

## PETROLEUM TAXATION IN AUSTRALIA: THE RESOURCE RENT TAX BILLS 1986

### 1. INTRODUCTION

On 28 November 1986, the Federal Treasurer tabled a package of proposed resource rent tax legislation in the House of Representatives. The resource rent tax would be profits-based and not production-based. It would replace royalty and excise.

The Bills had been a while coming. A profits-based royalty or tax on petroleum had been mooted as long ago as 1976.<sup>1</sup> Politically, it was justified by the proposition that undeveloped petroleum was ultimately owned by the community and, consequently, the community was entitled to share in the profits from an exceptionally profitable project.<sup>2</sup> At the same time, it was important not to stifle petroleum exploration and production, which was carried out by companies under licences from the Crown - accordingly, it was thought appropriate that companies exploiting petroleum reserves should be assured of at least a commercial rate of return on funds invested. A tax which recognises these competing considerations, as the resource rent tax sets out to do, is sometimes referred to as 'economic rent'.<sup>3</sup>

When Labor came to office in March 1983, it proceeded to put a resource rent tax into place, initially by consultation with industry. A Discussion Paper distributed in December 1983 was followed by a number of press releases.<sup>4</sup> The tax was announced, with effect from 1 July 1984, in a Ministerial statement issued on 27 June 1984.<sup>5</sup> Later, a Ministerial Statement issued on 20 May 1985 in connection with the development of the Jabiru Oil Field, announced interpretations of the policy statements contained in the Ministerial Statement of 27 June 1984.<sup>6</sup>

The initial plan was to introduce a resource rent tax both offshore, where the Commonwealth had jurisdiction, and in onshore and seaward areas, where the States had jurisdiction. However, the co-operation of the States, which was necessary for the introduction of the tax onshore, was not readily forthcoming.

Nevertheless, a resource rent royalty, the onshore equivalent of the

---

### FOOTNOTES

\* Solicitor, Adelaide.

1 IAC Reports on the Mining & Petroleum Industries and Crude Oil Pricing (1976), Canberra.

2 Australian Labor Party Platform, Constitution and Rules (1982) - Ch 17, Minerals and Energy, 1.

3 Crommelin, 'Resources Law and Public Policy' (1983) 15 UWAL Rev 1, 6; Garnaut, 'Mining Royalties and the Implications of the Northern Territory Green Paper for the Australian Mining Industry' (1982) 4 AMPLJ 283.

4 'Discussion Paper on Resource Rent Tax in the Petroleum Sector', December 1983, which accompanied Ministerial Press release No 83/47, 21 December 1983.

5 'Resource Rent Tax on 'Greenfields' Offshore Petroleum Projects', Ministerial Statement, 27 June 1984.

6 'Resource Rent Tax on 'Greenfields' Offshore Petroleum Projects: Developments in NT/P26 and End-of-Project-Life Adjustments', Ministerial Press Release No 41/85, 20 May 1985.

resource rent tax, was introduced in 1985 to apply to the Barrow Island Oil Field development.<sup>7</sup> And thus, the Petroleum Revenue Act 1985, the ultimate vehicle for the resource rent royalty, preceded the Resource Rent Tax Acts. Briefly, the Petroleum Revenue Act 1985 prescribed two kinds of agreements which, if both were adopted in relation to a petroleum project, would result in the project being subject to resource rent royalty but not to State royalty and Commonwealth excise.<sup>8</sup> The prescribed Resource Rent Royalty Agreement, to be entered into between the State and the producers, specified the royalty unit and the royalty base. The prescribed Revenue-Sharing Agreement, to be entered into between the State and the Commonwealth, provided for a revenue-sharing arrangement between the State and the Commonwealth. The Petroleum Revenue Act 1985 is relatively brief and straightforward.

The Resource Rent Tax Acts are much more complex. The resource rent tax is imposed on the 'taxable profit of a person of a year of tax in relation to a petroleum project'.<sup>9</sup> A number of questions arise. What is the 'petroleum project', particularly in the case of a multi-field development? How does the notion of the point of 'production of [a] marketable petroleum commodity' contribute to the delineation of a petroleum project? What is the nature of the 'taxable profit', given that it is a statutorily determined profit and varies from a normal commercial profit, for example, by disallowing the deductibility of interest on borrowed funds, a legitimate and substantial business expense? The object of this paper is to examine the legislation and some analogies and to pursue those questions.

## 2. THE BILLS

The package of proposed resource rent tax legislation comprised four Bills: the Petroleum Resource Rent Tax Bill 1986 ('the Tax Act'); the Petroleum Resource Rent Tax Assessment Bill 1986 ('the Assessment Act' or, simply, 'the Act'); the Petroleum Resource Rent Tax (Interest on Underpayments) Bill 1986; and the Petroleum Resource Rent Tax (Miscellaneous Provisions) Bill 1986 ('the Miscellaneous Amendments Act') (collectively, 'the Resource Rent Tax Acts').

The Tax Act imposes the tax at a rate of 40%.<sup>10</sup> The Assessment Act provides, principally, for the determination of the taxable profit.<sup>11</sup> The Miscellaneous Amendments Act amends a number of Acts, including the Excise Tariff Act 1921 and the Petroleum (Submerged Lands) (Royalty) Act 1967, to ensure that, where the tax applies, it replaces pre-existing excise and royalty. The Miscellaneous Amendments Act also amends the Income Tax Assessment Act 1936 to ensure that the tax is imposed prior to company income tax and is deductible in the assessment of company income tax.

---

7 'Barrow Island Oil Field: New Royalty Arrangements', Ministerial Press Release No 49/85, 25 June 1985; 'Legislation Introduced to Set Up Profits-Based Royalty for Oil Producers', Ministerial Press Release No 94/85, 16 October 1985; 'Commonwealth-State Resource Rent Royalty Arrangements Finalised', Ministerial Release No 24/86, 23 March 1986.

8 Petroleum Revenue Act 1985 (Cth) ss5,6.

9 Tax Act s4.

10 Ibid ss4, 5.

11 The Assessment Act is incorporated into the Tax Act to be read as one with the Tax Act: Tax Act s3.

Where may a court find assistance in interpreting the Resource Rent Tax Acts? Certain extrinsic material, including the Explanatory Memoranda, the Second Reading Speeches and other material 'capable in assisting in the ascertainment of the meaning of the provision', may be referred to to *determine* the meaning of a provision which is 'ambiguous or obscure' or to *confirm* that the meaning of a provision is its 'ordinary meaning taking into account its context in the Act and the purpose or object underlying the Act'.<sup>12</sup>

Which of the Ministerial Statements may be referred to? The Ministerial Statement of 27 June 1984 announced the imposition of the tax and set out its principal policy elements, whilst the Ministerial Statement of 20 May 1985 issued in connection with the Jabiru Oil Field development gave some interpretations in relation to the policy elements set forth in the earlier Statement. As both were statements upon which industry was intended to, and indeed did, rely, it is arguable that both may be referred to as aids to interpretation. But the same cannot be said of the Discussion Paper of December 1983 which was followed by a process of consultation with industry.

A court may of course refer to a statute in *pari materia*.<sup>13</sup> Is the Petroleum Revenue Act 1985 a statute in *pari materia* with the Resource Rent Tax Acts? Although history shows that the resource rent royalty was intended to be the onshore equivalent of the resource rent tax, there are differences in the two sets of legislation. The Resource Rent Tax Acts are much more complex in their language than the Petroleum Revenue Act 1985. But more significantly, there are apparent differences of substance, for example, the Petroleum Revenue Act 1985 appears to take the production facilities as the focal point in the inquiry as to what in any particular case constitutes the royalty unit,<sup>14</sup> whilst the Resource Rent Tax Acts appear to focus instead on the source of the petroleum, ie the production licence.<sup>15</sup> Further, the Resource Rent Tax Acts are to be administered by the Commissioner of Taxation, whilst primary responsibility for the administration of the Petroleum Revenue Act 1985 lies with the State Minister responsible for the administration of petroleum-related matters in the relevant State. On balance, it is thought that, where the provisions under scrutiny do not clearly have different objects as between the two sets of legislation, a court could refer to the Petroleum Revenue Act 1985.

#### (a) Tax Unit: 'Petroleum Project'

The tax is assessed on the taxable profit of a person in relation to a 'petroleum project'.<sup>16</sup> A 'petroleum project' or 'project' is defined to mean a 'petroleum project within the meaning of sub-sections 19(1) or

12 Acts Interpretation Act 1901 (Cth) s15AB.

13 *Federal Commissioner of Taxation v ICI Australia Ltd* (1972) ALR 715, per Gibbs J at 730; *ICI Australia Ltd v Federal Commissioner of Taxation* (1972) 46 ALJR 35, per Walsh J at 41; *Gale v Federal Commissioner of Taxation* (1960) 102 CLR 1, per Fullagar J at 12; *Lennon v Gibson and Howes Ltd* [1919] AC 709, at 711 (Privy Council on appeal from the High Court); Pearce, *Statutory Interpretation in Australia* (2nd edn 1981) para 89.

14 *Infra* 3(d).

15 *Infra* 3(a).

16 Assessment Act s21.

(2)'.<sup>17</sup> However, neither of those sub-sections explicitly defines a 'petroleum project'. Sub-section 19(1) merely states that there shall be taken to be a petroleum project in relation to an eligible production licence, whilst ss19(2) merely states that, where two or more eligible production licences in force are specified in a project combination certificate, there shall be taken to be a project in relation to such of the eligible production licences as are in force.<sup>18</sup> These provisions do little more than say that 'petroleum projects' are production licence-based.

To further elicit the meaning of 'petroleum project' one must turn to ss19(4), which indicates that a 'petroleum project' comprises 'operations, facilities and other things', including services and employee amenities, involved in the recovery of petroleum from the production licence area or areas upon which the project is based and in the transportation, treatment, processing and storage of that petroleum prior to the 'production of [a] marketable petroleum commodity'. Sub-section 19(4) provides:

'a reference to the operations, facilities and other things comprising a petroleum project is a reference to:

- (a) operations and facilities for the recovery of petroleum from the production licence area or production licence areas in relation to the project; and
- (b) such of the following as are carried on or provided:
  - (i) operations and facilities involved in moving petroleum so recovered between any storage or processing facilities prior to the production of any marketable petroleum commodity from the petroleum;
  - (ii) operations and facilities involved in the storage, processing or treatment of petroleum so recovered to produce any marketable petroleum commodity from the petroleum;
  - (iii) services, or facilities for the provision of services, in connection with the operations, facilities, amenities and services referred to in this [s19];
  - (iv) employee amenities in connection with the operations, facilities and services referred to in this [s19].'

As acknowledged in ss19(4), the basis of the tax unit is not always limited to a single production licence. Where, upon his own initiative or following an application or request from one or more of the participants, the Minister considers that a number of petroleum projects are sufficiently related, having regard to certain specified facts, the Minister may, pursuant to s20, issue a certificate combining the projects. Where such a certificate is issued, the several projects specified in the project combination certificate are treated, for the purposes of assessment, as a single project.

---

17 Ibid s2.

18 Ibid s2: A production licence related to an 'excluded exploration permit' is not an 'eligible production licence'. Where a production licence was in force on or before 1 July 1984, the exploration permit relating to that production licence is an 'excluded exploration permit'. The effect of this exclusion is to leave undisturbed the production licences and associated exploration permits comprising the Bass Strait and North West Shelf projects as at 1 July 1984.

### **(b) Tax Base: 'Taxable Profit'**

The tax is assessed on a person's 'taxable profit' in relation to a petroleum project.<sup>19</sup> In a particular year of tax, the 'taxable profit' is the excess of assessable receipts derived by the person over deductible expenditures incurred by the person.<sup>20</sup> It is not a commercial profit determined from the accounts, but rather a profit determined by accounting for a number of items of receipt and expenditure specified in the Assessment Act.

The computation of the taxable profit takes into account, *inter alia*, certain exploration and production expenditure, on the one side, and certain receipts in respect of production from a production licence area and, to the extent authorised by the Petroleum (Submerged Lands) Act 1967 (Cth), production from an associated exploration permit area, on the other side. In order to distinguish between production operations under a production licence and exploration operations, sometimes involving production of petroleum, under an exploration permit, the Assessment Act utilises the concept of an 'eligible exploration or recovery area in relation to a petroleum project'.<sup>21</sup> In essence, 'the eligible exploration or recovery area in relation to a petroleum project' is the area of the exploration permit from which the production licence or licences comprising part of the project were excised or, where a retention lease was interposed between the exploration licence and the production licence, the area of the retention lease from which the production licence was excised.

The computation of the taxable profit also takes into account any dealing by a joint venturer in its participating interest in the project. Division 5 addresses such a situation.<sup>22</sup> Where a person enters into 'a transaction' that has 'the effect of transferring the whole of the entitlement of the vendor to derive, after the transfer, assessable receipts in relation to the project, and any property held by the vendor that is or was being used in relation to the project, to another person or persons', then the purchaser, or where a number of purchasers acquire the entitlement, each purchaser in proportion to his acquired entitlement, is deemed to have derived the assessable receipts and to have incurred the deductible expenditure that, in the absence of the transfer, the vendor would have incurred up to the transfer date and, further, to have incurred any liabilities for and to have paid any amounts of tax incurred or paid by the vendor up to the transfer date. The vendor, on the other hand, is deemed not to have derived those receipts, incurred that expenditure or those liabilities, or paid those amounts. In short, these provisions place the purchaser or purchasers in the shoes of the vendor.

#### **(i) Assessable Receipts**

The Assessment Act provides that a number of specified receipts derived by a person in relation to a petroleum project must be brought to tax in the financial year in which they are derived.<sup>23</sup> No distinction is made

---

<sup>19</sup> *Supra* n 16.

<sup>20</sup> Assessment Act s22.

<sup>21</sup> *Ibid* ss5(2).

<sup>22</sup> *Ibid* s47.

<sup>23</sup> *Ibid* s23.

between receipts of a capital and revenue nature.<sup>24</sup> The following are the specific categories of receipts:

- (i) Assessable Petroleum Receipts.
- (ii) Assessable Exploration Recovery Receipts.
- (iii) Assessable Property Receipts.
- (iv) Assessable Miscellaneous Compensation Receipts.
- (v) Assessable Employee Amenities Receipts.

Those categories of receipts may be classified into two broad groupings: first, receipts derived from the sale or other disposal of petroleum, a constituent of petroleum or a marketable petroleum commodity produced from petroleum which is recovered from the production licence upon which the project is based or from an associated exploration permit, namely, Assessable Petroleum Receipts and Assessable Exploration Recovery Receipts; and, secondly, incidental receipts derived in the course of petroleum production operations which do not constitute proceeds of sale or deemed proceeds of sale of petroleum or of a constituent or product of petroleum, namely, Assessable Property Receipts, Assessable Miscellaneous Compensation Receipts and Assessable Employee Amenities Receipts.

Assessable Petroleum Receipts are deemed or actual receipts derived from the production of petroleum or of a constituent or product of petroleum or of a constituent or product of petroleum from a production licence area or areas within the tax unit.<sup>25</sup> They are determinable by reference to the point at which a marketable petroleum commodity is produced, whether or not that point coincides with a sale or other disposal of a marketable petroleum commodity. They encompass not only proceeds from the sale of a marketable petroleum commodity, but also receipts from the sale or other disposal of petroleum or a constituent of petroleum which has not been converted into a marketable petroleum commodity, as well as deemed receipts from the production of a marketable petroleum commodity which has not been sold. Accordingly, an Assessable Petroleum Receipt may come into existence prior to, upon, or immediately after, 'the production of [a] marketable petroleum commodity'. Section 24 provides:

'a reference to assessable petroleum receipts derived by a person in relation to a petroleum project is a reference to -

- (a) where any petroleum, or a constituent of petroleum, recovered from the production licence area or areas in relation to the project is or was sold, whether processed or unprocessed, before any marketable petroleum commodity is or was produced from it - the consideration received by the person for the sale;
- (b) where any marketable petroleum commodity produced from petroleum recovered from the area or areas to which paragraph (a) applies is or was sold at or immediately after the point at which it is or was produced - the consideration received by the person for the sale;

---

<sup>24</sup> Ibid.

<sup>25</sup> Ibid ss24, 26.

- (c) where any petroleum, or a constituent of petroleum, recovered from the area or areas to which paragraph (a) applies is or was disposed of otherwise than by sale or destruction, whether processed or unprocessed, before any marketable petroleum commodity is or was produced from it - so much (if any) of the market value of the petroleum, or of the constituent, at the point of disposal, or, where there is insufficient evidence of that market value, of such amount as, in the opinion of the Commissioner, is fair and reasonable, as is taken by s 26 to have been derived by the person; and
- (d) where any marketable petroleum commodity produced from petroleum recovered from the area or areas to which paragraph (a) applies is or was not sold at or immediately after the point at which it is or was produced - so much of the market value of the commodity at that point, or, where there is insufficient evidence of that market value, of such amount as, in the opinion of the Commissioner, is fair and reasonable, as is taken by s 26 to be derived by the person.'

Not all petroleum is produced pursuant to a production licence. Some petroleum may be produced in the course of exploration activities. Assessable Exploration Recovery Receipts are deemed or actual receipts attributed to or derived from petroleum or a constituent or product of petroleum recovered from the 'eligible exploration or recovery area (other than any production licence area) in relation to the project'.<sup>26</sup> The only feature distinguishing those receipts from Assessable Petroleum Receipts is the source. In all other respects, including the determination of the value of deemed receipts, Assessable Exploration Recovery Receipts correspond to Assessable Petroleum Receipts.

Assessable Property Receipts include deemed or actual receipts by way of compensation,<sup>27</sup> insurance recoveries, lease or hiring fees or otherwise where property, in respect of which capital expenditure being eligible real expenditure was incurred,<sup>28</sup> is sold, lost, destroyed or leased or hired to another. They also include amounts received from the provision of information obtained from any survey, appraisal or study, in respect of which eligible real expenditure was incurred in relation to the project.

Assessable Miscellaneous Compensation Receipts include receipts,<sup>29</sup> either by way of insurance, compensation or indemnity or by way of refund, rebate, discount or commission, in connection with which eligible real expenditure was incurred in relation to the project.

Finally, in the course of petroleum production activities, the participants may provide, on a non-profit basis, certain employee amenities such as housing and recreation. Assessable Employee Amenities receipts include any amounts received in respect of the provision of such employee

---

<sup>26</sup> Ibid ss25, 26.

<sup>27</sup> Ibid s27.

<sup>28</sup> 'Eligible real expenditure' means 'exploration expenditure, general project expenditure or closing-down expenditure': Assessment Act s2.

<sup>29</sup> Ibid s28; supra n 28.

amenities so long as deductible expenditure was incurred in providing them.<sup>30</sup>

## (ii) Deductible Expenditure

Under the Assessment Act, there are three deductibles which, in a financial year, may be offset against the assessable receipts derived by a person in the financial year.<sup>31</sup> They are:

- (i) Augmented Bond Rate General Expenditure.
- (ii) Augmented Bond Rate Exploration Expenditure.
- (iii) GDP Factor Expenditure.

In turn, the computation of the deductibles involves four categories of expenditure: 'general project expenditure', 'exploration expenditure', 'excluded expenditure' and 'closing-down expenditure'. None of those categories of expenditure makes any distinction between payments of a capital and revenue nature.

'General project expenditure' includes expenditure incurred in carrying on or providing the operations,<sup>32</sup> facilities and other things comprising the project, but does not include exploration expenditure or closing-down expenditure. It is used in computing those deductibles which involve expenditure incurred in connection with the production of petroleum from the area of the production licence or production licences comprising the project, ie the Augmented Bond Rate General Expenditure and the GDP Factor Expenditure.

'Exploration expenditure'<sup>33</sup> includes expenditure incurred 'in carrying on or providing operations and facilities in connection with exploration for petroleum in 'the eligible exploration or recovery area in relation to [the] project', as well as expenditure incurred in the recovery, treatment, processing and storage of petroleum produced from the exploration licence area of the eligible exploration or recovery area prior to the production of a marketable petroleum commodity, but does not include closing-down expenditure. It is used in computing those deductibles which involve expenditure incurred in connection with exploration for or production of petroleum from 'the eligible exploration or recovery area in relation to a petroleum project', ie the Augmented Bond Rate Exploration Expenditure and the GDP Factor Expenditure.

'Closing-down expenditure' includes expenditures incurred in connection with the closing-down of the project or environmental restoration upon closing-down.<sup>34</sup> It is used inter alia in the computation of tax credits.

'Excluded expenditure' may not enter the computation of any of the deductibles.<sup>35</sup> The more significant items of excluded expenditure include interest on borrowed funds, expenditure incurred in acquiring an interest in a project or a potential project and income and fringe benefits taxes. Cash bidding payments are also 'excluded expenditure', even though they are deductible for the purposes of income tax. In the words of the Act:

---

30 Ibid s29; supra n 28.

31 Ibid s32.

32 Ibid s38.

33 Ibid s37.

34 Ibid s39.

35 Ibid s43.



'a reference to excluded expenditure is a reference to:

- (a) payments of principal or interest on a loan or other borrowing costs;
- (b) interest components of hire-purchase payments;
- (c) payments of dividends or the cost of issuing shares;
- (d) the repayment of equity capital;
- (e) payments of a kind known as private override royalty payments;
- (f) payments to acquire, or to acquire an interest in, an exploration permit, retention lease, production licence, pipeline licence or access authority, otherwise than in respect of the grant of the permit, lease, licence or authority;
- (g) payments to acquire interests in petroleum project profits, receipts or expenditures;
- (h) payments of tax under the Income Tax Assessment Act 1936 or the Fringe Benefits Tax Assessment Act 1986;
- (i) payments of administrative or accounting costs, or of wages, salary or other work costs, incurred indirectly in carrying on or providing operations, facilities or other things of a kind referred to in [s37 - 'exploration expenditure', s38 - 'general project expenditure' and s39 - 'closing-down expenditure']; or
- (j) payments in respect of land or buildings for use in connection with administrative or accounting activities in respect of the carrying on or provision of other operations, facilities or things of a kind referred to in [s37 - 'exploration expenditure', s38 - 'general project expenditure' and s39 - 'closing-down expenditure'], not being land or buildings located at or adjacent to the site or sites at which those other operations, facilities or things are carried on or provided.<sup>36</sup>

Deductible expenditure which exceeds assessable receipts and remains undeducted at the end of a financial year may be uplifted, augmented and carried forward to the next financial year. Two augmentation rates apply - the Long-term Bond Rate and the GDP Factor, whichever is the lower of the two.<sup>37</sup>

General project expenditure incurred five years or less than five years prior to the date upon which the first production licence comprising the

---

36 Ibid.

37 The 'long term bond rate' is defined as a specific figure for each financial year in the period from 1 July 1979 to 1 July 1985 and, beyond 1 July 1985, by reference to 'the assessed secondary market yields in respect of 10 year non-rebate Treasury bonds published by the Reserve Bank': Assessment Act s2.

The GDP factor is to be determined for a financial year by dividing the GDP deflator for the financial year by the GDP deflator for the immediately preceding financial year, where the GDP deflator is 'the Implicit Price Deflator for Expenditure on Gross Domestic Product first published by the Australian Statistician in respect of the financial year': Assessment Act ss35(4) and (5).

project came into force is deductible as Augmented Bond Rate General Expenditure.<sup>38</sup>

The total deduction available in any financial year is the sum of general project expenditure incurred *in that financial year*, any Augmented Bond Rate General Expenditure carried forward from the preceding financial year and any amount deemed to have been incurred by the person as a result of a dealing in an interest in the project pursuant to Division 5.

Where, in a financial year, the Augmented Bond Rate General Expenditure incurred by a person on a project exceeds the assessable receipts derived by the person from that project, an amount determined by the formula  $A(1.15 + B)$ , where A is the amount of that excess of Augmented Bond Rate General Expenditure and B is the Long-term Bond Rate for the financial year, is taken to be Augmented Bond Rate General Expenditure incurred by that person on the project on the first day of the next financial year. In this manner, the excess is uplifted, augmented and carried forward.

Exploration expenditure incurred in five years or less than five years prior to the date upon which the first production licence comprising the project came into force is deductible as Augmented Bond Rate Exploration Expenditure.<sup>39</sup>

The total deduction available in any financial year is the sum of exploration expenditure incurred *in that financial year*, any Augmented Bond Rate Exploration Expenditure carried forward from the preceding financial year, any exploration expenditure offset attributed to the project pursuant to ss36(1) and any amount deemed to have been incurred by the person as a result of a dealing in an interest pursuant to Division 5.

Where, in a financial year, the sum of the Augmented Bond Rate General Expenditure and the Augmented Bond Rate Exploration Expenditure incurred by a person in relation to a project exceeds the assessable receipts derived by the person, an amount determined by the formula  $A(1.15 + B)$ , where A is so much of the excess of Augmented Bond Rate General Expenditure and Augmented Bond Rate Exploration Expenditure over assessable receipts as does not exceed the amount of the Augmented Bond Rate Exploration Expenditure and B is the Long-term Bond Rate for the financial year, is taken to be Augmented Bond Rate Exploration Expenditure incurred by that person in relation to the project on the first day of the next financial year. In this manner, the excess is uplifted, augmented and carried forward.

Exploration expenditure and general project expenditure incurred more than five years prior to the date upon which the first production licence comprising the project came into force is deductible as GDP Factor Expenditure.<sup>40</sup>

The total deduction available in any financial year is the sum of any GDP Factor Expenditure carried forward from the preceding financial year, any exploration expenditure offset attributable to the project pursuant to ss36(1) and any amount deemed to have been incurred by the person as a result of a dealing in an interest pursuant to Division 5.

---

38 Assessment Act s33.

39 Ibid s34.

40 Ibid s35.

Where, in a financial year, the sum of the Augmented Bond Rate General Expenditure, the Augmented Bond Rate Exploration Expenditure and the GDP Factor Expenditure incurred by a person in relation to a project exceeds the assessable receipts derived by the person, an amount determined by the formula  $AB$ , where  $A$  is so much of the excess as does not exceed the amount of the GDP Factor Expenditure and  $B$  is the GDP factor for the financial year, is taken to be the GDP Factor Expenditure incurred by that person in relation to the project on the first day of the next financial year. In this manner, the excess is uplifted, augmented and carried forward.

In contrast, closing-down expenditure is not augmented but gives rise to tax credits calculated at a rate of 40% of that expenditure, with the proviso that total tax credits in relation to a project shall not exceed total resource rent tax otherwise payable in relation to the project.<sup>41</sup>

Although the term descriptive of each of the deductibles, namely, Augmented Bond Rate General Expenditure, Augmented Bond Rate Exploration Expenditure and GDP Factor Expenditure, implies that the relevant expenditure is augmented, consistently with the notion of a threshold rate of return on funds invested, this is the only case where, in any financial year, available deductibles exceed assessable receipts. Once all available deductibles in relation to a project have been used up and assessable receipts exceed deductible expenditure in a financial year, the deductible expenditure is not augmented when deducted and there is no longer a threshold rate of return but merely an additional tax.

Furthermore, the mechanics of deduction ensures a ranking as amongst the various deductibles. The net effect is that expenditures involving higher rates of augmentation are deducted in priority to expenditures involving lower rates of augmentation, ie Augmented Bond Rate General Expenditure is deducted before Augmented Bond Rate Exploration Expenditure which, in turn, is deducted before GDP Factor Expenditure. This optimises, in favour of the Commonwealth, the threshold rate of return extended to the producers.

Finally, where the project to be assessed is but one of a number of projects in a 'project group' or in a number of related 'project groups', the Augmented Bond Rate Exploration Expenditure and the GDP Factor Expenditure deductions are subject to exploration expenditure offsets under s36. A 'project group' occurs where at least one of the production licences in each project is related to the same exploration permit. Two or more project groups will be related to each other where at least one of the petroleum projects in one project group is common to each of the project groups. One step removed, where a petroleum project is common to two project groups and the second of those project groups has another project which is common with a third project group, ie where the relation between the three groups is established not by one single common project but by two common projects where each such common project is common to two only of the three project groups, all three project groups are related to each other for the purposes of the exploration expenditure offsets.<sup>42</sup>

---

41 Ibid s45.

42 It is apparent that the concept of a combined project, on the one hand, and the concepts of a project group and related project groups, on the other hand, are independent concepts, ie where there is a combined project the individual projects within the combined project could not form part of a project group or related groups but the combined project could.

Where there exists deductible exploration expenditure, whether Augmented Bond Rate Exploration Expenditure or GDP Factor Expenditure, in respect of a project in a project group or in two or more related project groups, that deductible exploration expenditure is to be deducted successively from each project in the project group or the related project groups.<sup>43</sup> Only any excess, which remains after this round robin process, is uplifted, augmented at the applicable rate and carried forward to the next financial year.

**(c) Analysis**

Upon the writer's analysis, ss19(1) and (2) taken together with s20 laterally delineate, and ss19(4) vertically delineates, what is to be treated as a single petroleum project for the purposes of assessment. By lateral delineation is meant the identification of those production sources and associated production areas which are included in the tax unit. By vertical delineation is meant the identification of those processes which, out of a number of successive processes, are included in the tax unit. Of the processes constituting exploration, extraction, treatment, processing, storage, distribution and refining, vertical delineation will include some in the tax unit and exclude the others. Under the Act, vertical delineation at the downstream perimeter is achieved primarily by a demarcation at the point of production of a marketable petroleum commodity.

Further, the tax unit is defined not only by those lateral and vertical limits but also by the content, within those limits, of what is to be treated as part of a single petroleum project; ss19(4) specifies those 'operations, facilities and other things' which comprise a petroleum project.

And further, the taxable profit depends not only on the lateral and vertical limits and the content of the tax unit, but also on the tax base. The tax base limits what within the tax unit is admissible in the computation of the taxable profit and allows some items occurring outside the tax unit to enter the computation. Thus, interest on loans is not a deductible expenditure. On the other hand, certain exploration expenditure not incurred on what is to be treated, for the purposes of assessment, as a single petroleum project is deductible.<sup>44</sup> Further, the tax base introduces temporal limits on items to be taken into account in the computation of the taxable profit, for example, the differential treatment of costs incurred five years or less than five years prior to the date upon which the first production licence comprising the project came into force, on the one hand, and costs incurred more than five years prior to that date, on the other hand.

Thus, the tax unit and the tax base operate in conjunction to control and determine the taxable profit. As each is an artificial device, it is likely that the taxable profit will vary from the commercial profit determined by normal accounting principles.

---

43 Assessment Act ss36(3): The order in which the carry forward expenditure is to be successively deducted against projects in a project group or in two or more related project groups is determined by the order in which the production licence or licences upon which the projects are based came into force; in the case of a combined project, the order is determined from the date upon which the first production licence came into force.

44 Ibid ss34-36.

### 3. PETROLEUM PROJECT

#### (a) Production Licence

In the subject-matter upon which the resource rent tax is to operate, there are a number of natural units which could have been selected as the tax unit. Thus, the tax unit could have been a petroleum field - in approximation to the unit utilised by excise.<sup>45</sup> Alternatively, it could have been the project, where what constitutes a project is determined by a natural inference from the facts - for example, where there is a sufficient relation between production sources, surface facilities, participants in the various production sources and facilities, or evidenced by a State Agreement or financing, the scope and content of the project could be determined by a natural inference from the facts.

Instead, the resource rent tax is *prima facie* assessable on an unnatural unit. A production licence under the Petroleum (Submerged Lands) Act 1967 may be granted in respect of a maximum of five blocks.<sup>46</sup> The area of a block is determined by the area of the graticular section delineated by five minutes of longitude and five minutes of latitude,<sup>47</sup> being in the Australian region approximately 75 square kilometres per block. Economic offshore gas fields, as exemplified by the North West Shelf Project, will have a much greater area than economic offshore oil fields. The permissible production licence area under the Petroleum (Submerged Lands) Act 1967 is not related to field size and, hence, neither is an uncombined project under the Resource Rent Tax Acts.

Consideration of the North West Shelf Project indicates the artificial nature of the tax unit.<sup>48</sup> The North West Shelf Project has three fields: the Goodwyn Field, the North Rankin Field and the Angel Field. Of the eight production licences covering those fields, the five covering the Goodwyn and North Rankin Fields adjoin each other. The remaining three, covering the Angel Field, also adjoin each other, but together are further away. They stand separately and, relative to the Goodwyn and North Rankin Fields, the Angel Field is a solitary field. A common attribute or feature is that all three fields use the same treatment plant onshore near Dampier. Although the use of the same treatment plant would aid an inference that all eight production licences constitute part of a single project, an uncombined project would on these facts encompass only a portion of a field.

In conclusion, the sense of 'project' in the Statute is an artificial sense, meaning in some cases merely a constituent of what is a 'project' in the vernacular or industry sense. Only where petroleum is produced from a single isolated production licence will the statutory sense of 'project' coincide with its industry sense. Even when the combination provisions in the Assessment Act are taken into account, the concept of a 'project' in the Act appears narrower than the concept portrayed in the succession of Ministerial Statements heralding the Resource Rent Tax Acts.

45 The Excise Tariff Act 1921 utilises the concept of a 'prescribed production area' which, in any particular instance, may be either a petroleum pool, the volume drained by a well or a petroleum field: vide ss5B, 6B, 6C and 6D.

46 Petroleum (Submerged Lands) Act 1967 (Cth) s40.

47 *Ibid* s17.

48 These facts have been taken, with some inference, from Thompson, 'The Legal Features of the North West Shelf LNG Project', vol 1, Proceedings of the International Bar Association Banff Conference - Energy Law 1981, 431.

**(b) 'Mining Operations' - Income Tax Assessment Act 1936**

The Discussion Paper of December 1983 stated that the tax would be applied separately to each individual project and not to aggregate company results.<sup>49</sup> So far that is a broad distinction, which implies a segregation for resource rent tax purposes of the income and expenditures of the project from the income and expenditures of other business activities of a company.

The Discussion Paper also referred to a set of established rules for determining for company tax purposes 'what constitutes a petroleum mining process'.<sup>50</sup> This, apparently, was a reference to a series of decisions on the meaning of the term 'mining operations' in the context of ss122(1) of the Income Tax Assessment Act 1936 as it stood prior to the 1968 Amendments. Although the decisions dealt with minerals mining, of which the closest in nature to petroleum is brine-pumping, they could also apply to petroleum operations. In one of the decisions, the *BHP case*, petroleum operations were referred to in the course of reasoning.<sup>51</sup> But, more significantly, the Income Tax Assessment Act 1936 itself defines 'prescribed petroleum operations' to mean 'mining operations in Australia for the purpose of obtaining petroleum'.<sup>52</sup>

Clearly, the phrase 'mining operations upon a mining property' in ss122(1) has the ability to delineate both vertically and laterally and thereby to quarantine a project from the remainder of a company's business. Vertical delineation could be achieved by identifying those processes which comprise 'mining operations', for example, extraction is one such process, but refining is not. Lateral delineation could be achieved by the application of the term 'mining property'.

The Assessment Act bases a petroleum project on a production licence with an opportunity, in some cases, to combine projects and, vertically, introduces a demarcation at the point of production of a marketable petroleum commodity. Consequently, it is worthwhile examining the principal cases in which the terms 'mining operations' and 'mining property' were considered, as they could provide guidance to the Administrative Appeals Tribunal or the Federal Court, on appeal, as to the proper application of those provisions of the Assessment Act which delineate a petroleum project or a combined project.

*Federal Commissioner of Taxation v Broken Hill Pty Co Ltd*,<sup>53</sup> dealt with a number of appeals against decisions of the Commissioner of Taxation. Extensive ironstone deposits occurred at Iron Knob, Iron Monarch and Iron Prince in the Middleback Ranges in South Australia and approximately 30 miles inland from Whyalla, the nearest seaboard town. Although Whyalla was initially established as a port solely for the shipping of iron ore extracted from the Middleback Ranges, it also possessed, at the date of the hearing, a steelworks, a blast furnace and a ship yard. The taxpayer had built a tramway linking Whyalla with the iron ore deposits in the Middleback Ranges. The ore was extracted by open cut mining and then, in the vicinity of the mine, it was crushed

---

49 Para 29.

50 Para 31.

51 (1969) 120 CLR 240, Barwick CJ and McTiernan and Menzies JJ at 273.

52 Ss124(1).

53 Supra n 51.

and treated as required to remove sand. After that, it was despatched to Whyalla, where approximately one quarter of the quantity was used as feedstock in the blast furnace and the remainder shipped via the harbour facilities at Whyalla to steelworks at Port Kembla and Newcastle. The only commercial access to markets from the Middleback Ranges was through Whyalla.

The taxpayer held a large number of mining leases covering the mines - they included most of the Middleback Ranges. The taxpayer also held perpetual leases for the purposes of the tramway to Whyalla. In addition, the Broken Hill Proprietary Company's Indenture Act 1937 conferred on the taxpayer rights in respect of lands at and near Whyalla for the purpose of facilitating the production of iron ore from the Middleback Ranges, but those rights did not include mining rights.

In 1965, the taxpayer constructed a pellet plant at Whyalla which was to take feedstock from the mines in the Middleback Ranges. The appeals involved, inter alia, the deductibility of expenditure incurred on the pellet plant. Initially, the appeals were heard by a single judge, Kitto J.

Both Kitto J and the Full Court on appeal held that the expression 'mining operations' had a wider meaning than 'mining'. It included not only mining but also operations connected with mining. Kitto J said: '[The expression 'mining operations'] is wider than 'the working of a mining property'. It embraces not only the extraction of mineral from the soil, but also all operations pertaining to mining: *Parker v Federal Commissioner of Taxation*((1956) 94 CLR 509 at 525)...It extends to any work done on a mineral-bearing property in preparation for, or, as ancillary to the actual winning of the mineral (as distinguished from work for the purpose of ascertaining whether it is worthwhile to undertake mining at all): *Federal Commissioner of Taxation v Broken Hill South Ltd*((1941) 65 CLR 150 at 153, 156, 159, 161). Likewise, it extends to any work done on the property subsequently to the winning of the mineral (eg, transporting, crushing, sluicing and screening) for the purpose of completing the recovery of the desired end product of the whole activity: *Federal Commissioner of Taxation v Henderson* ((1943) 68 CLR 29 at 45, 50). In each case it is the close association of the work with the mining proper that gives it the character of operations pertaining to mining'.<sup>54</sup>

In the Full Court, Barwick CJ and McTiernan and Menzies JJ agreed with Kitto J's dictum insofar as it extended to work done in preparation for or as ancillary to the actual winning of the mineral, but felt constrained to qualify it in respect to work done subsequently to the winning of the mineral:

*'We do not doubt that to separate what it is sought to obtain by mining from that which is mined with it, eg the separation of gold from quartz by crushing etc, or the separation of tin from dirt by sluicing, is part of a 'mining operation' but we would not extend the conception to what is merely*

---

54 Ibid 244-245 (emphasis supplied).

*the treatment of the mineral recovered for the purpose of the better utilization of that mineral.* Thus to crush bluestone in a stone crushing plant so that it can be used for road making, or to fashion sandstone so that it becomes suitable for building a wall or a town hall is not, as we see it, a mining operation. Nor would the cutting of diamonds or opals which have been recovered by mining operations fall within the description of mining operations. In *Federal Commissioner of Taxation v Henderson* ((1943) 68 CLR 29) it was decided that to obtain gold from gold-bearing material, ie slum dumps, by sluicing, screening, filtering and chemical treatment was a mining operation and this, of course, we accept. The reason for so deciding, however, has no application to a process that does no more than either reduce in size lumps of ironstone of manageable size taken from the earth, or, to increase the size of small fragments of ore taken from the earth in order that the ore which has been mined can be conveniently carried away from the mine and utilized in steel making. In *Henderson's Case* the object of the taxpayer's mining operations was to obtain gold and those operations comprehended all the steps in the recovery of the gold from the slum dumps; *here the object of the taxpayer's mining operations is to obtain iron ore - the end product - and those operations comprehend all the steps taken to do so, but once the iron ore is obtained in manageable lumps then its further treatment, either to reduce or increase its size so that it can be conveniently transported from the mine and better utilized in industry, forms no part of the mining operation.* In the same way we would not regard the converting of brown coal into briquettes as part of a mining operation; nor would we regard the treatment in a refinery of naturally occurring hydro-carbons in a free state as part of the operation of mining for petroleum. The mining operation in the last-mentioned instance would finish with what is referred to in s122AA as the 'obtaining' of petroleum as defined. *Accordingly, we would not treat 'the whole activity' referred to in [Kitto J's dictum] as extending to the disposal of the product mined, and because we think 'the end product' of the mining activity in this case is iron ore to be taken away from the mining property, we consider that 'mining operations' ends when the iron ore is in a state suitable for this.*<sup>55</sup>

In the result, neither Kitto J nor the Full Court on appeal held that the pelletisation process was part of the 'mining operations'. Kitto J felt that if the pellet plant had been constructed in the vicinity of the mines, the pelletisation may have constituted a 'mining operation' by virtue of its close association with the processes occurring at the mines.<sup>56</sup> Barwick CJ and McTiernan and Menzies JJ stated that pellet making, upon their understanding, did not by its nature constitute a 'mining operation'.<sup>57</sup>

55 Ibid 272-274 (emphasis supplied).

56 Ibid 252-253. Owen J disagreed with him on this: *ibid* 282-283.

57 Ibid 275.



In deciding that the pelletisation process at Whyalla was not a part of 'mining operations' upon a 'mining property', Kitto J and the Full Court on appeal took the view that the 'mining property' constituted the leases in the Middleback Ranges - they did not accept the contention that the 'mining property' included the tramway and areas at Whyalla.

In *Federal Commissioner of Taxation v ICI Australia Ltd*,<sup>58</sup> the taxpayer had acquired a number of mining leases over an area near Port Alma in Queensland which was underlain by an aquifer containing brine. Under the conditions of lease the taxpayer was obliged to work the brine. The taxpayer's purpose in working the brine was to produce common salt. The brine was pumped to the surface and then into surface ponds and channels, where it was concentrated by controlled evaporation and improved by the removal of unwanted calcium sulphate. As evaporation continued, common salt crystallised. During crystallisation, further unwanted substances, including magnesium salts, were drained off. The salt was then harvested, washed and dried and conveyed to a hopper, whence it was trucked to Port Alma and stock-piled to await shipment to other destinations. The taxpayer claimed that costs incurred in connection with all operations prior to the harvesting of the salt were deductible under ss122(1) of the Income Tax Assessment Act 1936, because they were costs incurred in connection with 'mining operations upon a mining property'.

The decision turned, initially, on the question whether brine-pumping constituted mining and, thereafter, on the question which of the processes from the extraction of the brine to the crystallisation of the common salt constituted 'mining operations' within the meaning of that term in ss122(1). The meaning of the term 'mining property' was not in issue - presumably, any contention that the 'mining property' was something less in extent than the mining leases was thought not worth pressing.

The appeal was first heard by a single judge of the High Court. Walsh J decided that brine pumping was mining and then turned to the question of what processes were included in the term 'mining operations': that question was to be determined by reference to the object of the taxpayer's operations. That object was to produce a certain end product: either brine or common salt. In his view, the object was to produce common salt and, accordingly, he held that all processes up to and including crystallisation of the salt were 'mining operations'.<sup>59</sup>

In relation to refining processes and the removal of unwanted materials, Walsh J had this to say:

'It was suggested that the respondent's argument gains support from the reference in the *BHP Case* ((1969) 120 CLR 240 at 273), to the operation of mining for petroleum. It was there said that this would finish with the obtaining of petroleum as defined, that is, naturally occurring hydrocarbons in a free state and that treatment in a refinery of the hydrocarbons would not be part of the operations of mining...I do not think that it should be said that to refine petroleum in order to obtain oil of a particular type

---

58 (1972) 127 CLR 529.

59 *Ibid* 549.

is to separate the oil from 'unwanted' materials or substances mined with it. But, in my opinion, it can be said that the concentration and crystallization processes are operations to separate the end product from other substances (water and some salts other than sodium chloride which are precipitated before the brine reaches the crystallisers) obtained from the earth with it and I think that these are operations of the kind which the leading judgment in the *BHP Case* ((1969) 120 CLR 240 at 272) describes as 'mining operations'.<sup>60</sup>

The Full Court affirmed the decision of Walsh J. Barwick CJ, with McTiernan J concurring, observed that the recovery of the salt from the brine was not complete until the evaporative process had taken place. In his view, the 'mining operations' included the recovery of salt from the brine by evaporation. He stated:

'The facts that the brine is the immediate product, as I think, of a mining operation and that the recovery of the mineral raised by the mining operation is not complete until the evaporative process has taken place, lead me to conclude that the evaporative process is itself so associated with the raising of the brine and the recovery of the metal, sodium chloride, as to be part of the mining operation.'<sup>61</sup>

Gibbs J, the other member of the majority, relied on the distinction drawn by the majority of the Full Court in *BHP* between extraction and separation of unwanted products, on the one hand, and 'what is merely the treatment of the mineral recovered for the better utilisation of that mineral', on the other hand, to observe that the treatment of the brine after extraction and before harvesting was 'for the purpose of separating that which it was sought to obtain by mining, namely, salt, from that which was mined with it, namely, water and the calcium and magnesium salts'. In his view, all the operations up to and including crystallisation formed part of the 'mining operations'.<sup>62</sup>

*Federal Commissioner of Taxation v Northwest Iron Co Limited*<sup>63</sup> involved the exploitation of two crude iron ore mines located near Savage River in Tasmania. At the Savage River site, crude iron ore extracted from the mines was crushed and ground into very fine particles to produce a slurry in which the particles were suspended in water. The slurry was transported along an 85 km pipeline to the company's pellet plant at Port Latta. At Port Latta, the concentrate was further treated and converted into pellets which were loaded into ships for transport overseas. The Court delivered a unanimous judgment written by Lockhart J. It was a central issue whether or not expenditure on the pipeline and pellet plant and on other facilities at Port Latta was incurred in connection with the carrying on of 'mining operations upon a mining property'.

The Full Federal Court relied principally on the judgments of Walsh J and Barwick CJ in *BHP*. 'Mining operations' was a wide and not inflexible expression which denoted operations pertaining to mining. It could include both works done prior to or ancillary to the mining of

---

60 Ibid 549-550.

61 Ibid 565.

62 Ibid 582-583.

63 (1986) 86 ATC 4202.

minerals and the separation of what was sought to be obtained by the mining from unwanted substances. In each case, it was a question of fact whether particular operations or processes constituted 'mining operations' for the purposes of ss122(1).<sup>64</sup>

The object of the mining operations based on the Savage River mines was to produce pellets from the iron ore. Wet processes were used and, eventually, water was removed. The Court considered that transportation by pipeline to Port Latta and pelletisation were integral to the operations of the mining venture:

'The object of the taxpayer's activities is the production of pellets after treatment of the ore, essentially by wet processes and the eventual removal of the water content from the slurry. It is not the object of the taxpayer's operations to produce 'fines'. The slurry, the water content of which is finally removed in the pelletisation process, is not a slurry used merely for the purpose of transporting 'fines' otherwise free of water; it is the result of the treatment process of the ore itself which, prior to transportation, results in a slurry containing powdered metal. It is true that further water and some chemical is added for ease of movement through the pipeline; but the mining operations extend until the completion of the pellet producing process. The process of pelletisation is integral to the whole operations of the mining venture and essential to the development of the potential of the low-grade ore of the Savage River site by means of the taxpayer's technology.

The pipeline is essential to the end product. It is not different in essence from a necessary conveyor line conveying material from one section to another within a mining complex. The end product of the taxpayer's mining activities is the production of pellets.'<sup>65</sup>

Practical and businesslike considerations were relevant to the solution of the question of where the 'mining operations' came to an end:

'It is unreal to draw a line between the operations being conducted at Savage River (up to the point where some adjustment was made to the water content of the slurry and some chemical introduced immediately before the slurry was pumped into the pipeline) and the operations thereafter. Practical and businesslike considerations clearly led to the conclusion that the whole of the relevant operations of the taxpayer to the final stage where pellets emerge are part of its mining operations. Although, at first sight it may seem somewhat incongruous that a pipeline, extending for some 85 km from the Savage River to Port Latta, is part of the taxpayer's mining operations, the apparent incongruity disappears when the role of the pipelines is considered in the context of the taxpayer's activities as a whole.'<sup>66</sup>

The Court held that the various operations up to and including pelletisation

64 Ibid 4209-4210.

65 Ibid 4210.

66 Ibid 4211.

comprised 'mining operations' carried out upon a 'mining property'. In each case, it was a question of fact what was the 'mining property'. It was a relevant consideration, though not conclusive, that leases had been granted pursuant to an Act of Parliament passed for the furtherance of the iron ore project. All the operations up to pelletisation were carried out on such leases.<sup>67</sup>

To sum up, the cases on the meaning of the term 'mining operations' in ss122(1) considered the object of the taxpayer's activities in determining what came within the term. In *ICI*, the object was to produce common salt, not brine, and in *Northwest Iron*, the object was to produce a saleable commodity, pellets, not unsaleable fines.

A further aspect of the decisions was that the 'mining operations' continued up to the point of recovery of the end product which was the object of the taxpayer's activities - that is to say, up to the point of removal of unwanted substances, being various salts other than common salt in *ICI* and titanium oxide and water in *Northwest Iron*.

In *Northwest Iron*, the court reasoned that the downstream perimeter of 'mining operations' could not, for the purposes of ss122(1), occur upstream of the point of production of a saleable commodity and then referred to practical and businesslike considerations to produce a realistic result. The Resource Rent Tax Acts utilise the criterion of the point of production of a marketable petroleum commodity in the vertical delineation of what constitutes a petroleum project under that legislation. However, in relation to 'mining operations' under the Income Tax Assessment Act 1936, that criterion is merely an incident of a wider test, ie what is the object of the taxpayer's operations. Will the Administrative Appeals Tribunal have regard to practical and businesslike considerations in determining, in any particular case, the vertical delineation of a petroleum project for the purposes of the Resource Rent Tax Acts? Only time can tell.

Finally, it appears that the phrase 'upon a mining property' inhibited the courts' readiness to interpret the phrase 'mining operations upon a mining property' to reflect the factual patterns which came before them, because the extraction process normally occurred on the mining leases whilst subsequent treatment and processing commonly occurred outside those leases. This was a self-imposed limitation, as the courts were most comfortable with the position that the mining leases constituted the mining property. Yet this produced differing results. In *BHP*, neither the perpetual lease of the land upon which the tramway between the mine-sites and Whyalla was constructed, nor any tenure of land at Whyalla, were accepted as constituting part of the 'mining property'. On the other hand, in *Northwest Iro*, not only the mining leases at the mine site, but also the pipeline licence in respect of the pipeline from Savage River to Port Latta and certain leases at Port Latta, were held to constitute the 'mining property'. Such a limitation does not appear in the Petroleum Resource Rent Tax Acts which clearly contemplate that operations which do not occur within the areas of the subject production licences may nevertheless comprise part of the tax unit.

---

67 Ibid 4211-4212

**(c) 'Mining operations' - Excise Act 1901**

The Diesel Fuel Taxes Legislation Amendment Act 1982 introduced into the Excise Act 1901 an entitlement to obtain a rebate of excise duty paid on diesel fuel which had been purchased for use 'in mining operations...(otherwise than for the purpose of propelling a road vehicle on a public road)'.<sup>68</sup>

This involved the following definition:

'mining operations' means:

- (a) exploration, prospecting or mining for minerals; or
- (b) the dressing or beneficiation (at the mining site or elsewhere) of minerals, or ores bearing minerals, as an integral part of operations for their recovery,

and includes:

- (c) other operations connected with exploration, prospecting or mining for minerals that are carried out in, or at a place adjacent to, the area in which the exploration, prospecting or mining occurs;
- (d) where minerals, or ores bearing minerals, are dressed or beneficiated, at a place other than the mining site, as an integral part of operations for their recovery - the transporting of the minerals or ores from the mining site to the place where they are dressed or beneficiated;
- (e) the liquefying of natural gas;
- (f) where natural gas is liquefied at a place other than the mining site - the transporting of the natural gas from the mining site to that place; or
- (g) the production of common salt by means of evaporation, but does not include quarrying operations carried on for the sole purpose of obtaining stone for building, road making or similar purposes.<sup>69</sup>

Of particular significance are the express inclusion of the liquefaction of natural gas and the production of common salt by evaporation and the express exclusion of quarrying operations. There is no restriction to operations carried out on a 'mining property'. Dressing and beneficiation are expressly included, whether or not those processes are conducted at the mine-site or elsewhere, so long as the processes are 'an integral part of operations for...recovery' of minerals or ores bearing minerals.

In *Cliffs Robe River Iron Associates v Collector of Customs*,<sup>70</sup> the Administrative Appeals Tribunal was encouraged by the common features of that definition of 'mining operations' and the meaning of 'mining operations' under the Income Tax Assessment Act 1936 to compare the two in the course of interpreting the former. The Tribunal noted that the meaning of 'mining operations' under the Excise Act 1901 was both narrower and wider than the meaning under the Income Tax Assessment

68 Excise Act 1901 (Cth) s78A.

69 Customs Act 1901 (Cth) ss164(7), which is imported into the Excise Act 1901 (Cth) by ss78A(7) thereof.

70 AAT Judgement No W84/14.

Act 1936. Paragraph (a) referred only to mining for minerals but not to associated activities, whilst paragraph (b) introduced operations connected with mining. On balance, the meaning in the Excise Act 1901 was wider than the other.<sup>71</sup>

In *Western Mining Corporation Ltd v The Collector of Customs, Western Australia*,<sup>72</sup> the Administrative Appeals Tribunal had to decide whether certain activities constituted 'the dressing or beneficiation...of minerals, or ores bearing minerals, as an integral part of operations for their recovery'. In so doing, the Tribunal classified those activities into various processes.

The applicant mined nickel ore at Kambalda. The ore was concentrated at the mine site and then transported, as to one part, to a smelter at Kalgoorlie and, as to another part, directly to a nickel refinery at Kwinana. The concentrate transported to Kalgoorlie was there processed to produce high grade nickel matte which was then transported to the refinery at Kwinana, as to some, and directly to overseas markets, as to the remainder. The nickel refinery received, as feedstock, concentrate from Kambalda and high grade nickel matte from Kalgoorlie. The Tribunal identified a number of processes, including mining, crushing and screening, grinding, concentration by flotation, thickening and smelting. In addition, the processes involved transportation.

The decision turned on the nature of a milling process at the Kwinana refinery, which took place prior to a leaching process. The milling process did not increase the concentration of nickel in the concentrate - it merely changed its physical characteristics by converting the matte to a powder form. It made no change to the chemical composition of the matte. In holding that the milling process at Kwinana did not constitute 'dressing' or 'beneficiation', the Tribunal applied a meaning of 'recovery' which involved an increase in nickel content in the concentrate. In contrast to the milling process at Kwinana, the smelting process at Kalgoorlie did increase the nickel content of the concentrate and was caught by the definition of 'mining operations'. The Tribunal said:

'In our opinion, the milling process which takes place at the refinery at Kwinana is not a process of 'dressing' or of 'beneficiation'. It is not a process undertaken with a view to improving the concentrate. We view it as a step taken as part of the final process whereby metal is produced from the concentrate. In order to carry out this process it is necessary to convert the matte into a powder form. This step does not improve the raw material but is undertaken because the process adopted for the production of the metal uses the raw material, the concentrate, in powder form.'

Moreover, the milling step is not taken as an integral part of operations for the recovery of the mineral. Nickel is a naturally occurring mineral, although it is extremely rare in its natural state. As a matter of logic, it could therefore be said that the production of the nickel metal was the final stage of the recovery of the nickel mineral. But the term

---

71 Ibid 6-7.

72 AAT Judgement No W83/13.

'recovery' is not so used. It is used in relation to the beneficiation processes which result in an upgrading of the quality of the ore or concentrate. The milling process undertaken at Kwinana is not such a process. That process produces no change in the mineral percentage of the concentrate. It produces a change in form only and is not a step taken as part of a series of steps designed to improve the ore or the concentrate.<sup>73</sup>

The Tribunal's reasoning is not readily explicable. First, the refining process at Kwinana, to which the milling process was ancillary, further increased the percentage of nickel in the product. Secondly, a process not involving any increase in the percentage of nickel in the ore, namely, the crushing and grinding of ore, also occurred prior to the smelting process at Kalgoorlie. However, the conclusion is justifiable on the basis that a demarcation is to be drawn between the 'mining operations' and the refining process, because that marks the transition between the upgrading of ore or concentrate and the production of metal from that concentrate.

The decision in *WMC* is significant in our inquiry because the Tribunal analysed the facts according to processes. On such an analysis, it could not be said that ethane has been 'produced' at a certain level in a de-ethanising tower, notwithstanding that at that level it has attained sales specification. Upon a process-based analysis, the ethane would be 'produced' upon completion of the de-ethanising process, ie when it leaves the de-ethanising plant. Furthermore, it could be argued that the production of the ethane includes such storage, not amounting to stock-piling, as is necessary to allow the de-ethanising process to proceed.

#### **(d) 'Production Unit' - Petroleum Revenue Act 1985**

The Petroleum Revenue Act 1985 takes as its tax unit a 'production unit', which is defined to include one or more 'production sources' and associated facilities. Where two or more sources use the same processing facilities, a 'project' enters into the determination of the tax unit.

A 'production unit' is defined to mean:

'a production source together with the plant and facilities (wherever situated) used in, or in relation to, the production of market petroleum from that source (other than plant and facilities used in, or in relation to, the refining or transport of market petroleum).'<sup>74</sup>

A 'production source' is defined to mean:

- '(a) a source of petroleum in a State (which, without limiting the generality of the foregoing, may be a production area within the meaning of s5B of the Excise Tariff Act 1921);  
or
- (b) or more sources referred to in paragraph (a) that constitute, or form part of, a project for the production of petroleum.'<sup>75</sup>

73 Ibid 30-31.

74 Petroleum Revenue Act ss3(1).

75 Ibid.

Under the Petroleum Revenue Act 1985, the determination of what constitutes a 'production unit', a 'production source' or a 'project' does not depend on an exercise of Ministerial discretion. Indeed, provision for such an exercise of discretion is not required. Prior to entering into a prescribed Resource Rent Royalty Agreement, the State and the producers would have an opportunity to negotiate and agree as to what within the meaning of the term should constitute the 'production unit'.

**(e) Combination of Petroleum Projects**

In some cases, it will be difficult to reconcile a petroleum project based on a single production licence with what upon an inference from the facts appears to be the actual petroleum project. Thus, a single plan or scheme may involve production of petroleum from a number of proximate or scattered production licences within a region. It may involve a single investment decision and be financed as a whole. One or more State agreements may be in force in respect to the whole or a part of the scheme or plan. There may be a single objective - the production of one or more end products, notwithstanding that the petroleum may come from a number of sources. There may be common facilities for the processing of petroleum from different sources - such as, a crude stabilisation plant, fractionation plant, naptha splitter and storage facilities. The Assessment Act addresses such a situation.

Where a number of projects each based on a production licence are sufficiently related on the facts, they may be combined by an exercise of Ministerial discretion and treated for the purposes of assessment as a single project. Sub-section 20(1) provides:

'Where within the qualifying period in relation to an eligible production licence, the certifying Minister, whether on application, request or otherwise, having regard to:

- (a) the respective operations, facilities and other things that comprise, have comprised or will comprise the petroleum project in relation to the eligible production licence and any other petroleum project or projects existing at the time at which the eligible production licence came into force;
- (b) the persons by whom or on whose behalf the operations, facilities and other things referred to in paragraph (a) are being, have been or are proposed to be carried on or provided; and
- (c) the geological, geophysical and geochemical and other features of the production licence areas in relation to the projects,

considers that the projects are sufficiently related to be treated for the purposes of this Act as a single petroleum project, the certifying Minister shall issue a certificate under this sub-section specifying the eligible production licence or eligible production licences in relation to each of the projects.'<sup>76</sup>

---

<sup>76</sup> At 37, the Explanatory Memorandum provides an example, under sub-para (c), of an instance where petroleum projects might be combined - the case where a petroleum pool crosses the common boundary of two adjoining production licences.



The certifying Minister is the Minister for Resources and Energy. The qualifying period is the period of 90 days after the first production licence upon which the project is based comes into force.<sup>77</sup>

The requirement on the Minister to issue a certificate of combination appears mandatory once he or she has had regard to the prescribed facts and comes to the view that projects are sufficiently related to be treated, for the purposes of the Act, as a single petroleum project. The Minister's decision is reviewable by the Administrative Appeals Tribunal.<sup>78</sup> Review by the Tribunal is a review on the merits and the prospect of such a review introduces some control on the Minister's exercise of discretion. Further, the Tribunal's decision is reviewable on the questions of law by the Federal Court.

What then is the meaning of the statement that having regard to certain specified facts, certain projects are 'sufficiently related to be treated for the purposes of [the] Act as a single petroleum project'?

The phrase 'for the purposes of this Act' in s20 is not particularly helpful. The purposes of the Assessment Act are to specify the basis upon which the tax is assessed. That does not assist, because that very basis is in issue in s20. But, because the Tax Act incorporates the Assessment Act, it could be argued that the purposes of imposition of the tax is a purpose referred to in s20 of the Assessment Act. Again, that does not assist. A charging act is to be narrowly construed in favour of the taxpayer. Any attempt by reference to the facts referred to in s20 of the Assessment Act to increase the tax payable by the taxpayer by means of applying stringent criteria for acceptance of a number of projects as a combined project would be improper.<sup>79</sup>

Let us turn to the word 'project'. 'Project' does not have a dictionary meaning which is particularly appropriate to the context in which that word appears in the Assessment Act. The *Shorter Oxford English Dictionary* includes the following meanings:

'a mental conception of idea...something projected for execution; a plan, scheme, purpose; a proposal...'

According to those dictionary meanings, a 'project' is forward looking - it amounts to something planned to be done. In the petroleum and mining industries, on the other hand, a 'project' may include a scheme or plan which has been commenced and is partly executed, for example, the 'Roxby Downs Project'.

Because the Assessment Act, in the phrase 'operations, facilities and other things', specifies the content of a 'project' by reference to activities, physical equipment and other things comprising a petroleum project, the

---

77 Assessment Act ss20(2). In some circumstances, the Minister may extend the qualifying period in order to enable him to adequately consider an application or request for combination.

78 Ibid ss20(11).

79 There is another possible explanation of the meaning of the phrase 'for the purposes of this Act' in s20. Many of the sections of the Act contain the phrase 'for the purposes of this Act', whilst others contain the phrase 'for the purposes of [a particular section, sub-section or part of the Act]'. In this function, the respective phrase does no more than indicate whether a provision applies generally throughout the Assessment Act or has a more limited application within the Act.

meaning of 'project' in the Assessment Act conforms with the industry sense of the word.

The word 'single' is used as an adjective descriptive of what is to be treated as a 'project' for the purposes of assessment. The conception of a 'plan' or a 'scheme' implies a unity of all the elements comprising the plan or scheme. It implies a single scope. The adjective 'single' in the term 'single petroleum project' in s20 highlights this idea of unity. The *Shorter Oxford English Dictionary* includes the following meanings of 'single':

'unaccompanied or unsupported by others; alone, solitary...individual, as contrasted with larger bodies or numbers of persons or things...separate; distinct from each other or from others; not combined or taken together...standing alone in comparison with other persons or things...'

Particularly interesting is that dictionary meaning of 'single' which is in contradistinction to combination. Under the Act, a number of single petroleum projects may be combined where they are sufficiently related to be treated as a single petroleum project!<sup>80</sup> Confusion of meaning and, indeed, tautology is apparent in s20.

The phrase 'sufficiently related' is more helpful. The *Shorter Oxford English Dictionary* includes the following meanings of the words 'sufficient' and 'relation':

'Sufficient'...of a quantity, extent or scope adequate to a certain purpose or object...'

'Relation'...that feature or attribute of things which is involved in considering them in comparison or contrast with each other...any connection, correspondence, or association which can be conceived as naturally existing between things...'

What is the object of 'sufficient relation' in s20? It appears to be that upon particular facts the natural inference is that a number of petroleum projects each based on a production licence together constitute, in reality, a single petroleum project.

What features and attributes will contribute to such a relation between petroleum projects, where each is based on a production licence? Some of those have already been adverted to above. They must be referable to the facts specified in s20. They could be found in the use of common facilities for production from various sources, parties common to a number of joint ventures engaged in petroleum production operations within a region, a petroleum reservoir extending across the boundaries of adjoining production licence areas, a State Agreement or a single financing facility. The mere fact that various production sources occur in production licence

80 Given that the Parliamentary draftsman in the Explanatory Memorandum used the word 'integral' in describing the vertical, ie upstream/downstream, delineation of a project, it appears that a deliberate choice was made to use the word 'single' in s20 rather than the word 'integral'. At 7, the Explanatory Memorandum states: 'A petroleum project can only exist when a production licence comes into force and, broadly, will consist of the production licence area, as well as treatment facilities and other facilities and operations outside that area which are integral to the processes for production of a marketable petroleum commodity...'

areas which are neither contiguous with, nor proximate to, each other but otherwise within a region ought not be sufficient ground for the denial of combination.

In conclusion, the combination provisions in the Assessment Act compound the uncertainty introduced into the tax unit by the use of an unnatural unit, a production licence, as the basis for a petroleum project. The combination of projects, so that they may be treated as a single project for the purposes of assessment, is subject, in the first instance, to a favourable exercise of discretion by the Minister of Resources and Energy. Any review by the Administrative Appeals Tribunal of the Minister's decision and any subsequent appeal to the Federal Court, would be presented with the task of attempting to determine Parliament's intent. Having regard to the following considerations - first, that Parliament took a single production licence as *prima facie* constituting a petroleum project; and, secondly, that Parliament imposed a 90-day qualifying period for the combination of a project - the Federal Court could well decide that Parliament intended something narrower and more specific than the meaning of the word 'project' in either its vernacular or industry sense. The provisions in relation to exploration expenditure offsets could also be relied upon as being indicative of Parliament's intent that the tax unit should be based on a production licence and not a 'project' in either its vernacular or industry sense. Parliament could have introduced an objective definition of a project by reference to an integrated plan or investment with a limitation excluding downstream activities such as refining or distribution, but, instead, Parliament based the project on a production licence and introduced the requirement of an exercise of discretion by the Minister for the combination of single projects.

To put it another way, it is not clear from the legislation whether Parliament intended that the tax be levied on a petroleum source or on what, upon a natural inference from the facts, constitutes the project. The requirement of an exercise of Ministerial discretion for the combination of a number of single projects, each based on a production licence area, could produce either, or an intermediate, result.

Any exercise of the Minister's discretion to combine projects will have an impact on the economics of production. The fiscal effect of combination is that profits from a high yielding production licence will be averaged out with profits from a lower yielding production licence. So long as one or more production licences yield less than the threshold rate of return, combination will reduce the tax payable and provide an incentive for the development of the more marginally economic fields in the combined project.

#### **4. 'PRODUCTION OF [A] MARKETABLE PETROLEUM COMMODITY'**

The phrase 'production of [a] marketable petroleum commodity' enters into three aspects of the assessment of the tax: first, the vertical delineation of a petroleum project;<sup>81</sup> secondly, the point at which receipts, either actual or notional, are to be brought to tax;<sup>82</sup> and, thirdly, the limitation of those expenditures which are deductible as exploration expenditure.<sup>83</sup>

---

81 Assessment Act ss19(4).

82 Ibid ss24, 25.

83 Ibid ss5(2), s37.

A 'marketable petroleum commodity' is defined to mean:

'any of the following products produced from petroleum:

- (a) stabilised crude oil;
- (b) sales gas;
- (c) condensate;
- (d) liquefied petroleum gas;
- (e) ethane;
- (f) any other product declared by the regulations to be a marketable petroleum commodity,

not being a product produced from another product of a kind referred to in paragraphs (a) to (f) (inclusive).'<sup>84</sup>

'Stabilised crude oil' is not separately defined. Taken literally, without any inference of a marketability requirement, stabilised crude oil would be a marketable petroleum commodity even where processes subsequent to stabilisation, eg further processing to remove unwanted substances such as water, have yet to take place.

'Liquefied petroleum gas' is separately defined to mean 'a mixture that includes propane and butane, where the propane and butane comprise more than 50% by weight of the mixture'.<sup>85</sup> This definition presents difficulties, as propane and butane are commonly sold as separate products, notwithstanding that they may have been produced from a single production stream. The Act does not acknowledge that, in order to become marketable, a mixture of propane and butane may need to be separated into propane and butane.

On the other hand, the overriding exclusion from the definition of a 'marketable petroleum commodity' of 'a product produced from another product of a kind referred to [in one of the paragraphs in the definition]' is consistent with a demarcation quarantining, for the purposes of the Act, production processes from downstream activities such as refining and distribution.

Must a product produced from petroleum be marketable to come within the definition of a 'marketable petroleum commodity'? Although the word 'marketable' appears in the defined expression 'marketable petroleum commodity', the product-specific definition of that expression taken literally would appear not to admit an overriding requirement that, notwithstanding that a particular commodity might otherwise come within the definition, the commodity must nevertheless be marketable.

The question of marketability of a product of mining operations was considered by the Full Federal Court in *Northwest Iron*. In the Court's view, the object of the taxpayer's activities was relevant to the question whether the mining operations extended to include the pipeline, the pellet plant and other facilities. The object was to produce a saleable commodity. Accordingly, the Court examined the question where, in the sequence of processes, a saleable commodity had been produced. It stated:

'The Savage River crude ore is a low grade iron ore. It

84 Ibid s2.

85 Ibid.

holds an average iron content of only 38% and in the international trade is not a saleable commodity. It would only be a saleable commodity in its crude form if it had an average iron content of about 62% and was of suitable sizing so as to be capable of being used for direct feed into blast furnaces without treatment of any kind.

Due to the need to crush and grind the Savage River crude ore to about 80% minus 325 mesh...in order to permit liberation of the titanium to an unobjectionable level, the particle size of the resultant 'fines' product makes it unsuitable for use as sinter feed...

The Savage River concentrates are only suitable for being used as pellet feed...

Pellet feed (fines) for pellet producing plants...was not a saleable commodity at the time the Savage River project was being evaluated in the early 1960s. The reasons for this were twofold. First, whilst there were pellet plants in existence in the western world at the time which were capable of consuming the total output of Savage River pellet feed, most of them obtained their pelletising ore from related mining operations. They had no capacity or need for pellet feed from external sources. Second, whilst there were at least two pellet plants in Japan built in 1962 and 1963, which obtained their pellet feed from external sources their capacity was 180,000 tons of pellets per year and 130,000 tons of pellets per year respectively; well below the economic level required to justify the Savage River project. Over two million tons of pellets are produced from the [Savage River mines] joint venture. Even today the market for pellet feed is extremely limited.<sup>86</sup>

On a fine difference of fact, the Court distinguished *BHP*, in which the High Court had held that the transportation of fines produced in the Middleback Ranges, from iron ore extracted from several mines there, to Whyalla did not come within the expression 'mining operations' in ss122(1):

'At no stage of the crushing, grinding and concentration of the crude ore at Savage River does concentrated ore appear in a form that can be described as 'fines'. The first time the so-called 'final magnetic concentrate' appears, after the concentration process, it does so in a slurry form which enters the pipeline at Savage River. The slurry is then a...mixture of water and of iron ore concentrate. The slurry is not a saleable commodity and it is not dewatered until it reaches Port Latta as part of the pelletisation process. The only saleable commodity available from the Savage River development as a modern blast furnace feed was, and is today, pellets.'<sup>87</sup>

In determining what was the saleable commodity produced by the

---

86 86 ATC 4202 at 4207-4208.

87 Ibid 4210.

operations based on the Savage River mines, the Court considered: first, marketability in international trade by reference to both chemical and physical specifications; secondly, the particular markets available at the time when the project was established; and, thirdly, the end uses of the particular iron ore.

It is submitted that, to be commercially workable, the definition of the expression 'marketable petroleum commodity' should implicitly contain a requirement that the commodity is saleable by reference to the markets existing either at the time when the project was established or at the time of sale.<sup>88</sup>

The following statement in the Explanatory Memorandum infers an analysis according to a marketability requirement, notwithstanding that otherwise a particular substance may come within the description of one of the products listed in the definition of 'marketable petroleum commodity':

'[the Bill identifies]...in the case of certain petroleum products that have not been sold by the point in the production process *at which they become marketable*, amounts deemed to be receipts - that are to be assessable for PRRT purposes.'<sup>89</sup>

Furthermore, the definition of 'market petroleum' in the Petroleum Revenue Act 1985, a statute arguably in *pari materia* with the Resource Rent Tax Acts, contains a clear marketability requirement. It refers to 'petroleum in a form in which petroleum is commonly sold' and to 'a product that is derived from petroleum and is of a kind that is commonly sold'.

To take another tack, could the Administrative Appeals Tribunal or the Federal Court rely on the words 'products' and 'produced' in the phrase 'products produced from petroleum' to make the definition of a 'marketable petroleum commodity' commercially workable? In ordinary parlance, a product is an end-result of an activity or process. Production is not complete until the process has been completed, notwithstanding that a substance may have attained the chemical composition of the specified commodity mid-way in a process, eg ethane may occur in the de-ethaniser tower, but it would be impractical, unbusinesslike and incongruous as against the facts to say that that is where ethane is first produced. If it be accepted that the ethane is produced upon delivery from the processing plant, notwithstanding that chemically it was ethane in the de-ethaniser, a further question arises. Are any storage facilities, not amounting to stock-piling, which are necessary to enable the de-ethanising process to proceed part of the petroleum project?

The *Shorter Oxford English Dictionary* includes the following meanings of the verb 'produce':

'To bring (a thing) into existence from its raw materials or elements. Of a country, river, mine, process etc: To give forth, yield, furnish, supply...'

Given the dictionary meaning of 'produce', it is but a short step to

<sup>88</sup> Because the markets existing at the time when the project was established influenced the investment decision to proceed with the project, it is arguable that that is the appropriate time.

<sup>89</sup> Explanatory Memorandum at 1 (emphasis supplied).

say that the production of petroleum products from crude petroleum necessarily involves certain processes and that the 'product' is 'produced' from crude petroleum when the last of those processes yields or gives up the 'product'.

The word 'process' has been judicially considered in a number of cases on facts dealing with industrial activities. In *Kilmarnock Equitable Co-operative Society Ltd v Inland Revenue Commissioners*,<sup>90</sup> it was held that the breaking up of coal, separating it from dross and packing it for distribution was a process within the meaning of s271 of the Income Tax Act 1952 (UK). In *Commissioner of Inland Revenue v Leith Harbour and Docks Commissioners*,<sup>91</sup> the court held that grain elevators performed processes upon grain conveyed by the elevators. In *Ellerker (Inspector of Taxes) v Union Cold Storage Co Ltd*,<sup>92</sup> cold storage was considered to be a process.

In *Vibroplant Ltd v Holland (Inspector of Taxes)*,<sup>93</sup> Dillon J, in the Chancery Division, considered the meaning of the word 'process'. He said:

'In my view, 'process' connotes a substantial measure of uniformity of treatment or system of treatment. I note that a dictionary definition of 'process' in the Shorter Oxford English Dictionary, which was cited by Slade J in *Buckingham (Inspector of Taxes) v Securitas Properties Ltd* (1980) STC 166 at 173, (1980) 1 WLR 380 at 386 is: 'a continuous and regular action or succession of actions, taking place or carried on in definite manner; a continuous (natural or artificial) operation or series of operations'.<sup>94</sup>

It has been suggested above that some storage, not amounting to stock-piling, is on the facts a sine qua non of the processing of crude petroleum. Without some storage, there is nowhere for processed petroleum to be delivered to and processing must halt. Accordingly, does the point of 'production of [a] marketable petroleum commodity' occur at the point of delivery from the processing plant or is storage, not amounting to stock-piling, included in the 'production of [a] marketable petroleum commodity'?

In the writer's view, counsel would be well-advised to contend that, having regard to practical and businesslike considerations, the various activities involved in the 'production of [a] marketable petroleum commodity' should be classified into processes; that a marketable petroleum commodity would not, for the purposes of the Assessment Act, be produced mid-way in a process; and that such storage as is necessary to allow the processes to proceed is included, either as being part of the main purpose or incidental thereto. It has been held that a 'process' includes an operation which is merely incidental to the main purpose of the activities.<sup>95</sup>

The following fact situation illustrates the impracticality of a narrow interpretation of the phrase 'production of [a] marketable petroleum

90 (1966) 42 Tax Cas 675.

91 (1942) 24 Tax Cas 118.

92 [1939] 1 All ER 23, 22 Tax Cas 195.

93 [1981] 1 All ER 526.

94 *Ibid* 532.

95 *Forster v Llanelly Steel Co* (1941) 110 LJKB 120.

commodity'.<sup>96</sup> In the Bass Strait, hydrocarbons are extracted at offshore production platforms whence they are conveyed by pipeline to a gas processing plant and a crude oil stabilisation plant at Longford, onshore Victoria. There they are processed and separated into stabilised crude oil, natural gas and gas liquids. The constituents of the gas liquids (by reference to the end products of the project) are condensate, propane and butane. Three trunk pipelines convey product streams from Longford to other onshore destinations in Victoria. One carries the stabilised crude oil to a crude oil tank farm where further water is removed; the product is then sold. Another carries the gas liquids to a fractionation plant at Long Island Point where they are processed, purified and separated into condensate, propane and butane; those products are sold ex-Long Island Point. The third, a buyer's pipeline, carries dry natural gas to Melbourne for use; the gas is sold ex-Longford.

In the case of the stabilised crude oil, a further unwanted substance, ie water, is removed following processing in the crude stabilisation plant. Yet, on a narrow interpretation of the phrase 'production of [a] marketable petroleum commodity', the project in respect of crude oil would extend only to the outlet of the crude oil stabilisation plant at Longford and would not include the pipeline to the crude oil tank farm. The further separation process which is necessary to make the product marketable would be excluded from the project and the crude oil would be assessed for tax at Longford.

In the case of the gas liquids, it appears that a narrow interpretation of the phrase 'production of [a] marketable petroleum commodity' would ensure that the pipeline and fractionation plant at Long Island Point were included in the project, as condensate is not separated from propane and butane until that point; thus, the purification and separation processes at Long Island Point would be included in the project. However, were the product stream in the pipeline liquefied petroleum gas, as defined in the Act, and not a mixture of condensate and liquid petroleum gas, each as defined in the Act, then on the basis that liquefied petroleum gas is a marketable petroleum commodity the project would end at Longford and the liquefied petroleum gas would be assessed for tax at Longford.

On the other hand, there is nothing incongruous in the contention that the pipeline carrying dry natural gas from Longford to Melbourne occurs outside the project. In that case, the gas is sold ex-Longford and actual sales proceeds would be used in the computation of the taxable profit.

A narrow interpretation of the phrase 'production of [a] marketable petroleum commodity' could, in the writer's opinion, overlook the broader descriptions of the processes occurring during and following production of petroleum. For example, distribution and refining clearly occur after production. To limit the tax unit, for the purposes of the Act, by a strict application of the device of the point of 'production of [a] marketable petroleum commodity' could produce impractical and unbusinesslike results.

In the writer's view, a court could find a basis in the Explanatory Memorandum and the Second Reading Speeches for an analysis utilising

---

<sup>96</sup> These facts have been taken, with some inference, from *Hematite Petroleum Pty Ltd and Another v State of Victoria ('Pipelines Case')* (1983) 47 ALR 641.



process-based or step-wise distinctions between those operations which fall within a petroleum project for the purposes of the Act and those which do not. That basis is evident in the following passages:

*'The boundaries of a petroleum project will not extend beyond the first point at which a marketable petroleum commodity is produced. That is, the project boundaries will not extend to 'downstream activities' such as refineries and facilities for the transport of marketable products.'*<sup>97</sup>

In the event that a marketable petroleum commodity is not sold at the point at which it is produced, the market value - or a fair and reasonable value of the commodity - at that point will be treated as an assessable receipt of the project.

*The need to attribute the value could arise, for example, in the case of an integrated producer who both extracts crude oil and refines it.'*<sup>98</sup>

Finally, there is the fundamental consideration that the tax is stated to be a tax on profits as distinct from a tax on production. Where there are no markets and no sales, there can be no profits; in that event, in order to remain in substance a profits-based tax, the imposition of the tax would need to be limited to commodities which are saleable.

## 5. CONCLUSION

The model for the tax unit, as it was presented in the early Ministerial Statements, had a number of analogues which could have been followed in whole or in part. Those analogues included: the term 'mining operations' in the Income Tax Assessment Act 1936, which had undergone substantial judicial analysis; the definition of 'mining operations' in the Excise Act 1901, which appears to be largely based on the term 'mining operations' in the Income Tax Assessment Act 1936 as interpreted by the High Court; and the 'production unit' under the Petroleum Revenue Act 1985 which is used in the determination of resource rent royalty, the stated onshore equivalent of the Resource Rent Tax Acts. Both the Ministerial Statements and the Explanatory Memorandum are consistent with the adoption of one of those analogous concepts as the tax unit for the resource rent tax. However, an examination of the Resource Rent Tax Acts indicates that it is not at all certain that Parliament intended to follow any of those analogues.

As a result of the uncertainty in the tax unit, it appears that the Resource Rent Tax Acts could be applied to produce widely differing results - at the one extreme, taxation by source and, at the other extreme, taxation by (what is upon a natural inference from the facts) the project. Similarly, the concept of the production of a marketable petroleum commodity could be applied either to include the costs of storage which is a necessary part of processing or to exclude such storage and, indeed, to limit the tax unit even more strictly in favour of the State.

Whilst it is not at all clear whether the tax unit under the Resource Rent Tax Acts is intended to accord with either the ordinary or the

97 Second Reading Speech at 7, Explanatory Memorandum at 5 (emphasis supplied).

98 Explanatory Memorandum at 5-6 (emphasis supplied).

industry sense of the term 'project', it is clear that the tax base does not accord with the commercial sense of the term 'profit'.

Under the Assessment Act, the 'taxable profit' is an artificial profit and not a commercial profit determined by normal accounting methods. The Act specifies the expenditures and receipts which are to enter the calculation of the 'taxable profit', eg interest on borrowed funds is expressly excluded. Further, where a product produced from petroleum constitutes a marketable petroleum commodity prior to the point of sale, its value at that point constitutes an assessable receipt. And further, it appears that, where a product produced from petroleum which constitutes a marketable petroleum commodity is neither subjected to a refining process nor sold, but stock-piled, its value at the point where it becomes a marketable petroleum commodity nevertheless constitutes an assessable receipt.

Although the Assessment Act incorporates, with certain limitations, a return on funds invested in production and certain exploration activities, that return on funds invested is variable according to the time when the expenditure was incurred. In the case of closing-down expenditure, there is no return at all on funds invested.

The so-called threshold rate of return on investment is achieved by augmenting certain undeducted expenditure in any tax year and carrying it forward to the next tax year. The rate of augmentation is higher in respect of recent expenditure, which is likely to be predominantly production expenditure, and lower in respect of earlier expenditure, which is likely to be predominantly exploration expenditure. Under the Assessment Act, the expenditure carrying the higher rate of augmentation is deducted prior to expenditure carrying the lower rate of augmentation.

Finally, when all deductions have been used and assessable receipts exceed deductible expenditure in any year, there is no threshold rate of return on funds invested. Coupled with the non-deductibility of interest on borrowed funds this alone has the potential, depending on the level of project-related borrowings, to distort the 'taxable profit' as compared with the commercial profit and produce a real resource rent tax rate in excess of the figure of 40% prescribed in the Tax Act.

Surprisingly, the Resource Rent Tax Acts display a remarkable divergence from the Ministerial Statements and, indeed, the Explanatory Memorandum. As a result, the Resource Rent Tax Acts can be expected to become a bountiful source of litigation. Such litigation appears inevitable, as without it producers cannot be certain as to Parliament's intent.

This paper has put a number of lines of argument which could be pursued in order to produce a result which accords with practical and businesslike considerations or, in other words, commercial reality. Some or all of these lines of argument may not succeed. In any event they would be unnecessary if the Resource Rent Tax Acts:

- (a) Omitted the requirement of an exercise of discretion by the Minister for the combination of petroleum projects, and, instead of basing a project on a production licence, contained an objective definition of the tax unit which excluded refining and distribution processes.
- (b) Omitted the prescription of the vertical limit of the tax

unit as the point of production of a marketable petroleum commodity - thus allowing the single objective definition to determine the tax unit.

Finally, to the extent that the 'taxable profit' departs from anything that can be said to be a commercial profit, the tax may be a profits-based tax in name only and not in substance. The question then arises - what is taxed and what are the consequences?<sup>99</sup>

---

99 Consider Parker, 'Implications of the Pipelines Case for State Resource Revenue', (1984) AMPLA Yearbook 1, at 17-18.