TR 2008/6EC - Compendium

Ruling Compendium – TR 2008/6

This is a compendium of responses to the issues raised by external parties to draft TR 2008/D2 – Petroleum resource rent tax and income tax: treatment of geosequestration expenditure and receipts

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

The compendium of comments provides references to TR 2008/D2. However references to TR 2008/6 are also given in brackets in the Response Column.

Summary of issues raised and responses

Issue No.	Issue raised	Response
1.	We are pleased that the Commissioner intends to issue a ruling dealing with the Petroleum Resource Rent Tax (PRRT) and Income Tax issues relevant to geosequestration. We believe it has the potential to assist taxpayers in a number of industries achieve a greater level of certainty when complying with their taxation obligations. We consider that the ruling should be issued soon to provide a foundation for ongoing possible future policy developments.	Noted.
2.	We have not participated in and are unaware of any formal policy consideration that has been given to how geosequestration activities should be treated under the PRRT and income tax legislation. We recommend that a final ruling be formally deferred until detailed discussions have been held between industry and the respective policy agencies.	A public ruling expresses the Commissioner's opinion of the way in which a relevant provision of the law applies, or would apply, to entities generally or to a class of entities. That opinion may be confined to a class of schemes or to a particular scheme. A possibility of policy and law change should not prevent the expression of the Commissioner's opinion on the way in which the provisions discussed in the ruling apply, or would apply, in relation to geosequestration expenditure and receipts.

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3.	The scope of the ruling should be extended to include other forms of carbon sequestration such as biosequestration – the establishment of carbon sink forests.	The Tax Office does not consider it appropriate to extend the scope of the ruling as suggested. We note that *Tax Laws Amendment (2008 Measures No. 2) Act 2008*, which received royal assent on 24 June 2008, introduced a specific income tax deduction for establishment expenditure on trees in carbon sink forests.
4.	Once carbon dioxide is removed from hydrocarbons being processed as external petroleum, it is not external petroleum and the further step involving the sequestration of the separated carbon dioxide does not involve the processing of external petroleum. Therefore, the consideration received to sequester carbon dioxide for another petroleum project is not an assessable tolling receipt for PRRT purposes, contrary to paragraph 11, example 2 in paragraph 42, paragraph 51, or example 4 in paragraph 56.	The tolling fee referred to in example 2 in paragraph 42 (44) and example 4 in paragraph 56 (62) is the fee paid for another PRRT project to process a petroleum stream from your PRRT project into marketable petroleum commodities of yours. Those examples are not referring to a fee paid for another PRRT project specifically to sequester some component of the stream, such as carbon dioxide. Paragraph 11 (11) states: > Any consideration receivable by a person in relation to the geological sequestration of something sourced from the processing of external petroleum in relation to a petroleum project is part of the assessable tolling receipts derived by the person in relation to that project and so is part of the assessable receipts derived by the person in relation to that project. Paragraph 51 (53) includes a statement to the same effect. As paragraph 61 (67) mentions, for the purposes of the Petroleum Resource Rent Tax Assessment Act 1987 (the PRRTAA), 'petroleum' has the same meaning as under the extended definition given to that term in section 6 of the Offshore Petroleum Act 2006 (at the time the draft ruling was issued, 'petroleum' had the same meaning as in section 5 of the Petroleum (Submerged Lands) Act 1967 which, for present purposes, was to the same effect) which relevantly is: (a) any naturally occurring hydrocarbon, whether in a gaseous, liquid or solid state; or (b) any naturally occurring mixture of hydrocarbons, whether in a gaseous, liquid or solid state; or (c) any naturally occurring mixture of: (i) one or more hydrocarbons, whether in a gaseous, liquid or solid state; and

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		(ii) one or more of the following, that is to say, hydrogen sulphide, nitrogen, helium and carbon dioxide; and: (d) includes any petroleum as defined by paragraph (a), (b) or (c) that has been returned to a natural reservoir; …. Although carbon dioxide once separated from hydrocarbons is no longer 'petroleum' or part of 'petroleum' as defined, the Tax Office considers that such carbon dioxide may reasonably be described as a 'constituent of petroleum' for the purposes of the definition of 'external petroleum' in section 2 of the PRRTAA. Therefore, the Tax Office considers that the geological sequestration of such carbon dioxide can be the 'processing of external petroleum' in relation to a petroleum project (which includes the stabilisation, transportation, storage or recovery of external petroleum in relation to the project) as defined in section 2 of the PRRTAA. Therefore, the Tax Office considers that consideration receivable to geologically sequester carbon dioxide separated from other constituents of 'petroleum' (as defined) recovered from an area or areas other than the production licence area or areas in relation to the project is 'consideration receivable by the person in relation to the processing of external petroleum in relation to the project' for the purposes of section 24A of the PRRTAA. Therefore, such consideration is assessable tolling receipts derived by the person in relation to the petroleum project and so is included in the assessable receipts derived by the person in relation to the project: see sections 23 and 24A of the PRRTAA.
5.	Very similar to comment 4. The draft ruling does not adequately discuss the basis for the conclusion that tolling receipts from processing another party's carbon dioxide are assessable tolling receipts for PRRT purposes.	See the response to comment 4. The Tax Office has added to paragraph 11 (11) in the ruling and expanded on paragraph 51 (53) in the explanation by adding paragraphs (54) to (57) on this point in line with the response to comment 4.

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6.	At paragraph 17, it is concluded that expenditure on the geosequestration of something from a source other than a petroleum project would be deductible (subject to the excluded expenditure provisions) if this is a legal requirement of the carrying on or providing of operations, facilities or other things of a kind referred to in sections 37, 38, or 39 of the PRRT Assessment Act (PRRTAA). However, the draft ruling fails to provide any detailed analysis of the legal provisions underpinning this conclusion in either the ruling or the explanation.	Paragraph 17 (17) is preceded by paragraph 16 (16) which states: > Geological sequestration of something that is not petroleum and is from a source other than a petroleum project is not generally part of the carrying on or providing of operations, facilities or other things of a kind referred to in sections 37, 38 or 39 of the PRRTAA even if the sequestration makes some use of petroleum project facilities. Therefore, expenditure on such geological sequestration is not generally deductible expenditure incurred in relation to a petroleum project. Paragraph 17 (17) makes the point nevertheless that where you geologically sequester something from a source other than a petroleum project because that is a legal requirement of the carrying on or providing of operations, facilities or other things of a kind referred to in sections 37, 38 or 39 of the PRRTAA in relation to a petroleum project, the expenditure you incur on that sequestration is deductible expenditure (of the class referred to in the relevant section among those three) incurred by you in relation to that project (provided that the expenditure is not excluded expenditure). In other words, the fact that such geological sequestration is a legal requirement of the carrying on or providing of operations, facilities or other things of a kind referred to in sections 37, 38 or 39 of the PRRTAA in relation to a petroleum project, means that your expenditure on such geological sequestration is not merely connected with, but rather is actually in, the carrying on or providing of operations, facilities or other things of a kind referred to in sections 37, 38 or 39 of the PRRTAA in relation to a petroleum project. The Tax Office has expanded the explanation in paragraph 63 (69) by adding paragraph (70) (which is along the lines of this response) to make this point clearer.
7.	The view expressed at paragraph 17 of the draft ruling appears to be at odds with that expressed by the Tax Office in disputes with taxpayers regarding the deduction provisions of the PRRTAA.	As explained in the response to comment 6, the view expressed at paragraph 17 (17) is entirely consistent with the views expressed by the Tax Office elsewhere concerning the close connection required for the purposes of section 37, 38 or 39 of the PRRTAA between the particular expenditure and the physical activities involved in the petroleum project. Indeed, the Tax Office notes that the Federal Court in *Woodside Energy Ltd* [2007] FCA 1961 considered at [276] that such a close connection is required for the purposes of section 38 of the PRRTAA.

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8.	In example 5, the draft ruling states that there is a requirement for the apportionment of expenditure. The ruling should state why there is a requirement for apportionment, what legal basis exists in the PRRTAA to achieve an apportionment and how this should occur.	Apportionment of expenditures is necessary and is clearly implied by the provisions of the PRRTAA. There are express apportioning provisions (such as subsection 37(2) of the PRRTAA, deeming apportionment in the context of the operation of the retention lease concepts and the allocation of exploration expenditure from larger exploration and retention lease areas to smaller production licence areas) only where there would be no reasonable basis for apportionment without such express provisions or where normal apportionment would be inconsistent with a specially desired outcome. Absent the clearly implied apportionment under the PRRTAA, potentially substantial mismatching could arise easily. The particular operation of section 41 of the PRRTAA illustrates how absurd any reading of the provisions without apportionment would be. Suppose the common case for which section 41 of the PRRTAA was clearly designed, that is, the case of joint venturers one of which (the operator) actually carries on and provides the operations of the petroleum project for all. If the provision were not clearly self-apportioning, each payment by another joint venturer to the operator would preclude any deduction by the operator for any part of the expenditure, because all the operations would be taken to be carried on by the other joint venturer to the exclusion of the operator. And the same would be true for each other joint venturer. This would be so obviously absurd that an apportioning interpretation must be applied. The same is true of a range of other provisions, including excluded expenditure provisions under the various paragraphs of section 44 of the PRRTAA, where without an apportioning interpretation either exclusions would fail to be applied when intended or would extend to parts of expenditure not meant to be excluded (depending on how the provision could be misconceived to operate without apportionment). The ruling is about geosequestration, both in the context of the PRRT and in income tax contexts. The apportionment out of other expenditure of deductible expenditure for the purposes of the PRRT explains and examples the operation of the ruling. Explanation of this kind does not require a ruling and an explanation of its own before the example and the explanation can be given.

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9.	In a number of places within the draft ruling the conclusion that geosequestration expenditure is deductible for PRRT purposes is caveated by stating that such expenditure will never be deductible if it is excluded expenditure. We disagree with the Commissioner's approach to interpreting section 44 of the PRRTAA [excluded expenditure] (as espoused in written and oral submissions in the *Woodside Energy* case). However, it is reasonably clear that if this position is maintained, much (if not all) of the geosequestration expenditure which the Commissioner concludes is deductible under the deduction provisions of the PRRT Act will be excluded expenditure and non-deductible under section 44 of the PRRTAA. If this is the position of the Tax Office, the ruling should state so and provide a detailed analysis of the reasons why. If this is not the position of the Tax Office, the ruling should state so and provide a detailed analysis of the reasons why.	This contention asserts that 'much (if not all) of the geosequestration expenditure…will be excluded expenditure and non-deductible'. The assertion lacks illustration or reasoning. It is not possible to identify in this assertion any particular category or categories of excluded expenditure which would apply particularly to all or most – or much – geosequestration expenditure. Paragraph 44(a) of the PRRTAA excludes payments of principal or of interest and other borrowing costs; no application of this paragraph to geosequestration expenditure more than any other expenditure is suggested. The same is true of paragraph 44(b) of the PRRTAA excluding the interest components of hire-purchase payments. Payments of dividends and the cost of issuing shares are excluded by paragraph 44(c); of the PRRTAA this has no obvious particular application to geosequestration expenditure, and nor has the excluded repayment of equity capital under paragraph 44(d) of the PRRTAA. Private override royalty payments excluded under paragraph 44(e) of the PRRTAA have no particular link to geosequestration expenditure. Those payments to acquire exploration permits, retention leases, production licences, pipeline licences or access authorities (or interests in them) other than in respect of their grant are excluded under paragraph 44(f) of the PRRTAA; geosequestration expenditure has no particular character of this kind, nor any character of being a payment to acquire an interest in petroleum project profits, receipts or expenditures excluded under paragraph 44(g) of the PRRTAA. Payments of Australian income tax excluded under paragraph 44(h) of the PRRTAA do not appear capable of ever being geosequestration expenditure otherwise, and nor do payments of GST excluded under paragraph 44(i) of the PRRTAA. Geosequestration expenditure does not appear unusually likely to be administrative or accounting costs or wages, salary or other work costs incurred indirectly and excluded by paragraph 44(j) of the PRRTAA. Geosequestration expenditure is unlikely to be paid in respect of land or buildings not adjacent to the project site and used for project administrative or accounting activities, excluded by paragraph 44(k) of the PRRTAA.

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10.	For each of the PRRT related examples set out in the explanation of the ruling, the Tax Office should express a view on the income tax treatment of the income and expenditure discussed.	Each of the PRRT related examples set out in the explanation of the ruling provides an example of the specific PPRT related point that immediately precedes the example. As such, those examples do not, and are not intended to, contain the detailed facts that would be necessary in order for meaningful views to be expressed on income tax aspects that might arise in different ways on different income-tax related factual applications of those basic scenarios.
11.	The comments and examples in the draft ruling tend to indicate that deductions that are allowable under sections 8-1 and 40-755 of the ITAA 1997 are limited to geological sequestration of a taxpayer's own emissions. We do not agree with such a position.	Paragraphs 19 to 21 (19 to 21) (and the associated paragraphs – 68 to 77 (75 to 84) – in the explanation) do not suggest, nor are they intended to suggest, that deductions under section 8-1 of the ITAA 1997 for expenditure on geological sequestration are limited to expenditure on geological sequestration of a taxpayer's own emissions. Paragraph 20 (20) specifically mentions in the context of deductibility under section 8-1 of the ITAA 1997 of expenditure on geological sequestration that a taxpayer's expenditure on geological sequestration can have a sufficient connection with the operations or activities which more directly gain or produce the taxpayer's assessable income through the taxpayer deriving assessable income, or carrying on a business for the purpose of deriving assessable income, from carrying out geological sequestration. Such geological sequestration would obviously be of something of other taxpayers. Further, in paragraph 71 (78), it is explained that expenditure on geological sequestration can have a sufficient connection with the operations or activities which more directly gain or produce the taxpayer's assessable income even where the geological sequestration is carried out for reasons related relatively indirectly to assessable income production. The example is given that geological sequestration could be carried out by a taxpayer with the capacity to do it, so as to create a favourable impression of the taxpayer's assessable income earning activity or business carried on for the purpose of deriving assessable income. Such geological sequestration could obviously be of something of other taxpayers.

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		Further, the statement in paragraph 21 (21) that: > [a] taxpayer's expenditure on geological sequestration that is done to ameliorate any adverse effects upon the environment of the taxpayer's mining or other industrial activity carried on for the purpose of deriving assessable income or in carrying on its business for the purpose of deriving assessable income is likely to have a revenue, rather than capital, character …, is able to apply to a taxpayer's expenditure on geological sequestration of something of other taxpayers provided that such geological sequestration is done for the purpose set out in that statement. Section 40-755 applies to your expenditure for the sole or dominant purpose of carrying on environmental protection activities. These may only relate to pollution or waste from your earning activity, of or from a site of your earning activity, or of or from a site where an entity was carrying on a business that you have acquired and carry on substantially unchanged as your earning activity ('your predecessor business site'). Your environmental protection activities (carried on by or for you) include preventing, fighting or remedying this pollution, or treating, cleaning up, removing or storing this waste. Your environmental protection activities do not extend to preventing, fighting or remedying pollution from someone else's activities, or of or from someone else's site or predecessor business site even if such pollution is equivalent to the pollution from your earning activity, or of or from a site of your earning activity or your predecessor business site. Similarly, your environmental protection activities do not extend to treating, cleaning up, removing or storing waste from someone else's activities, from or on someone else's site or predecessor business site even if such waste is equivalent to the waste from your earning activity, or on or from a site of your earning activity or your predecessor business site.

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		However, the nature of the pollution resulting from your earning activity, or from a site of your earning activity, or from your predecessor business site, may be such that on its entry into the atmosphere it becomes an indistinguishable part of a common pool of material of the same nature already in the atmosphere (for example, as may happen when a greenhouse gas such as carbon dioxide is released into the atmosphere). For the purposes of section 40-755 you (or someone else for you) can be 'fighting or remedying' such pollution by extracting from the common pool (to which the pollution resulting from your earning activity, or from a site of your earning activity, or from your predecessor business site was added) and geologically sequestering an amount of the polluting material, up to the amount that entered the pool resulting from your earning activity, or from a site of your earning activity, or from your predecessor business site, as relevant. To that extent, costs of your geosequestration can be deductible under section 40-755 (and applicable deductions in relation to depreciating assets can be available) as relating to environmental protection activities and as relating to a taxable purpose, even where section 8-1 and the other capital allowance provisions would not apply. Beyond that amount, your geosequestration cannot be 'fighting or remedying' pollution from that source and so the rules relating to environmental protection activities would not apply. The Tax Office has expanded on paragraph 24 (24) by adding paragraphs (25) and (26) in the ruling and expanded on paragraph 87 (94) by adding paragraphs (95) and (96) in the explanation, in line with the previous two paragraphs in this response to make these points clearer.
12.	The ruling seems to unnecessarily quote large sections from another ruling in paragraph 67, particularly when it is then summarised in paragraph 68. In addition, there seems to be an inappropriate and unnecessary emphasis on the need to identify the genuine nature of arrangements.	The quote in paragraph 67 (74) from Taxation Ruling TR 2006/2 allows general principles concerning the application of the 'positive limbs' of section 8-1 to be comprehensively set out in a general way wholly consistent with current published views of the Commissioner, therefore providing a transparent basis for the summary (in paragraph 68 (75)) of the application of those general principles specifically to expenditure on geological sequestration.

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13.	The draft ruling does not consider the application of the specific exploration provisions in subdivision 40-H of the ITAA 1997.	The Tax Office assumes this is a reference to section 40-730 of the ITAA 1997 as it is the only provision in subdivision 40-H that deals specifically with exploration. Expenditure on exploration or prospecting for minerals or quarry materials obtainable by mining operations is deductible under section 40-730 subject to various specific limitations and exclusions. Seeking to locate a suitable site for geosequestration, even if in some sense involving exploration, is not itself exploration or prospecting for minerals or quarry materials within that section and so the section has no direct application to geosequestration appropriate for consideration in this ruling.
14.	The draft ruling does not consider the interaction with the mining capital expenditure provisions under section 40-860 of the ITAA 1997.	Whether and in what circumstances particular expenditure related to geosequestration is mining capital expenditure does not depend on or relate to the general character of expenditure as being related to geosequestration. As no particular interaction or application of facts have been raised, and as no matters of uncertain technical interpretation have been identified, no addition to the ruling in this respect is proposed.
15.	The ruling needs to state clearly (and support with examples) the Commissioner's opinion as to what kinds of geosequestration expenditure are deductible under section 40-755 and what kinds are not deductible.	Section 40-755 and the relevant limitations and exclusions in sections 40-760 and 40-765 express general rules which are to be applied to particular facts, rather than elaborating highly specific rules for particular kinds of expenditure or particular kinds of environmental protection activity. The discussion in the ruling and in the accompanying explanation is considered appropriate to the legislative context. No particular interpretative issues about particular expenditures have been identified by comments on which a further specific view in the ruling is considered warranted.
16.	It is not clear in paragraph 87 of the draft ruling whether or not the examples are environmental protection activities.	The examples in paragraph 87 (94) have been replaced with expanded explanation as described in the response to comment 11.