PEPANZ
PETROLEUM EXPLORATION & PRODUCTION
ASSOCIATION OF NEW ZEALAND

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PO Box 25259, Featherston Street, Wellington 6146
pepanz.com / energymix.co.nz / petroleumconference.nz

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Submission on the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill.

Finance and Expenditure Select Committee
Parliament Buildings
Wellington

PEPANZ Submission: Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill

Introduction

1. The Petroleum Exploration and Production Association of New Zealand ("PEPANZ") represents private sector companies holding petroleum exploration and mining permits, service companies and individuals working in the industry.
2. This document constitutes the PEPANZ's submission on the *Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill*.
3. We wish to appear before the Select Committee to discuss this submission.

Summary

We submit that the Finance and Expenditure Committee should amend the *Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill* to include a provision to renew an important income tax provision for petroleum explorers which will otherwise expire on 31 December 2019.

The relevant provision is section for which we seek renewal is section CW 57 of the Income Tax Act 2007. Section CW 57 provides an exemption for income derived by a non-resident company from exploration and development activities in an offshore permit area.

Prior to section CW 57 being enacted some 15 years ago, drilling and seismic ships were in some cases incentivised to inefficiently leave New Zealand (with a new rig being mobilized to complete the exploration programme) before triggering a day count threshold in New Zealand's double tax agreements. The day count threshold (presence in New Zealand for 183 days, or sometimes a shorter period, in a 12 month period) is relevant to whether the owner would be subject to New Zealand tax and so can create an artificial incentive for swapping out one ship/rig before the period has elapsed for another.

Renewal of section CW 57 is important for the following reasons:

- It removes the incentive for the inefficient 'rig churn' described above and thereby minimises unnecessary costs.

- It supports the delivery of current work programmes for petroleum exploration permits. All exploration permits in New Zealand have ‘drill-or-drop’ commitments in the coming months and several years, which means that regulatory settings (including section CW 57) within this time must be certain and conducive to drilling taking place.
- It is critical to maintaining investor confidence in New Zealand. This is especially important in the current context of significant sovereign risk and policy uncertainty facing the petroleum sector in New Zealand following the unexpected ban on new petroleum exploration permits outside of onshore Taranaki.
- The Government has previously stated that it will honour existing permit holders’ rights and we consider that maintaining long-standing exploration rules (including section CW 57) is an important part of that. Section CW 57 has been in place for almost 15 years and although it has a sunset period it has been renewed by successive Labour-led and National-led Governments. Businesses have inferred from this support that the exemption was a relatively stable aspect of New Zealand's tax policy settings.

Officials consider this measure to be "revenue neutral and possibly revenue positive"[1], so renewing the provision has no fiscal cost to the Crown.

Submission

Recommendation

4. We submit that the Finance and Expenditure Committee should recommend that the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill be amended to include a provision to renew an important income tax provision for petroleum explorers which will otherwise expire on 31 December 2019. The section for which we seek renewal is section CW 57 (Non-resident company involved in exploration and development activities) of the Income Tax Act 2007.
5. We understand that the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill is likely to be the last tax bill to be enacted this year. Given that the exemption expires on 31 December 2019 it is critical that Parliament uses the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill to enact an amendment extending the application of section CW 57.

Background to section CW 57

6. New Zealand's double tax agreements provide that non-residents are taxable on their New Zealand-sourced business profits only if they have a "permanent establishment" in New Zealand. Many of New Zealand's double tax agreements provide that a non-resident that carries on activities in New Zealand in connection with exploration for natural resources will be taxable in New Zealand only if the enterprise carries on those activities for a particular period, often 183 days in any 12 month period.
7. Prior to the exemption in section CW 57, the 183-day or other threshold incentivised drilling and seismic ships to inefficiently leave New Zealand before exceeding the threshold, with a new rig mobilized to complete the exploration program. The introduction of section CW 57 meant this inefficient ‘rig churn’ has been avoided and has also assisted with seeing discoveries being made sooner than would otherwise be the case.

The importance of the provision

8. Renewal of section CW 57 is important for the following reasons.
    a. It removes the incentive for the inefficient ‘rig churn’ described above and thereby minimises both unnecessary mobilisation costs on petroleum operators and associated transport-related emissions.
    b. It supports the delivery of current work programs for petroleum exploration permits. All exploration permits in New Zealand have ‘drill-or-drop’ commitments in the coming months and several years, which means that settings within this time must be conducive to drilling taking place.

[1] Asia-Pacific Economic Cooperation *Peer review on fossil fuel subsidy reforms in New Zealand – Final report* (September 2015) at p86.

c. It is critical to maintaining investor confidence in New Zealand. This is especially important in the current context of significant sovereign risk and policy uncertainty facing the petroleum sector in New Zealand following the unexpected ban on new petroleum exploration permits.

The views of officials

9. Government departments have supported this provision since its inception in 2005, and the Regulatory Impact Statement from the Inland Revenue Department accompanying the 2014 renewal outlines the public policy case in detail. We refer the Committee to the official advice for a comprehensive analysis[2].

The nature of the provision

10. MBIE, Treasury and the IRD do not consider the provision to be a subsidy. This view was affirmed by APEC (the Asia-Pacific Economic Co-operation forum) in its *Peer Review on Fossil Fuel Subsidy Reforms in New Zealand*. Pages 39-41 of the APEC report[3] cover this matter in detail. It is, like similar tax exemptions involving non-residents, a compliance cost-saving measure. We have set out in the appendix to this submission some examples of such exemptions involving non-residents.

11. The exemption in section CW 57) is not concessionary and is not a subsidy. This is on the basis that:

    a. if the exemption was repealed no extra revenue is likely to be collected from petroleum operators and New Zealand firms purchasing their services could pay less tax as a consequence of their deductible expenditure increasing;

    b. the progress of petroleum exploration and subsequent generation of royalty revenue from any ensuing production would be slowed in the absence of the exemption; and

    c. encouraging non-resident rig operators to remain within New Zealand's territorial waters for longer periods may generate increased tax revenue by way of PAYE on rig-worker salaries and GST charged on supplies to those employees.

[2] IRD. 2013. Regulatory Impact Statement for the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill*. The RIS can be found at this link, and the relevant section is *Extending the tax exemption for non-resident offshore oil rig and seismic vessel operators:* https://treasury.govt.nz/sites/default/files/2009-02/ris-ird-ete-nov13.pdf

[3] https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/international-engagement-on-energy/apec-fossil-fuel-subsidy-reform-peer-review/

Appendix

Example 1: Proceeds of share disposal by qualifying foreign equity investor (section CW 11B)

Rule

1. An amount that a person derives from the sale (or other disposal) by a "qualifying foreign equity investor" of a share, or option to buy a share, in a New Zealand resident company is exempt income if:
   a. the share is bought at least 12 months before the day of the sale (or other disposal);
   b. the person who buys and disposes of the share is a "qualifying foreign equity investor" from the time of the purchase to the time of disposal; and
   c. at some time in the 12-month period that starts from the time of purchase the shares are not quoted on an official list of a recognised exchange.
2. The exemption is not available if the New Zealand resident company has certain activities as a main activity (e.g. land development or ownership, mining and insurance), and certain additional requirements must be met if the resident company has a main activity of providing capital in the form of debt or equity funding to other companies.

Policy rationale

3. This exemption is intended to "remove a tax barrier to unlisted New Zealand companies gaining access to offshore private equity and venture capital":[4]

> *Before the amendments, there were no special tax rules for venture capital investment. Therefore a venture capital investor that purchased shares in an unlisted New Zealand company would be taxed on any gains according to ordinary tax concepts.*
>
> …
>
> The new rules target non-resident venture capital investors established or resident in an approved country that are sensitive to the imposition of New Zealand tax. Non-resident investors will generally be sensitive to such tax if they are tax-exempt in their own jurisdiction, since their tax-exempt status will mean that they will not be able to claim, or make use of, a credit for New Zealand tax paid. In the venture capital context this is an important issue because a number of institutional investors that invest in venture capital internationally, such as United States pension funds, are tax-exempt in their home jurisdiction.

Example 2: 92-day rule for personal or professional services (section CW 19)

Rule

4. Income derived by a non-resident from performing personal or professional services in New Zealand during a visit is exempt income if the visit is for 92 or fewer days (counting the days of arrival and departure as a whole day each), the person is present in New Zealand for 92 days or fewer in total in each 12-month period that includes the period of the visit, the services are performed for or on behalf of a person who is not resident in New Zealand and the amount derived from the services is chargeable in the country or territory in which the person is resident with a tax that is substantially the same as New Zealand income tax.

Policy rationale

5. This exemption is aimed at reducing compliance costs for New Zealand employers and double taxation for non-residents performing personal or professional services in New Zealand (to the extent that double taxation is not relieved by a double tax agreement or foreign tax credit regime).

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[4] Inland Revenue Tax Information Bulletin (February 2005) Vol 17, No 1 at 37.

Example 3: Non-resident aircraft operators (section CW 56)

Rule

6. Income derived by a non-resident aircraft operator from air transport from New Zealand is exempt income to the extent to which the Inland Revenue Department determines that an aircraft operator resident in New Zealand is, in circumstances corresponding to the circumstances of the non-resident aircraft operator, exempt from, or not liable to, income tax imposed by the laws of the country or territory in which the non-resident aircraft operator is resident.

Policy rationale

7. This exemption is aimed at ensuring that New Zealand income tax is not an impediment to non-resident aircraft operators for whom the cost of complying with income tax obligations in every country to which they fly would be significant.