Energy Resources Aotearoa
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Submissions on the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill

Finance and Expenditure Committee
Submitted online

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Introduction

1. Energy Resources Aotearoa represents people and firms in the energy resources sector, from explorers and producers to distributors and users of natural resources like oil, LPG, natural gas and hydrogen.

2. This document constitutes Energy Resources' submissions to the Finance and Expenditure Committee on the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill.

Executive Summary

3. The term "plugging and abandoning" used within the definition of "decommissioning" in section YA 1 of the Income Tax Act 2007 ("the ITA") should not be amended to "permanently plugging and abandoning."

4. Paragraph (b)(ii) contained in the definition of decommissioning should not be repealed. We suggest that policy concerns are addressed by additional amendments to section LT 1 to narrow the scope for exploratory wells that qualify for the refundable tax credit claims. We have provided a possible solution for consideration by the Committee.

Stable and predictable tax settings are crucial

5. The petroleum mining industry requires continuity and certainty of tax policy to effectively plan and complete the decommissioning of wells and infrastructure. The scope of the existing definition of "decommissioning" was extensively consulted on and reviewed when the current rules were introduced in 2018 and the fundamental concept agreed at that time should not be subject to unnecessary disruptive changes.

6. The changes proposed to the definition of "decommissioning" are to address concern around unintended consequences of the current definition. However, it is also important to consider the unintended consequences of newly proposed changes, and the consultation process has not been the most conducive to that.

7. We express some disappointment that these changes were introduced to the bill without prior departmental consultation. Prior engagement would have provided an opportunity to work through what is in fact a substantial change in advance of it entering the more confined select committee process.

Energy security implications

8. As explained in the substantive recommendations, the current drafting may perversely incentivise the permanent abandonment of wells earlier than is efficient, purely for tax reasons. One perverse social implication of this is, on the margins, a reduction in domestic energy security. Given constraints on natural gas supplies and a tight energy outlook, policy makers should be careful to ensure that the provision of energy is not artificially discouraged through tax policy.

9. Briefly, on the matter of greenhouse gas emissions, all domestic emissions are priced under the Emissions Trading Scheme with its fixed and falling lid on total emissions – a policy we support. This tool can be relied upon to reduce emissions, meaning that tax policy should be left to do its proper job of efficiently raising Crown revenue.

Submission point one – term "plugging and abandoning" should remain unchanged

10. We submit that the term "plugging and abandoning" used within the definition of "decommissioning" in section YA 1 of the Income Tax Act 2007 ("the ITA") should not be amended to "permanently plugging and abandoning."

11. If the proposed amendment were to proceed, it will result in petroleum miners being unfairly denied the refundable tax credit under section LT 1 (tax credit).

12. Under current legislation, the tax credit is available to petroleum miners on a year-by-year basis, i.e., the tax credit is allowed in the petroleum miner's income year in which decommissioning expenditure is incurred (and decommissioning expenditure includes plugging and abandoning a well).

13. If section LT 1 was amended to "permanently" plugging and abandoning, due to the annual nature of the tax credit, a petroleum miner would be denied the tax credit for decommissioning costs incurred in an income year where work is being undertaken to plug and abandon that well permanently but that work has not been able to be completed by the end of the relevant income year.

14. If the requirement to "permanently" plug and abandon proceeds, this would result in behavioural changes with petroleum miners choosing to plug and abandon a well in order to be eligible for the tax credit.

15. Requiring a well to be abandoned removes optionality over any potential secondary use of that well and results in costs being incurred much earlier than would otherwise be the case.

16. Thus, if the proposed amendment is passed, it will be distortionary in that it will generate behaviour changes to avoid adverse economic results.

17. We note that the definition of "decommissioning" affects both the availability of the tax credit and deductibility of expenditure (section DT 16). Because of that, we consider that the definition should *not* be altered to ensure there are no unintended consequences or consequences beyond the policy concern on limiting certain access to the tax credit.

18. For the reasons set out above, we therefore recommend that the proposed amendment to require a well to be "permanently" plugged and abandoned not proceed.

Submission point two – paragraph (b)(ii) in the definition of "decommissioning" should remain unchanged

19. We submit that paragraph (b)(ii) contained in the definition of "decommissioning" is not repealed. We suggest that policy concerns are addressed by additional amendments to section LT 1 to narrow the scope for exploratory wells that qualify for the tax credit. We provide a possible solution below for consideration by the Committee.

20. The effect of not repealing paragraph (b)(ii) is that exploratory wells would continue to be subject to the decommissioning tax credit, subject to certain additional criteria being met (see our proposed solution in paragraph 23).

21. We understand that the policy concern over the definition of "decommissioning" as it currently stands is that it may cover exploratory wells that are drilled at a later life in the field even though the wells may not be intended to be used in the production process or may not

generate sufficient subsequent income from production against which decommissioning costs can be offset.

22. While a blanket removal of exploratory wells from the definition of "decommissioning" would likely address the policy concern, it would also have other significant unintended implications for petroleum miners where eligible exploratory wells could be denied access to the tax credit.

23. The eligibility for an exploratory well to access the tax credit should not depend on the timing of its decommissioning. Restricting the credit may incentivise petroleum miners to make sub-commercial decisions in order to ensure that tax relief is available for the costs. Tax rules should not interfere with a petroleum miner's decision on when exploratory wells are decommissioned; rather, the decision should be based on optimisation of operations, production and field life.

24. Allowing the petroleum miner to defer decommissioning of exploration wells until the decommissioning of other production wells (and related infrastructure) allows material cost efficiencies in the decommissioning process. For example, the required rigs and contractors need only to be bought into New Zealand once.

25. Our suggested solution to addressing the policy concern would be to exclude an exploratory well from qualifying for the tax credit if it is drilled towards the end of the field production life and there is insufficient subsequent income to cover the decommissioning costs of the well.

26. On the basis that late life exploration wells are the policy concern sought to be addressed, we submit that additional amendments are made to section LT 1 of the ITA to exclude any exploratory wells that fall within the above circumstances as opposed to repealing paragraph (b)(ii) of the "decommissioning" definition.

27. We note that the definition of "decommissioning" affects both the availability of the tax credit and deductibility of expenditure (section DT 16). Because of that, we consider that the definition should *not* be altered to ensure there are no unintended consequences or consequences beyond the policy concern on limiting certain access to the tax credit.

Conclusion

28. We appreciate the opportunity to submit on this bill. We are keen to constructively engage on this issue in a way that is mindful of the policy objectives being sought.