



PCG 2016/13 - Petroleum Resource Rent Tax - deductibility of general project expenditure

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Petroleum Resource Rent Tax – deductibility of general project expenditure

Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this Guideline is about

1. This Guideline explains how we will allocate compliance resources according to our assessment of risk in relation to the application of section 38 of the *Petroleum Resource Rent Tax Assessment Act 1987* (the Act).

Date of effect

2. This Guideline will apply in relation to general project expenditure that is actually incurred (or taken by Division 5 of Part V of the Act to be incurred) on or from 1 July 2015 by an entity in relation to a petroleum project.

What entities are covered by this Guideline?

3. This Guideline is intended to cover an entity that is entitled to derive assessable petroleum receipts in relation to a petroleum project in a financial year.

Background

4. Generally a payment is deductible under section 38 of the Act as general project expenditure where it is not excluded, exploration or closing-down expenditure, and:

- (a) it has a close or quite direct connection with the physical activities of the petroleum project, and
- (b) it can either be traced or reasonably allocated to the operations, facilities or other things set out in subsection 19(4) of the Act.

5. Generally a payment will not be deductible as general project expenditure where it is too remote from the physical activities of the petroleum project or future petroleum project, or only has an incidental connection with such activities.

6. Payments that cannot be reasonably allocated to the operations, facilities and other things in subsection 19(4) of the Act will be considered 'indirect' for the purposes of paragraph 44(1)(j) of the Act.

7. Section 112 of the Act requires a person to keep records that record and explain all transactions and other acts including deductions for general project expenditure, that are relevant to ascertaining the person's liability under the Act.

8. The approach set out in this Guideline also applies to payments made to procure the carrying on or providing of operations, facilities or other things of a kind described in section 38 of the Act by another entity where paragraph 41(1)(d) of the Act applies.

Expenditure type that is outside the scope of this Guideline

9. This Guideline does not cover the overhead component of a time written cost charged to a joint venture billing statement or sole risk operation account to the extent that the expenditure is actually incurred (or taken by Division 5 of Part V of the Act to be incurred) on or from 1 July 2015.¹

Allocation of compliance resources – expenditure types we consider to be low risk

10. Paragraph 11 of this Guideline sets out examples in relation to various activities that are described as low risk for the purposes of this Guideline. We will not generally apply significant compliance resources to examining whether these expenditure types qualify for deduction under section 38 of the Act to the extent that an entity satisfies the relevant provisions of the Act² and the following conditions:

¹ This type of expenditure is the subject of Practical Compliance Guideline PCG 2016/12 *Petroleum Resource Rent Tax - deductibility of general project expenditure relating to the overhead component of time written costs*.

² Subsection 19(4) and sections 38 and 44 of the Act.

- (a) the payment or part payment does not include a cost relating to a downstream asset or activity, and
- (b) the Commissioner is satisfied that the entity keeps records in accordance with section 112 of the Act including using reliable systems, processes, procedures and policies to reasonably capture, record and allocate payments to the petroleum project.

11. Low risk expenditure types are:

- (a) technical labour cost that is allocated to the petroleum project via time writing or another reasonable allocation method
- (b) technical labour cost of a project participant relating to their obligation as a member of a Joint Venture Operating Committee that is allocated to the petroleum project via time writing or another reasonable allocation method (see Example 4 in Appendix 1 to this Guideline)
- (c) Non-technical labour cost relating to:
 - (i) human resource (HR)
 - (ii) information technology (IT)
 - (iii) contracts and procurement
 - (iv) legal, commercial or finance
 - (v) health, safety, security and environment (HSSE), or
 - (vi) public and government affairs (excluding investor and corporate/shareholder public relations)

that is allocated to the petroleum project via time writing or another reasonable allocation method (see Example 1 in Appendix 1 to this Guideline)
- (d) cost relating to an asset that is used for the recovery or treatment of petroleum for processing prior to becoming a marketable petroleum commodity (within the meaning of section 2E of the Act) and for the transfer or storage of project product prior to becoming an excluded commodity, including operations and maintenance service costs dedicated to supporting and controlling the asset
- (e) cost relating to a head office building that is remotely located from the project site and which accommodates technical and non-operational staff to the extent that it can be reasonably allocated to the physical activities involved in the particular petroleum project (see Example 3 in Appendix 1 to this Guideline)
- (f) cost relating to an operation or facility carried on or provided for an environmental purpose (such as a water treatment cost) and any other environmental requirement that must be complied with in accordance with any applicable legislation and regulations
- (g) cost relating to employee amenities (as defined in section 2 of the Act) at the project site or at the nearest township
- (h) cost relating to insurance of an upstream project asset
- (i) cost relating to the joint venture accounting system that supports the preparation of billing statements and other accounting information for dissemination to joint venture participants in relation to carrying on, or providing, the operations, facilities or other things comprising the petroleum project
- (j) cost relating to the preparation of a joint venture business activity statement

- (k) legal cost relating to an employment contract in respect of an employee working directly on the petroleum project (a project employee), a contract for a supplier of goods or services for the petroleum project (project supplier) or an issue concerning a project employee or a project supplier
- (l) professional development cost as part of deploying a qualified person into a petroleum project
- (m) travel cost of a technical employee to a project site (see Example 4 in Appendix 1 to this Guideline)
- (n) travel cost of a technical employee to attend a training conference or workshop that is directly related to the petroleum project
- (o) travel cost of a technical employee to attend a technical conference as part of the cost of deploying a qualified person into a petroleum project
- (p) overhead cost relating to office rent and associated utilities and other costs relating to operator support services, allocated to a petroleum project by reference to a project asset or activity via a reasonable allocation method (see Example 2 in Appendix 1 to this Guideline).

Allocation of compliance resources – expenditure types we consider to be high risk

12. Expenditure types that we consider high risk and likely to require the allocation of a higher level of compliance resources to determining whether they qualify for deduction under section 38 of the Act include those that:

- (a) do not have a close or quite direct connection to the operations, facilities and other things comprising a petroleum project as defined in subsection 19(4) of the Act, or
- (b) are not liable to be made in a year of tax but are provisions or contingent liabilities under accounting standards.

13. These expenditure types include the following:

- (a) enterprise or corporate shell cost (for example. company registration cost, listing fee, ASIC fee and financial statement audit cost)
- (b) non-technical labour cost relating to investor and corporate/shareholder public relations issues
- (c) joint venture audit cost
- (d) cost relating to the preparation of a petroleum resource rent tax (PRRT) annual return or instalment statement
- (e) legal expense in relation to drafting a joint venture agreement
- (f) cost relating to the preparation of an income tax return or general corporate business activity statement
- (g) expense charged to joint venture participants on a generalised basis for operator support services without reference to a specific underlying service, activity or cost (for example the cost of general joint venture assistance, management, administration and other support service that is non project-specific, including a cost that is in the nature of what is commonly referred to as parent company overhead)
- (h) membership fee (for example: association of petroleum industry companies)

- (i) professional development cost to the extent that it addresses or improves the general capability or skill of a person (as distinct from a specific skill that is necessary for a person to be deployed into a petroleum project)
- (j) travel cost for attending a professional development course of a kind described in paragraph 13(i) above
- (k) administrative or non-operational cost (including overhead cost) that is indivisibly directed at more than one project, or at a project and non-project activity, and the taxpayer is unable to show reasonable apportionment
- (l) legal expense associated with an ongoing dispute between its joint venture partner and another company over a liability to pay private overriding royalties in respect of a production field³
- (m) hedging expense⁴
- (n) fee paid for the purposes of operating a mutualised research program which affiliate companies in the payer's economic group may join and giving the payer access to royalty-free licences over patent rights and other technical information for use in a petroleum project
- (o) social infrastructure cost arising from a statutory requirement or an entity's social licence to operate. This includes sponsorship cost and cost to build a hospital, road, transport, water and sewerage and any other facility for the general community
- (p) legal cost in defending a negligence claim or a prosecution under environmental protection legislation in relation to an oil spill caused by damage in the offshore-to-onshore processing plant pipeline, and damages and fines in relation to this, and
- (q) legal expense in relation to a state royalty agreement.

More information

14. For more information concerning apportioning payments, refer to Apportionment of PRRT deductible expenditure.

Commissioner of Taxation
18 January 2018

³ ATO Interpretative Decision ATO ID 2006/312 *Petroleum Resources Rent Tax: deductibility of legal expenses*.

⁴ ATO Interpretative Decision ATO ID 2005/111 *Petroleum Resource Rent Tax - Hedging expenses (gains and losses)*.

APPENDIX 1 – Examples

Paragraph	Activities
11(c)	<p><i>Example 1 – Non-technical labour cost allocated to the project via time writing</i></p> <p>An employee is stationed at a site office that services the operations of two petroleum projects. The duties of the employee are to:</p> <ul style="list-style-type: none"> (i) maintain the time keeping records for technical employees performing petroleum project operations at the project sites of the two projects (ii) send time keeping information in relation to the technical employees to the payroll department (iii) implement the occupational health and safety policy and measures at the project sites (iv) maintain employee amenities at the project sites (v) manage investor and corporate/shareholder public relations issues, and (vi) provide site reports to assist in the preparation of income tax returns, PRRT instalment statements and PRRT annual returns. <p>For any part of the employee's salary cost to constitute general project expenditure of a particular petroleum project, it is necessary to determine the part of the employee's time attributable to the activities the employee supports that are in carrying on or providing relevant operations, facilities or other things for that petroleum project.</p> <p>The activities set out at (i) to (vi) above will relate to the staff served by the site office employee and therefore the site office employee's salary cost, to the extent that it relates to these activities, will have a close or quite direct connection to a project.</p> <p>The determination of the site office employee's time attributable to a particular project will depend on that employee's time spent on supporting the technical staff.</p> <p>On the other hand, payments relating to investor and corporate/shareholder public relations or income tax/PRRT returns and statements will not constitute general project expenditure as they do not have a close or quite direct connection with the physical activities of a petroleum project.</p> <p>Where the salary cost of the site office staff cannot be reasonably allocated to the operations, facilities and other things comprising a petroleum project, that payment will be considered 'indirect' for the purposes of paragraph 44(1)(j) of the Act.</p>
11(p)	<p><i>Example 2 – Overhead cost charged in accordance with joint venture operating agreement</i></p> <p>Petroleum Co is the operator and participant of an unincorporated joint venture that governs the operations of a petroleum project. The joint venture operating agreement contains accounting procedures that are intended to establish equitable methods agreed between the parties for determining charges and credits applicable to operations covered under the agreement.</p>

	<p>The agreement contains provisions concerning, among other things, the allocation of costs on an equitable basis, the treatment of 'direct' and 'indirect' costs, and the audit of joint accounts, sole risk operation accounts and records of the operation.</p> <p>These provisions govern the basis of charges to the joint venture billing statements and sole risk operation accounts and are regularly reviewed by each party to the joint venture to ensure the accounting procedures are reasonable.</p> <p>We recognise that in these circumstances a commercial tension exists amongst unrelated joint venture participants, and the accounting policy in the joint venture operating agreement is a suitable reference in working out the appropriate method of apportionment for PRRT purposes.</p> <p>Accordingly, an overhead cost (not embedded in any time written cost) which is charged to the joint venture billing statement or sole risk operation account in accordance with the terms of the joint venture operating agreement by reference to a specific underlying upstream activity, asset or facility may be deductible. This is on the basis that the overhead is also an undisputed, direct and identifiable charge.</p> <p>Acceptable allocation methods may include time write allocation of personnel labour hours through timesheets, headcount, maintenance hours across facility assets and floor space.</p> <p>However, an overhead cost charged to joint venture participants on a generalised basis for operator support services (including IT, HR and HSSE) without reference to a specific underlying service, activity or cost will not constitute deductible general project expenditure under section 38 of the Act.</p>
11(e)	<p><i>Example 3 – Remotely located head office building</i></p> <p>Petroleum Co carries on a petroleum project and its project engineers, together with its non-operational staff, are housed in its head office that is leased and remotely located from the project site. The non-operational staff include staff in the accounting, finance, HR and other departments that provide support services.</p> <p>The project engineers devote 100% of their time to the petroleum project and occupy 10% of the remotely located head office building. The non-operational staff provide 6% of their time to support the project engineers and they occupy 20% of the same building.</p> <p>The remotely located head office is a site where the operations, facilities and other things comprising a petroleum project are carried out. Therefore, the lease payments associated with the head office building have a close or quite direct connection to the physical activities of Petroleum Co's petroleum project and are not excluded expenditure under paragraph 44(1)(k) of the Act.</p> <p>In determining the extent to which the lease payments associated with the remotely located office building will be deductible, Petroleum Co should have regard to: (i) the percentage of time that project engineers and non-operational staff supporting the project engineers devote to the petroleum project; and (ii) the floor space occupied by the project engineers and the non-operational staff supporting those engineers.</p> <p>In this instance the project engineers devote 100% of their time to the petroleum project and occupy 10% of the remotely located head office building while the non-operational staff that support those engineers spend 6% of their time on project activities and occupy 20% of the</p>

	<p>building.</p> <p>Consequently, 11.2% (that is [100% x 10%] + [6% x 20%]) of the lease payments was treated as being incurred in carrying on or providing the operations and facilities comprising Petroleum Co's petroleum project and deducted under section 38 of the Act.</p> <p>In these circumstances, the 1.2% [6% x 20%] of the lease payments that is attributable to the non-operational staff would not be excluded expenditure under paragraph 44(1)(k) as it was reasonably allocated to the petroleum project activities carried out by the project engineers.</p>
11(m)	<p><i>Example 4 – Visits by parent company officers and overseas technical experts</i></p> <p>Petroleum Co is an Australian subsidiary of an overseas parent company that carries on a petroleum project as an operator and participant of an unincorporated joint venture. From time to time, senior officials and technical specialists from the parent company visit Australia to oversee its operations.</p> <p>The visits by the parent company officers and overseas technical experts involve:</p> <ul style="list-style-type: none"> • discussing the running of the business and the current and proposed petroleum projects of the Australian company • reviewing specific project activities being conducted by the Australian company, and • meeting government officials to discuss the proposed activities of the Australian company. <p>Petroleum Co bears all the costs associated with the travel of the parent company officers and technical specialists to Australia.</p> <p>The travel costs of the senior officials in relation to reviewing the activities of Petroleum Co and meeting with government officials will generally not constitute general project expenditure as they do not have a close or quite direct connection with the physical activities of a petroleum project. Where the senior officials review specific project activities, the travel costs would be deductible to the extent that they relate to these project activities and where they are based on a reasonable allocation method.</p> <p>The travel costs of the overseas technical specialists (for example, petroleum engineers) relate to visits they make to project sites in order to assist Petroleum Co to meet its obligations as an operator pursuant to programmes and budgets relating to joint operations which have been approved by the Joint Venture Operating Committee. Therefore, these costs do have a close or quite direct connection with the physical activities of a petroleum project.</p> <p>Petroleum Co collates expenditure information sourced from its natural systems and incorporates it into a series of excel spreadsheets that contain automated settings (for example, based on the Approval For Expenditure, general ledger account descriptions, etcetera). The spreadsheets identify and exclude obviously non-deductible PRRT expenditure including interest, provisions, corporate memberships and downstream costs.</p> <p>Petroleum Co manually reviews the preliminary classification of travel expenditure incurred by non-Australian based officers in order to identify any costs which were not incurred by visiting technical specialists in relation to project activities. Based on an analysis of the itineraries of the</p>

	<p>visiting parent company officers, an appropriate percentage of the remaining travel costs are excluded as not related to project activities.</p> <p>In these circumstances where Petroleum Co is able to demonstrate effective internal management processes which provide a fair and reasonable basis to ensure that only genuine general project expenditure is deducted, the parent company travel costs are treated as low risk. This obviates the need to take an extensive 'line by line' analysis of each item of travel expenditure.</p>
13(o)	<p>Example 5 – Social infrastructure cost</p> <p>Petroleum Co carries on a petroleum project as an operator and a participant of an unincorporated joint venture. The project is currently in construction.</p> <p>Pursuant to an agreement with the relevant state government, Petroleum Co is required to mitigate the project's social impacts on the town by:</p> <ul style="list-style-type: none"> (i) developing and executing upgrade works by way of a water tank and a desalination plant which will increase the town's potable water (ii) developing and executing upgrade works to the town's power infrastructure by way of a power station and associated transmission network (iii) contributing to the improvement of the town site's waste water management by upgrading the existing wastewater treatment plant (iv) constructing new residential housing in the town, including contributing to land development and release costs (v) upgrading the town's health services (vi) contributing to the expansion of the town's school, childcare and other education facilities as well as recreational facilities such as a swimming pool and picnic area (vii) contributing to the construction of a new road which will provide alternative access to and from the town site (viii) constructing new airport runway, apron and terminal building facilities to support the increased utilisation of the town's airport, and (ix) contributing to the expansion of the town's emergency services. <p>Petroleum Co also makes voluntarily contributions by sponsoring school-based apprenticeship programs and traineeships.</p> <p>The project has a construction village camp located about 15 kilometres away from the town which includes a temporary power station, waste water treatment plant, temporary housing for all employees, contractors and subcontractors related to the construction of the project, and health and recreational facilities.</p> <p>To the extent that expenditure relates to improving or developing the town's infrastructure due to an increase in the town's population as a result of the project, the expenditure is considered to be aimed at benefiting the general community only and will not have a direct or quite close connection to the project. This would include expenditure relating to</p>

	<p>the facilities or services in (i) through (vi) inclusive above. Similarly, the voluntary expenditure on sponsoring apprenticeship and traineeship programs will not have a close or quite direct connection to the project.</p> <p>Where facilities such as the newly constructed road and airport referred to at (vii) and (viii) above are used as part of project operations, the related expenditure may constitute general project expenditure to the extent that it reasonably reflects the use of the facilities for or as part of the operations, facilities or other things that comprise the project as defined in subsection 19(4) of the Act. Similarly, to the extent the emergency services referred to at (ix) above are used or available for use as part of the operations, facilities or other things in subsection 19(4) of the Act, the expenditure may be deductible under section 38 of the Act subject to reasonable apportionment of the expenditure to the project. Where an expenditure cannot be reasonably allocated, it will be considered to be excluded expenditure under subparagraph 44(1)(j) of the Act.</p>
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Amendment history

Date of Amendment	Part	Comment
18 January 2018	More information	Updated link in paragraph 14 to direct web address, and deleted footnote 5 which indicated how to search for the webpage.
8 November 2017	All	Updated to include social infrastructure expenditure costs arising from a statutory requirement or an entity's social license. Paragraphs 9 and 13, Examples and Legislative references amended.

References

ATOlaw topic(s)	Petroleum resource rent tax ~~ Deductible expenditure ~~ General expenditure Petroleum resource rent tax ~~ Other
Legislative references	PRRTAA 1987 PRRTAA 1987 2 PRRTAA 1987 2E PRRTAA 1987 19(4) PRRTAA 1987 38 PRRTAA 1987 41(1)(d) PRRTAA 1987 44 PRRTAA 1987 44(1)(j) PRRTAA 1987 44(1)(k) PRRTAA 1987 Pt V Div 5 PRRTAA 1987 112
Related Rulings/Determinations	PCG 2016/12
Other references	ATO ID 2005/111 ATO ID 2006/312
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