TR 2018/1 - Petroleum resource rent tax: character of expenditure incurred in relation to abandonment, decommissioning and rehabilitation activities undertaken on a part of a petroleum project

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Taxation Ruling

Petroleum resource rent tax: character of expenditure incurred in relation to abandonment, decommissioning and rehabilitation activities undertaken on a part of a petroleum project

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This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Summary – what this ruling is about

1. This ruling is about the characterisation of abandonment, decommissioning and rehabilitation expenditure (ADRE) incurred on a part of a petroleum project prior to a project being completely closed down.

2. In particular, we discuss whether ADRE incurred on a part of a petroleum project in such circumstances falls under sections 38 (about general project expenditure) or 39 (about closing-down expenditure) of the *Petroleum Resource Rent Tax Assessment Act 1987*.[1] ADRE that falls under either section 38 or 39 may be deductible.

[1] All legislative references in this Ruling are to the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRTAA 1987).

Ruling

Closing-down expenditure

3. ADRE will not be closing-down expenditure under subsection 39(1) while the production of petroleum[2] or marketable petroleum commodities[3] continues in another part of the petroleum project.

4. In the case of a combined project, ADRE activities in one production licence area cannot give rise to closing-down expenditure while production continues in the other production licence areas of that project.

5. ADRE incurred on activities to partially decommission and rehabilitate the petroleum project will not be expenditure incurred in closing down the entire project as a whole.

6. Where you make a decision, with a clearly defined plan, to imminently and permanently cease production from the entire project area, we accept that closing-down activities may occur progressively and in continuous stages over the project area. In these cases, you must consider all relevant circumstances objectively to determine whether there is closing-down expenditure.

General project expenditure

7. ADRE can be general project expenditure under section 38 while production of petroleum or marketable petroleum commodities continues in another part of the petroleum project.

8. ADRE activities in one production licence area of a combined project can give rise to general project expenditure while production continues in other production licence areas of the project.

9. ADRE can be general project expenditure under section 38 to the extent that it is incurred in carrying on or providing the operations, facilities or other things comprising the project and is not excluded expenditure[4], exploration expenditure[5] or closing-down expenditure.[6]

10. When discerning whether a payment is general project expenditure under section 38, the taxpayer's purpose in incurring the expenditure is irrelevant. What needs to be determined is whether the liability to make the payment in question has the requisite close and direct connection with the carrying on of the physical activities comprising the project (the nexus test).[7]

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[2] As defined in section 2.
[3] As defined in section 2E.
[4] As defined in section 44.
[5] As defined in section 37.
[6] As defined in section 39.
[7] *Woodside Energy Ltd v. Federal Commissioner of Taxation (No. 2)* [2007] FCA 1961 at paragraph 276 per French J; and *Esso Australia Resources Pty Ltd v. Federal Commissioner of Taxation* [2012] FCAFC 5 (the *Esso Case*) at paragraph 93 per Keane CJ and Edmonds J.

11. To this end, the character of the expenditure is to be ascertained at the time at which the liability to make the payment is incurred by reference to the arrangements under which it is incurred.[8] A liability is incurred when it is a presently existing liability to which the taxpayer is completely subjected and definitively committed.[9]

Date of effect

12. This Ruling applies to years of income commencing both before and after its date of issue. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
24 January 2018

[8] The *Esso Case* at paragraph 98 per Keane CJ and Edmonds J.
[9] *New Zealand Flax Investments Ltd v. Federal Commissioner of Taxation* (1938) 61 CLR 179; *Federal Commissioner of Taxation v. James Flood Pty Ltd* (1953) 88 CLR 492; *Nilsen Development Laboratories Pty Ltd & Ors v. Federal Commissioner of Taxation* (1981) 144 CLR 616; *Marbren Pty Ltd v. Federal Commissioner of Taxation* 84 ATC 4783.

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

What is a petroleum project?

13. For the purposes of the PRRTAA 1987, there is a separate petroleum project in relation to each production licence that is in force unless the production licence is specified in a project combination certificate or is part of the Bass Strait project or the North West Shelf project.[10]

14. The Bass Strait project and the North West Shelf project respectively consist of all the production licences derived from the specified exploration permits for those projects.[11]

15. Where two or more production licences are specified in a project combination certificate that is in force, they are considered a single petroleum project (the combined project).[12]

16. The combined project continues to exist in relation to the production licence(s) that remain in force as long as any one or more of the production licences specified in a project combination certificate remain in force.[13]

Closing-down expenditure

17. Subsection 39(1) provides that closing-down expenditure incurred by a person in relation to a petroleum project comprises of payments (not being excluded expenditure[14]) of a capital or revenue nature to the extent that they are made by the person in carrying on operations involved in closing down the project, including in any environmental restoration as a consequence of closing down the project.

18. Where closing-down expenditure, after taking into account other deductible expenditure in a year of tax, exceeds a person's assessable receipts in that year, a credit may be available under section 46 in relation to the excess closing-down expenditure.

Meaning of closing down a project

19. The Explanatory Memorandum (EM) to the Petroleum Resource Rent Tax Assessment Bill 1987 (the 1987 Bill) explains that 'closing-down expenditure incurred by a person in relation to a petroleum project':[15]

[10] Subsection 19(1).
[11] Subsections 19(1A) and (1B).
[12] Subsection 19(2).
[13] Subsection 19(3).
[14] As defined in section 44.
[15] Clause 39.

> ...consists of capital or revenue payments … made in carrying on operations involved in closing down a petroleum project. For this purpose, a project would not be taken to be closing down by reason of a temporary cessation of activities… Expenditure on the removal of, for example, a drilling platform from a production licence area as part of closing-down the petroleum project would ordinarily qualify as closing-down expenditure, although the deductibility of such expenditure (as closing-down expenditure) in relation to a combined project would depend on whether the platform was merely being moved to another production licence area of the project or whether activities for petroleum recovery in all licence areas of the combined project had ceased.

20. A project is closed down when the last related production licence, and the operations in relation to recovery under it, end.[16] If there is ongoing production in one or more of the production licence areas of a combined project, the combined project is neither closed down nor is it in the process of being closed down. The EM to the 1987 Bill confirms this in its explanation of *Division 4 Tax Credits* where it states:

> …Any credit will only be available where the whole project is being closed down. It would not be available in respect of expenditure on closing down only one of the production licence areas comprising a combined project while petroleum was still being recovered in another of the project's production licence areas.

21. It is clear from the above that closing-down expenditure will only be incurred in relation to a combined project if petroleum recovery activities in all production licence areas of the project cease. A partial closing down of such a project will not satisfy the requirements for closing-down expenditure in subsection 39(1).

22. Similarly, closing-down expenditure in relation to a single production licence petroleum project will only be incurred if the whole project is closing down. Closing down of some wells and rehabilitation activities in that area while production from other wells is to continue will not give rise to closing-down expenditure.

23. Expenditure that does not qualify as closing-down expenditure could, however, be general project expenditure under section 38.

General project expenditure

24. Subsection 38(1) provides that 'general project expenditure incurred by a person in relation to a petroleum project' comprises payments (not being excluded expenditure, exploration expenditure or closing-down expenditure) of a capital or revenue nature to the extent they are made by the person, among others, in carrying on or providing the operations, facilities and other things comprising the petroleum project.

[16] Paragraph 3.4 of the EM to the Petroleum Resource Rent Tax Assessment Amendment Bill 2006.

25. A payment is taken to be made by a person when that person becomes liable to make the payment.[17]

Meaning of 'operations, facilities and other things comprising the petroleum project'

26. Subsection 19(4) defines the 'operations, facilities and other things comprising the petroleum project' to include operations and facilities carried on or provided for an environmental purpose, in relation to the carrying on or provision of the operations, facilities and services referred to in section 19.[18]

Meaning of 'environmental purpose'

27. The EM to the Petroleum Resource Rent Tax Assessment Amendment Bill 2011 does not explain exhaustively when operations and facilities are carried on or provided for an environmental purpose. However, the EM makes it clear that environmental requirements must be met and as such environmental expenditure can be incurred before, after and throughout the life of a petroleum project when certain environmental requirements must be complied with.[19]

28. 'Requirements' in this context includes 'exigencies' and 'expediencies', whether of a commercial, social or ethical nature, rather than being strictly limited to 'legal or contractual obligations'.[20]

29. The Commissioner takes the view that an 'environmental purpose' is to be construed broadly such that abandonment, decommissioning and rehabilitation activities that can be undertaken for an environmental purpose can include the:

- removal of property brought into the relevant permit, lease or licence area
- plugging and closure of wells in the relevant permit, lease or licence area
- conservation and protection of natural resources in the relevant permit, lease or licence area, and
- making good of any damage or disturbance to the seabed or subsurface in the relevant permit, lease or licence area.

Example

30. *Petroleum Co holds an interest in a petroleum project comprised of PL1, which has two operating wells. Petroleum Co incurs ADRE to plug and abandon one of the wells after it is depleted. Petroleum recovery operations continue at the other well.*

[17] Subsection 38(3).
[18] Subparagraph 19(4)(b)(vi).
[19] Paragraphs 4.5 and 4.14–4.22 of the Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Amendment Bill 2011.
[20] The nexus test must still be satisfied: see paragraph 10 of this Ruling.

31. *Petroleum Co, through its participation in the ABC joint venture also holds an interest in a combined* petroleum *project comprising production licences PL2, PL3 and PL4. The joint venturers decide to cease further petroleum production from the production licence area bounded by PL4 as it is no longer economic, and they commence abandonment, decommissioning and rehabilitation activities in that area.*

32. *Petroleum production from PL2 and PL3 continues. Petroleum Co incurs its share of ADRE for the PL4 area. These activities are carried out in a manner that ensures the ongoing petroleum recovery and processing operations involving PL2 and PL3 can safely continue.*

33. *The ADRE incurred by Petroleum Co on both the first well in PL1 and in PL4 will not constitute closing-down expenditure under subsection 39(1). This is the case despite it permanently ceasing petroleum recovery from one of the wells on PL1 and from PL4 and the expenditure is incurred on environmental restoration as a consequence of petroleum recovery operations undertaken at these sites.*

34. *The ADRE is not closing-down expenditure for the purposes of subsection 39(1) because:*

- *when the ADRE is incurred, production has not ceased from the entire project, or all the production licences comprising the project specified in the project combination certificate (in the case of the combined project), and*
- *there is no decision or plan to close down the entire project permanently.*

35. *The ADRE is incurred by Petroleum Co in carrying on or providing the operations, facilities or other things comprising the project (or combined project). The ADRE is not exploration expenditure or closing-down expenditure. The ADRE is incurred for an environmental purpose in relation to the carrying on, or provision of, the operations, facilities and other things comprising the particular project.*

36. *In light of the above, the ADRE incurred by Petroleum Co on the first well in PL1 and in PL4 will constitute general project expenditure of each respective project under section 38, to the extent the ADRE does not comprise excluded expenditure.*

Appendix 2 – Detailed contents list

37. The following is a detailed contents list for this Ruling:

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References

Previous draft:

TR 2017/D9

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- PRRTAA 1987
- PRRTAA 1987 2
- PRRTAA 1987 2E
- PRRTAA 1987 19
- PRRTAA 1987 19(1)
- PRRTAA 1987 19(1A)
- PRRTAA 1987 19(1B)
- PRRTAA 1987 19(2)
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- PRRTAA 1987 19(4)
- PRRTAA 1987 19(4)(b)(vi)
- PRRTAA 1987 37
- PRRTAA 1987 38
- PRRTAA 1987 38(1)
- PRRTAA 1987 38(3)
- PRRTAA 1987 39
- PRRTAA 1987 39(1)
- PRRTAA 1987 44
- PRRTAA 1987 46
- TAA 1953

Cases relied on:

- Esso Australia Resources Pty Ltd v. Federal Commissioner of Taxation (2012) 200 FCR 100; [2012] FCAFC 5; (2012) 87 ATR 124; [2013] ALMD 3086; [2013] ALMD 3087; [2013] ALMD 3088;
- Federal Commissioner of Taxation v. James Flood Pty Ltd (1953) 88 CLR 492; [1953] HCA 65; (1953) 10 ATD 240; (1953) 5 AITR 579; (1953) 27 ALJR 481; [1953] ALR 903
- Marbren Pty Ltd v. Federal Commissioner of Taxation 84 ATC 4783; (1984) 15 ATR 1145; (1984) 75 FLR 439
- New Zealand Flax Investments Ltd v. Federal Commissioner of Taxation (1938) 61 CLR 179; [1938] HCA 60; (1938) 5 ATD 36; (1938) 1 AITR 366; (1938) 12 ALJ 313; [1939] ALR 1
- Nilsen Development Laboratories Pty Ltd & Ors v. Federal Commissioner of Taxation [1981] HCA 6; (1981) 144 CLR 616; (1981) 11 ATR 505; 81 ATC 4031; (1981) 55 ALJR 97; (1981) 33 ALR 161
- Woodside Energy Ltd v. Federal Commissioner of Taxation (No. 2) [2007] FCA 1961; (2007) 69 ATR 465

Other references:

- Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Bill 1987
- Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Amendment Bill 2006
- Explanatory Memorandum to the Petroleum Resource Rent Tax Assessment Amendment Bill 2011

ATO references

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