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5 July 2017

Committee Secretariat
Finance and Expenditure
Parliament Buildings
WELLINGTON 6011

PEPANZ Submission: Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill

Introduction

This document constitutes the Petroleum Exploration and Production Association of New Zealand's (PEPANZ) submission in respect of the *Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill* ("the Bill"), which was introduced to Parliament on 6 April 2017. PEPANZ represents private sector companies holding petroleum exploration and mining permits, service companies and individuals working in the industry.

Regulatory certainty is very important for the petroleum mining industry given the significant capital investments that have been made and the long term nature of petroleum mining projects. The stability of fiscal policy settings is particularly important.

We thank you for the opportunity to submit on the Bill and we wish to speak to the Committee in support of our written submission.

Summary

PEPANZ is broadly supportive of the amendments to the petroleum mining decommissioning rules contained in the Bill. We support the replacement of the current spread-back mechanism for decommissioning losses with the proposed refundable credit mechanism, so long as specific elements of it remain consistent with the original policy intent. We also welcome the correction of unintended errors and clarification of identified issues in the current legislation.

This submission is in three sections:

- Definition of "decommissioning"
- Interaction of refundable credit with imputation credit accounts
- Miscellaneous drafting issues

Definition of "decommissioning"

Decommissioning is a major and necessary part of the life cycle of petroleum mining activities. It is an unavoidable cost that petroleum miners must incur to derive income from a field, but it is generally incurred at the end of field life when there is little or no income generated from the field. This results in an effective overpayment of tax throughout the life of a field. The policy behind the current spread-back mechanism and the proposed refundable credit is to enable petroleum miners to get a refund of that overpaid tax, so that the overall tax burden on them is appropriate having regard to their net income over the life of the field.

PEPANZ supports the removal of the requirement for decommissioning actions to be linked directly to the relinquishment of a permit. We also support the ability for decommissioning actions undertaken at any point during the life of the permit area to qualify for the refundable credit.

However, we consider that the proposed "decommissioning" definition (in clause 172(8) of the Bill) could be further improved:

- The definition as currently drafted focuses on the physical acts of removal/restoration and does not expressly cover many material aspects of the decommissioning process. In particular, the decommissioning process requires extensive planning, technical and environmental assessments, stakeholder, community and regulatory engagement, regulatory approvals, as well as management support and ongoing monitoring. These activities are all a direct part of undertaking the decommissioning work, and the costs involved are significant and equally as unavoidable and necessary for the derivation of income as the costs of other more "physical" decommissioning activities such as dismantling or removing structures, plugging and abandoning wells, and restoring sites of petroleum mining operations.
- The definition should, where possible, align with the current "removal or restoration operations" definition in order to eliminate the potential for any unintended change in meaning. For example, while PEPANZ is not opposed to removing the reference to the defined term "petroleum mining asset" and replacing it with a description, that description should use the same terminology as used in the "petroleum mining asset" definition (such as "asset" rather than "equipment or structure", and "acquired for the purpose of carrying on" rather than "used").
- The description of commercial wells in subparagraph (b)(i) requires minor revision to make clear that it covers all wells involved with the commercial production of petroleum, which includes producing wells as well as those that involve the injection of water and gas. For example, wells used for water injection, water disposal, gas reinjection and gas disposal can all be integral parts of a petroleum mining operation and would require plugging and abandoning as part of decommissioning. The addition of the words "directly or indirectly" is proposed to make this clear.
- We note there is a drafting error with subparagraph (b)(ii) of the definition of "decommissioning" (i.e. it is not possible for a well to be both within the permit area and in an area that is geologically contiguous to the permit area) and so it will need to be re-drafted. The inclusion of certain exploration wells through this subparagraph is supported in principle as there are a range of logical reasons why it could be appropriate to plug and abandon such wells in conjunction with the decommissioning of petroleum mining activities. In redrafting this subparagraph there are however some matters that need to be considered. It is appropriate for this to be limited to wells in the same permit area. We are comfortable with the use of "as part of an arrangement" based on the existing definition of "arrangement" provided elsewhere in the Act and recognising that decommissioning activities are commonly

undertaken pursuant to decommissioning plans. We note the term "geologically contiguous" could be open to a degree of interpretation when used in this context and could overlook wells for which there are appropriate reasons to align plugging and abandoning with wider field decommissioning. Consideration should also be given to the varying use of "plugged and abandoned" and "abandoned" in the current drafting.

- The definition of "decommissioning" clarifies that the ongoing monitoring of plugged and abandoned wells is included, but sub-clause (d) should equally cover the ongoing monitoring of restored sites of petroleum mining operations.

PEPANZ therefore submits that the proposed "decommissioning" definition be amended to read:

> **decommissioning**, for a petroleum miner or farm-in party, means –
>
> (a) dismantling, demolishing, or removing ~~equipment or structures used in~~ assets acquired for the purpose of carrying on petroleum mining operations other than those referred to in section CT 6B(2)(a) (Meaning of petroleum mining operations):
>
> (b) plugging and abandoning the following wells on a site, or former site, of petroleum mining operations –
>
> (i) a well (a **commercial well**), including any associated processing facility connected to the well, used directly or indirectly for the commercial production of petroleum:
>
> (ii) [*note comments above in the redrafting of subparagraph (b)(ii)*]:
>
> (c) restoring a site, or former site, of petroleum mining operations other than a part of the site that has been used only for an activity referred to in section CT 6B(2)(a):
>
> (d) the ongoing monitoring of a commercial well or exploratory well referred to in **paragraph (b)** that has been plugged and abandoned or a site referred to in **paragraph (c)** that has been restored:
>
> (e) planning, managing and executing the actions referred to in **paragraphs (a) to (d)**.

Interaction of refundable credit with imputation credit account (ICA)

The Commentary to the Bill states that a petroleum miner that is an ICA company will be required to have sufficient balance in its ICA to obtain a refund from the decommissioning refundable credit. This requirement arises under existing legislation in section RM 2(1B) (which treats the amount of a refundable credit as an amount of overpaid tax for the refund provision in section RM 2) and section RM 13 (which applies when an ICA company is entitled to a refund of overpaid tax under section RM 2 and restricts the amount of the refund to the credit balance in the ICA).

It is clear that the general provision in section RM 15(2), which allows an imputation credit that has been extinguished as a result of loss of shareholder continuity to be reinstated for the purpose of the refund limitation in section RM 13, is intended to apply to any refund arising from the proposed decommissioning refundable credit. Officials have stated that "Consistent with the existing general provision in section RM 15(2), this refund limitation will not apply to the extent the insufficient imputation credits arises from a loss of continuity." (refer Inland Revenue Consultation Letter of 11

August 2016, page 6). That statement is consistent with Inland Revenue's policy of limiting the refundable credit to tax paid by the petroleum miner irrespective of ownership changes.

However, it is not clear that the legislation achieves the intended outcome:

- Section RM 15(2) is drafted with the classic refund scenario in mind, where a taxpayer wishes to reopen an earlier return to claim a refund of tax that was overpaid in that year, but there has been a shareholder continuity breach in the intervening period between the overpayment and the claiming of the refund.
- For the purpose of the refund limitation in section RM 13, section RM 15(2) reinstates imputation credits that are lost on a shareholder continuity breach if the debit for loss of shareholder continuity arises "after a credit is made to the company's imputation credit account for an amount that has satisfied the company's income tax liability for the tax year" (emphasis added). This means that the imputation credits for the overpaid tax that is to be refunded must have arisen before the debit for the loss of shareholder continuity.
- It is not clear whether the above timing requirement would be met where the refund in question arises from a refundable tax credit (i.e. it is not clear which tax year is being referred to in the phrase "for the tax year" in section RM 15(2)). Although the proposed decommissioning tax credit in section LT 1 is calculated by reference to the amount of tax paid by the petroleum miner in previous years, the refundable tax credit itself arises in the year of decommissioning. Section RM 2(1B) deems the amount of refundable tax credit to be an amount of tax paid for the purpose of the operative refund provision in section RM 2, but it does not specify the year in which that deemed tax payment is made. Accordingly, it is not clear whether the relevant imputation credits could be said to have arisen before the debit for the loss of shareholder continuity as required by section RM 15(2).
- This is an issue that applies not only to the proposed decommissioning refundable credit under section LT 1, but potentially to all refundable tax credits.

PEPANZ submits that the legislation should be clarified to achieve the clear policy intent that section RM 15(2) applies to a refund arising from the proposed decommissioning refundable credit and reinstates any imputation credits that were lost on a shareholder continuity breach, so that the refund is not unduly limited by section RM 13. For example, a new subsection RM 15(3) could be added to provide that, in the case of a refund of a refundable tax credit, the ICA balance is treated as increased by the amount of a debit for loss of shareholder continuity, to the extent that the debit arises after the imputation credits for the tax paid previously which was taken into account in calculating the amount of the refundable tax credit.

Miscellaneous drafting issues

There are a number of minor drafting issues and cross-referencing errors that should be corrected:

- Section EJ 13 should be linked back to section DT 5 which is the operative provision for the deduction of petroleum development expenditure;
- Section LT 1(10) should refer to subsection (8) rather than subsection (9);
- The cross-referencing error in subsection IS 5(1)(a) has been corrected by replacing the incorrect reference to section DT 7 with section DT 5, but there is no express linkage between section DT 5 and the allocation provision in section EJ 13 (see above comment re section EJ 13);

- As section IS 5 is being deleted, the cross references to section IS 5 in sections EJ 12B(9) and EX 21(14) should also be deleted;
- As section EJ 14 is being repealed, sections DZ 5, EA 2, EA 3, EJ 17 and EJ 18(b) which currently refer to "sections EJ 12 to EJ [16, 17 or 20]" should also be amended;
- As the definition of "petroleum mining operations" is being amended to exclude references to "removal or restoration operations" or "decommissioning", "or decommissioning" should be added back in after the phrase "petroleum mining operations" in sections LT 2(1), LT 2(3) and the header to section DT 20; and
- As the definition of "petroleum mining company" is being deleted, the "controlled petroleum mining holding company" definition should be amended to refer to "petroleum miners" instead.