Report recommends fiscal incentives to promote domestic gas supply

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Fiscal incentives are needed to encourage domestic gas supply, according to a report released by the DomGas Alliance.

The report recommends a range of Federal and State incentives, including tax, royalty and other fiscal measures to promote exploration and development of gas fields for domestic supply.

Alliance Chairman Stuart Hohnen said fiscal incentives were needed to balance the oil and gas industry's current focus on LNG exports.

"Under current tax and royalty arrangements, there is an incentive for producers to develop Australia's natural gas resources as large scale LNG projects," Mr Hohnen said.

"Through targeted incentives, government can play a key role in promoting domestic gas exploration and development."

The report recommends a package of incentives to promote smaller domestic gas developments, or LNG projects with a domestic gas component. These include:

- Commonwealth – State grants to support new domestic gas developments;
- State royalty concessions, such as royalty holidays or reduced royalty rates, for domestic gas developments;
- Increased Federal tax deductibility for pre-wellhead expenses incurred by domestic gas developments; and
- Flow Through Share Scheme for domestic gas exploration and development companies.

Such incentives could help support new frontier technical challenges such as onshore “tight gas” fields. Tight gas is held in “tight” or low permeability reservoirs and requires additional technology and processes to develop.

Tight gas currently accounts for around 30% of total gas production in the United States. Western Australia potentially has 9-12 trillion cubic feet (Tcf) of tight gas resources in the Perth Basin, located close to existing gas pipeline infrastructure.

“Tight gas developments involve significant pre-wellhead expenses compared to conventional gas fields,” Mr Hohnen said.

“Increased deductibility of pre-wellhead expenses could promote tight gas developments and unlock a new energy source for Western Australia.”

Mr Hohnen said governments have long used fiscal incentives to promote national goals like promoting investment and the environment. Ensuring energy security was of national interest and crucial to Australia’s economic future.

Fiscal incentives could also have a positive impact on the government bottom-line where they enable the development of gas fields that might otherwise not be developed.

“Governments benefit by having access to tax and royalty streams over the life of a project,” Mr Hohnen said.

“And the wider economy benefits from greater competition, diversity and security of energy supply.”

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Summary of Key findings

- Western Australia is the most energy and gas-dependent economy in Australia. Natural gas supplies half of WA's primary energy requirements. Natural gas also fuels 60% of the State's electricity generation.

- Ensuring greater competition, diversity and security of gas supply is therefore critical for the State's long term economic future.

- Tax and royalty arrangements can play an important role in promoting the exploration and development of gas fields for domestic supply.

- While the existing Commonwealth – State tax and royalty regime that operates in Western Australia does not provide any *deliberate* bias in favour of LNG exports, certain concessions may act as an incentive for large scale LNG development.

- Concessions under the Commonwealth Petroleum Resource Rent (PRRT) regime may act as an incentive for large companies to explore and develop large size petroleum fields in remote offshore locations. Because of the scale of the projects in terms of reserve development and production potential, gas export options have been pursued.

- Many of the smaller gas fields are located on-shore and in coastal waters. These fields are generally not large enough to support an LNG development and as such gas developed from these fields could be directed into the domestic market.

- These petroleum fields are subject to the royalty and excise regime, where royalties are calculated on the wellhead value of the petroleum produced, as opposed to profits. Because of this, producers may incur royalty liabilities for years before fields become profitable. This will impact upon the net present value of the investment.

- This report investigates fiscal incentives which may be implemented to promote domestic gas exploration and development – from smaller inshore or onshore domestic gas fields, or as a domestic gas component of an offshore LNG field.

- The report concludes that there is no single tax incentive which will alone ensure domestic gas supply. A package of incentives should instead be implemented to promote exploration and development of domestic gas fields.

- These incentives include both direct and indirect incentives, and fall within both Commonwealth and State responsibility.

Commonwealth – State grants

- Commonwealth and State grants are one important avenue for supporting companies to explore and develop gas fields for domestic supply.

- Such grants are administratively straight forward to implement, and would support Australia's long term energy security by promoting competition and diversity of domestic gas supply.

- Grants could in particular be used to promote new "frontier" developments and technology, such as greenfield tight gas developments.

- Grants have in the past been provided to support new technology development in the petroleum industry, such as coal seam methane and carbon sequestration.

State royalty concessions

- State royalty concessions could provide important encouragement for domestic gas developments. These include royalty holidays, reducing the royalty rate or rebasing the commodity value for royalty assessment.

- The Alliance proposes a reduction in the royalty rate for domestic gas developments to 5% or the provision of royalty holidays for the first 6 years of a domestic gas project.

- Such concessions can promote the development of domestic gas fields by improving the upfront economics of a project, particularly for tight gas projects.

- Any impact on State revenue could be limited, particularly where the concessions allow the development of a field that might otherwise be uneconomic to develop in its initial stages, which would subsequently generate significant royalties for the State over the long term life of the field.

- Where gas fields involve LNG projects with a potential domestic gas leg, royalty concessions can be provided for the domestic gas component to promote domestic supply.

Increased Commonwealth deductibility for pre-wellhead expenses

- Increased deductibility for pre-wellhead expenses should be provided for domestic gas developments under federal taxation arrangements.

- The Alliance proposes a 175% uplift on expenditure incurred in exploring and developing domestic gas reserves, particularly tight gas where development involves significant pre-wellhead expenses.

- The uplifted tax deduction would be available to companies once the expenditure is incurred, and the companies would not have to develop gas before they received the tax incentive. The impact of this incentive would be to reduce companies' taxable income and may provide an incentive to companies with an existing tax liability.

Commonwealth Flow Through Share Scheme

- A Flow Through Share scheme would provide significant assistance for smaller petroleum companies engaging in domestic gas exploration and development, and who are reliant on the market for risk capital.

- Such a scheme would promote frontier and start-up developments where companies might not otherwise generate a taxable income in the initial project years that would make tax deductions an appropriate incentive.

- By implementing an FTS scheme, these companies would be able to pass these losses through to investors who could use the tax deductions, which could in turn promote equity funding by investors.

The DomGas Alliance

The DomGas Alliance was formed in 2006 in response to serious gas supply shortages and includes current and prospective gas users and gas infrastructure investors.

Members include: Alcoa of Australia, Alinta, Burrup Fertilisers, Dampier Bunbury Pipeline, ERM Power / NewGen Power, Fortescue Metals Group, Horizon Power, Newmont Australia, Synergy, Verve Energy and Windimurra Vanadium.

Alliance members represent the majority of Western Australia's domestic gas consumption and gas transmission capacity, including smaller industrial and household users of gas. The Alliance also represents a significant proportion of prospective demand for additional gas supplies.

The Alliance works closely with the State and Federal Governments to promote competition and supply of gas for industry and households in Western Australia.