

25 May 2018

Senator the Hon Matt Canavan
Minister for Resources and Northern Australia
Parliament House
CANBERRA ACT 2600

Dear Minister

I am writing following a meeting I and my colleagues had with James Martin and Colin Clark from your office and Lisa Schofield from your department on 15 May 2018. We appreciated their time to meet with us.

At that meeting we had the opportunity to highlight the real and potential threat to our industry should a draft ruling be issued by the Australian Taxation Office (ATO) proposing to change the long held industry view of the tax treatment of costs incurred by geophysical companies when producing multi-client seismic data.

The draft ruling is referred to as *draft Taxation Ruling TR 2017/D11 Income tax: capital allowances: expenditure incurred by a service provider in collecting and processing multi-client seismic data*.

In the draft, the ATO has stated that taxpayers undertaking multi-client seismic surveys are not able to classify such activities as an “exploration business” under the tax law, nor able to claim the cost of obtaining exploration information as ordinary business costs or trading stock.

If the ATO’s position is adopted, such costs are thereby deductible over a fixed 15 year period as tax depreciation rather than being immediate deductible (as broadly adopted by the multi-client seismic data industry and supported by several leading tax consultants (PWC/EY)).

The impact of this proposed change is exacerbated by the fact the industry derives the bulk (in excess of 75%) of revenue from these business activities either during or immediately (i.e. within 12 months) following the acquisition and processing of the seismic data.

The proposed ATO changes therefore result in extremely high tax rates for the multi-client seismic data industry – even greater than 100% of profits (on a NPV basis), based on modelling undertaken by the industry on a standard multi-client project.

International Association
of Geophysical Contractors

office +1 713 957 8080
US toll free +1 866 558 1756
fax +1 713 857 0008

www.iagc.org

1225 North Loop West, Suite 220
Houston, TX 77008 USA

Background to the IAGC and the multi-client industry

By way of background, the IAGC is the global trade association representing the geophysical and exploration industry for over 47 years. The IAGC focuses on issues that affect the core business and freedom to operate of the industry, and the IAGC members play an integral role in the successful exploration and development of hydrocarbon resources through the acquisition and processing of geophysical data. The IAGC represents key participants in the multi-client seismic data industry both globally and in Australia. Undertaking multi-client seismic activities is a key business activity for seismic companies in this industry and Australia is a key market for these activities.

The Geophysical industry conducts offshore seismic and other geophysical surveys to identify potential oil and/or gas resources under the seabed. This work is undertaken either for a single client on an exclusive contract basis or, increasingly, using a 'multi-client' data licensing model. Multi-client surveys generally cover a large area and are undertaken by the geophysical company and licensed to multiple clients, offering an economical option for companies exploring for oil and gas.

As you may be aware, acquiring seismic data is an essential, early stage in oil and gas exploration. Proprietary seismic surveys are often conducted for exploration permit titleholders as part of their work program commitments; the data created becomes the intellectual property of the titleholder and is confidential for two or three years. In the case of multi-client data acquisition, the survey is acquired under a title held by the multi-client seismic company (Special Prospecting Authority). The newly acquired data is available for immediate licensing and can be used by multiple parties, including governments. The data is usually confidential for fifteen years. The time period of 15 years is consistent with similar practices in the UK and NZ, whereas in the United States multi-client data is confidential for 25yrs.

The multi-client (non-exclusive) business model has emerged in Australia in recent years as a means to maximise the discovery and ultimately the exploitation of hydrocarbons by providing multiple parties, including governments and energy and petroleum companies with an ability to immediately access the exploration information produced from the seismic survey.

Multi-client surveys often accelerate exploration activity by acquiring new exploration data in advance of the award of Gazetted acreage and quickly ramping up the knowledge base for governments and industry. Accordingly, these multi-client datasets provide significant support to the petroleum acreage release process.

The multi-client model is an alternative and/or complementary business model to the traditional service model to a single customer, and facilitates a lower cost for each user of the data by spreading the cost over multiple parties leaving the commercial and financial risk of the survey with the seismic company.

With the evolving nature of the exploration and resources industries, multi-client companies have taken on the traditional exploration functions of resource companies, thereby taking on significant risk in their own right to explore and generate new exploration information.

Impact of ATO's proposed tax treatment

The taxation outcomes in Australia in respect of multi-client activities have a key bearing on the sustainability of the industry and the future of exploration in Australia, affecting both companies active within this multi-client business, and those energy and petroleum companies that rely on the exploration information provided by multi-client surveys for their own further exploration purposes.

The ATO's current view in the draft tax ruling is that taxpayers undertaking multi-client seismic surveys are not able to classify such activities as an "exploration business" under the tax law, nor claim the cost of obtaining exploration information as ordinary business costs or trading stock.

The ATO has also indicated that its treatment will be applied retrospectively from May 2013, despite industry participants having long taken the view that such expenditure is immediately deductible. This application will affect previously lodged tax returns for some geophysical companies.

Perversely, this ATO ruling only impacts Australian multi-client taxpayer businesses as compared to:

- Foreign companies conducting the same work within Australian waters, thereby placing Australian businesses at a significant commercial disadvantage to overseas operators; and
- Geophysical contractors undertaking seismic surveys under a 'single client' contract on an exclusive basis, whereby the ATO have accepted that costs in undertaking such services contracts are immediately deductible.
- Oil and gas companies undertaking their own geophysical seismic exploration.

This tax treatment will have the effect of ultimately winding down the Australian multi-client geophysical contracting industry, or moving operations offshore.

To reiterate, industry modelling that has been undertaken shows that the proposed ATO ruling would have the effect of imposing an effective tax rate (on a NPV basis) of 104% on a typical multi-client model. Anonymised and commercially sensitive data has also been sourced from the majority of Australian resident companies undertaking offshore petroleum multi-client activities in Australia, which shows the investment multi-client companies have made in Australian exploration over the past 8 years. This data excludes companies who undertake onshore (land based) multi-client activities and also excludes foreign companies undertaking multi-client data activities in Australian offshore areas.

The risks being faced by the industry and ultimately Australia as a result of this draft ruling are already being felt. We understand, for example, in recent contract discussions to undertake a new multi-client seismic survey, a clause was proposed which would have the effect of the contract being cancelled should the draft ATO ruling be finalized in its draft form.

The Australian government risks the economic impact of a shutdown of Australian multi-client companies, resulting in less investment in Australian exploration data, less seismic vessel activity, less efficient exploration and higher costs for oil and gas permit operators.

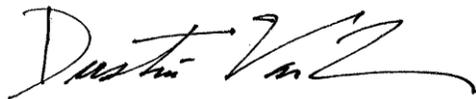
Consistency and certainty in the fiscal regime is necessary to promote exploration in Australia.

Therefore, from a policy perspective, the IAGC submits that multi-client companies which hold a Special Prospecting Authority (which is a licence to explore granted by the Australian Government) should be entitled to claim immediate deductibility for their activities as exploration expenditure, as afforded to other participants within the petroleum exploration industry.

Further, it is the IAGC's view, supported by several leading tax consultants (PWC/EY), that this outcome can be achieved within the scope of existing taxation legislation, as a correct interpretation of the existing taxation law does, and can continue to, result in immediate deductibility of the expenditure that is the subject of the draft tax ruling.

We look forward to continuing to engage with you and your office in relation to this critical issue for our industry.

Sincerely



Dustin Van Liew
Vice President, Regulatory & Governmental Affairs
International Association of Geophysical Contractors
T: +1 713 957 8080
Email: dustin.vanliew@iagc.org