WOODSIDE

Submission to Australia's Future Tax System Review

Woodside Energy Ltd

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Introduction

Woodside congratulates the Australian Government on its leadership in conducting the 2020 Summit and implementing the recommendation to conduct a comprehensive review of State and Federal taxes.

Woodside strongly supports the Government's stated objective to review Australia's tax system to create a tax structure that positions us to deal with the demographic, social, economic and environmental challenges of the 21st century.

Woodside recognises that this is the first formal opportunity in an ongoing consultative process which will lead to submission of the Review Panel's final report to the Treasurer by the end of 2009.

Woodside is a member of the Australian Petroleum Production & Exploration Association (APPEA) which is the peak national body representing Australia's oil and gas exploration and production industry. APPEA has made a comprehensive submission to the Review canvassing a range of issues of interest to its membership.

The submission herein is broadly referenced against items 3.1; 3.3 and 3.6 of the Review's Terms of Reference and is a contained discussion on accelerated depreciation for Liquefied Natural Gas (LNG) projects.

We welcome the opportunity to engage in dialogue with the Government on this issue of national significance and look forward to playing an active and constructive role.

About Woodside

Woodside is Australia's leading independent oil and gas company and a major supplier of energy to Asia. With a reserves to production ratio of 25 years, based on 2007 proved and probable reserves, we are positioned to deliver growth and value to our shareholders.

We operate Australia's two biggest resource projects, the North West Shelf Venture in Western Australia and the adjacent Pluto LNG project, currently under construction. Woodside also operates or holds interest in other oil and gas projects in Australia, the United States and Africa. Our exploration interests extend to North Asia and South America.

The Browse LNG development is based on large gas fields about 400km north-west of Broome, Western Australia. We are also developing an LNG project utilising the Sunrise gas fields, which lie about 450km north-west of Darwin.

What is Accelerated Depreciation?

Accelerated depreciation occurs when the tax deduction allowed for the decline in value of an asset is brought forward relative to the expected decline in the value of the asset.

Accelerated depreciation does not increase the nominal entitlement to taxation depreciation over the life of an asset, rather it brings forward deductions. This results in tax being deferred during the early years of an asset's useful life and increases in tax in the later years.

In after-tax returns, accelerated depreciation increases the net present value of an investment, or its rate of return, above what it would be in the absence of accelerated depreciation.

Companies value accelerated depreciation because it provides important cash flow benefits. Where a company has made substantial up-front capital expenditure, early positive cash flow is important in determining the overall rate of return on the project.

Recommendation Summary

Woodside submits:

There is a compelling case for re-instating accelerated depreciation for LNG projects in Australia.

The existing Australian Company Tax System introduces a significant element of regressiveness which leads to LNG projects becoming less profitable, or in some cases uneconomic, due to the existing depreciation provisions.

A move to five year straight line depreciation for all LNG expenditure will ensure that potential LNG projects can move forward towards development, and that the subsequent flow on benefits to export earnings, Government revenue through tax receipts and increased employment can be realised.*

Woodside is not seeking for the Government to reduce the amount of tax payments in respect of LNG projects. The move to a 5 year straight line depreciation write-off will more accurately match the returns from LNG Projects with the substantial risks involved in having to invest billions of dollars of expenditure and then waiting extensive periods of time before any return on the investments can be made.

**Preliminary analysis shows that as much as A$80 billion in future Government revenue could be generated over the next 45 years through the future development of projects such as Browse and Sunrise.*

Should special rules apply to long life resource projects, in particular gas projects?

Investments in LNG projects are fundamentally different to those in virtually any other type of business enterprise. LNG projects are often characterised by substantial time-lags between discovery and commercialisation of the resource. In the case of Australia, reserves are also often located in geographically remote locations, with vast distances to markets.

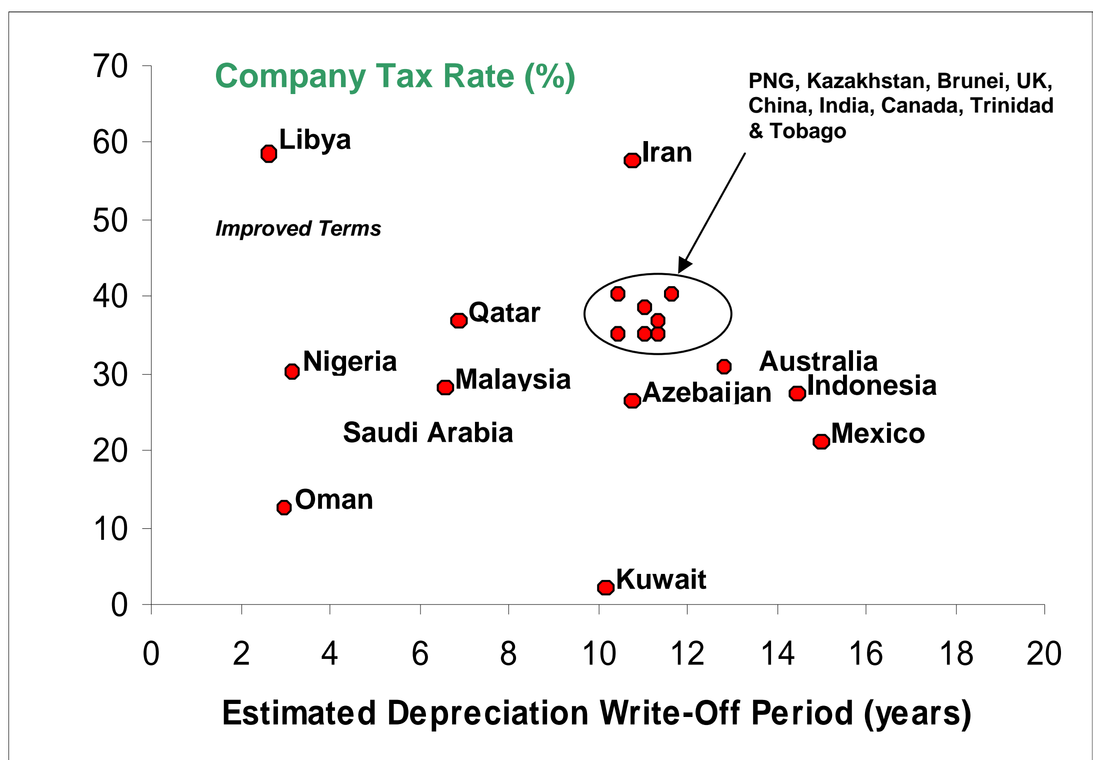
LNG projects also frequently involve the expenditure of vast sums of capital over long periods, with considerable outlays prior to the commencement of initial production being quite common. In addition, the pay-back period for an investor to achieve a positive economic return is often quite lengthy.

The characteristics of such projects mean that project viability is very sensitive to a number of key parameters, including taxation. Because such projects can have lives that are in excess of 20 years, the ability to depreciate the capital costs for income tax purposes fundamentally influences project economics. The re-instatement of accelerated depreciation is the most effective measure to address this issue.

LNG Competitiveness

A key measure of the project viability is the after-tax rate of return expected by project owners. This is strongly influenced by the rules governing depreciation of capital. Depreciation rules are especially important for capital intensive long-life projects such as LNG, where construction schedules of 3 to 4 years mean that depreciation deductions cannot commence until several years after expenditure is incurred.

The chart below compares tax rates and depreciation write-off periods applying to LNG projects currently operating or planned for development and shows the competitive position of Australia against overseas LNG projects.



The chart above illustrates that most competitors to Australian LNG (e.g. Malaysia, Qatar, and Oman) enjoy low effective company tax rates and are allowed to depreciate capital over a four to five year period. In each of these countries, accelerated depreciation is recognised as an important concession to improve the viability of long-life capital intensive projects such as LNG.

It should also be noted that unless LNG projects are shielded in some way, the proposed Carbon Pollution Reduction Scheme will have the effect of increasing Australia's taxation rate, further eroding the competitiveness of the fiscal regime applied to Australian LNG projects relative to projects in competitor countries such as Malaysia, Qatar and Oman.

The case for 5 year straight line depreciation

The Pluto LNG project is the most recently approved LNG development in Australia, reaching Final Investment Decision in July 2007. Analysis shows that it could take approximately nine years for the project to recoup the capital (in nominal terms) invested. During this nine year period, the Government will receive nearly A$2 billion in taxes.

The Pluto project tax analysis highlights the inefficiency embedded in the current depreciation write-off provisions. Although the amount of tax paid throughout the project period will remain the same, the early payment of tax resulting from the 20 year write-offs for LNG offshore expenditure and 15 year write-offs for LNG onshore expenditure, seriously impacts the viability of LNG projects.

Further information

Woodside is available to provide further information on this or any other issue should the Review Panel require it.