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Proposed changes to the income tax treatment of decommissioning costs and exploration expenditure

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Introduction

- Income tax overview
- Current tax treatment and policy intent
- Anomaly in the legislation
- Inland Revenue's (IR) proposal for an alternative tax model
- Specific aspects of the proposal
- Tax treatment in other jurisdictions

Income Tax

Income tax overview

- NZ companies' income tax rate is 28% of taxable income
- Taxable income is assessable income less allowable deductions and tax losses
- Most receipts from petroleum exploration and production activities are assessable income
- Most expenditures of exploration and production companies are allowable deductions – either immediately or over time on an amortisation basis
- Tax losses may be offset against other taxable income of a group, or carried forward indefinitely (subject to shareholder continuity rules)

Current income tax treatment and policy intent

Current income tax treatment

Decommissioning costs

- Decommissioning costs deductible when incurred
- Producer may not have taxable income at time of decommissioning or in the future
- Decommissioning costs incurred can result in unusable tax losses
- Provision enacted in 1979 allowed “spread back” of tax losses arising from decommissioning costs and unamortised petroleum development expenditure (PDE) to be offset against prior years’ taxable income
- Spread back allowed only when petroleum mining permit is relinquished

Current income tax treatment

Decommissioning costs *(cont.)*

- Current provisions for decommissioning in published company NZ financial statements are over:

NZD 2 billion

Current policy intent

- Current policy allows petroleum miners to benefit from a tax deduction
- Petroleum miners can expect refund of tax paid in prior years
- However, policy intent conflicts with an anomaly in the legislation

Anomaly in the legislation

Anomaly in the legislation

- Provision enacted in 1990 prevents the IR Commissioner from refunding amounts beyond four years prior
- Incentivises early abandonment of field to get benefits of a full deduction
- Industry sought to have the four-year time limit removed for decommissioning expenditure
- IR is currently proposing an alternative tax credit model

Industry expectations on alternative tax credit model

- Should be in line with the original policy intent
- Should not adversely impact taxpayers who made investments based on current rules
- Should be introduced to Parliament as early as possible to clarify position and eliminate uncertainty

Inland Revenue's proposal for an alternative tax model

IR's proposal
Refundable tax credit

- Original IR proposals released August 2016
- PEPANZ / industry submission September 2016
- IR draft of wording for bill released December 2016
- Bill expected to be introduced March 2017
- Enactment expected to be post 2017 election
- Apply from income year commencing after enactment

IR's proposal

Refundable tax credit *(cont.)*

- Net loss arising from decommissioning expenditure generates refundable credit at petroleum miner's tax rate
- Credit would be allowed in the year decommissioning costs are incurred
- Credit would be limited to tax paid by petroleum miner in prior years, not limited to tax paid on a particular permit

IR's proposal

Refundable tax credit *(cont.)*

- Credit eliminates the four-year limitation as spread back of losses will no longer be required
- Based on existing regime for mineral mining

Specific aspects of the proposal

IR's proposal

Agreed aspects of the refundable credit

Relinquishment of permit

Proposal	Industry
Removes relinquishment requirement of a permit before a refundable tax credit is available	Agrees with the removal of the qualification

IR's proposal

Agreed aspects of the refundable credit (cont.)

Imputation credits

Proposal	Industry
Refundable credit will be limited by available imputation credits	Agrees with proposal as it is consistent with current principles of imputation

IR's proposal

Amended aspects of the refundable credit

Exploratory wells

Proposal	Amendment
Restoration costs of exploratory wells will not be eligible for a refundable credit	Costs on restoration of an exploratory well are eligible for the credit where it is carried out with restoration of a commercial well

IR's proposal

Amended aspects of the refundable credit *(cont.)*

Unamortised PDE

Proposal	Amendment
Unamortised PDE would be excluded from the refundable credit	IR accepted unamortised PDE deducted on cessation of petroleum mining operations is eligible for the credit

IR's proposal

Amended aspects of the refundable credit *(cont.)*

Other expenditure eligible for credit

Proposal	Amendment
Only decommissioning required to comply with legislative requirements will be eligible for the credit	IR accepted expenditure eligible for credit is not limited to items required to comply with legislative decommissioning requirements

IR's proposal

Industry concerns

Defining "decommissioning expenditure"

- PEPANZ / industry continue to have concerns in the restrictive definition of decommissioning expenditure
- Planning, assessments, management, head office costs may not be included

IR's proposal

***Industry concerns** (cont.)*

Exploration expenditure in mining permits

- IR proposed that the expenditure should not be immediately deductible, but spread like PDE
- Proposed change has been deferred for further consultation as it can be progressed separately

Tax treatment in other jurisdictions

Tax treatment in other jurisdictions

Australia	UK	USA
Tax losses unable to be carried back to previous years	Tax losses arising from decommissioning costs can be spread back to April 2002	Tax losses may be carried back for two years

Conclusion

Conclusion

- Current policy intent to provide tax deduction benefits to petroleum miners
- IR's proposed alternative tax credit model allows a refundable tax credit in the year decommissioning costs are incurred
- IR has considered industry comments on specific aspects of the proposal and made changes accordingly
- Existing industry concerns around the restrictive definition of "decommissioning expenditure"

Thank you

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