-front and deferred elements will not be eligible for the concession.

We have a number of observations about this limitation:

(a) Hybrid agreements are common in the oil and gas industry. These are designed to ensure that the farmee has some legal interest in the permit and the joint venture from the beginning of the investment. This reduces the risks associated with only having an equitable (or synthetic) interest, during a period of time when the farmee is already spending considerable sums of money on exploration and development. Limiting the concession so that it does not apply to these arrangements will severely undermine the likelihood of the concession applying to farm in arrangements in the oil and gas industry or require parties to these arrangements to alter their existing commercial practices. Neither is a desirable outcome.

(b) There is no stated rationale for the limitation other than 'simplicity of administration'. While efficiency of administration is obviously one of the considerations in the design of the concession regime, this needs to be weighed against the risk of undermining the clear policy objectives sought to be achieved.

(c) There is nothing in the Commissioner's public ruling to indicate that the concession would not apply to hybrid agreements. Paragraph 6 of the public ruling states that 'transfer duty will not apply to a farm-in agreement where the only consideration for the agreement is the exploration amount'. The term 'farm-in agreement' is then defined to mean a deferred farm-in agreement <u>and</u> an upfront farm-in agreement. In contrast, the Bill defines a farm-in agreement to mean a deferred farm-in agreement <u>or</u> an upfront farm-in agreement. The use of the word 'and' in the public ruling indicates that access to the concession was not intended to be dependent on the agreement being characterised as either an upfront agreement or a deferred agreement. There is nothing in the public ruling to suggest otherwise. In order to preserve Queensland's reputation for minimal sovereign risk and regulatory stability, the Bill must be fully consistent with the terms of the public ruling.

(d) There is nothing in the Bill that would prevent a farmor and farmee from entering into multiple farm-in agreements in respect of the same exploration authority – that is, they could enter into an upfront agreement in respect of some portion of the exploration authority and a separate deferred agreement in respect of another portion of the exploration authority. In that event, neither agreement would be a hybrid agreement – the transfers under each agreement would be either wholly upfront or wholly deferred. While this is a possibility, requiring parties to enter into separate agreements in order to access the concession would seem to run counter to the 'simplicity of administration' cited as the rationale for limiting the concession in the manner outlined in the explanatory notes.

(e) Denying relief for hybrid agreements is also hard to reconcile with the statement on page 11 of the explanatory notes that:

> [W]here a farm-in agreement deals with more than one exploration authority, the Duties Act 2001 will apply so that there will be separate dutiable transactions for the separate dutiable property constituted by each exploration authority (and any other dutiable property dealt with under the agreement). The one written agreement may therefore constitute a number of farm-in agreements – one for each exploration authority, with the conditions of the concession applied separately to each farm-in agreement.

If a single written agreement deals with more than one exploration authority, with some authorities dealt with on an upfront basis and others on a deferred basis, would that be regarded as a hybrid agreement?

For the reasons outlined, we regard the proposed treatment of hybrid agreements as problematic and urge that consideration be given to removing any restriction on hybrid agreements.

3 Other comments

The concession operates so that duty on the transfer of an interest in the exploration authority is limited to the consideration paid to the farmor (or a related person of the farmor) to enter into the farm-in agreement, other than the 'exploration amount' spent by the farmee. If there is no consideration other than the exploration amount, there is no duty payable.

As a general comment, we anticipate that one of the more contentious issues with applying the concession in practice will be identifying what constitutes part of the 'exploration amount' (which will be exempt from duty), as opposed to 'other consideration' which will be dutiable. Under the Bill, the exploration amount is limited to expenditure on exploration or development which is comprised of, or associated with, carrying out an activity under the exploration authority. It would seem that the taxpayer will bear the onus of demonstrating that the relevant expenditure is, firstly, on 'exploration and development' and, secondly, is 'associated with carrying out an activity under the exploration authority'.

The boundaries of what constitutes exploration and development has been, and continues to be, a contentious issue in an income tax context. It would seem that similar complexities will now arise in a duty context. The Bill does not elaborate on what constitutes 'exploration or development' but the Office of State Revenue has previously indicated that it may be open to providing published guidance on this by way of a public ruling. Guidance on this, plus the type of evidence that the Commissioner will require during the assessment process in order to be satisfied about the characterisation of particular expenditure, would be very welcome.

We trust that these comments are helpful. If the Committee would like us to elaborate on any of the issues raised in these submissions, we would be pleased to do so. In the first instance, please contact Sean Jermy on [redacted].

Yours sincerely

David Mendelson
Managing Director