

Regulatory Impact Statement

Tax treatment of petroleum mining decommissioning

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue. It provides an analysis of options to address a problem with the tax rules for decommissioning expenditure incurred by petroleum miners.

Petroleum mining decommissioning incurs significant expenditure near or after the end of production at which point there will be little or no assessable income. The tax rules for petroleum mining allow decommissioning expenditure to effectively be offset against income from previous periods, rather than carried forward as a loss against future income (which would be the standard treatment in the absence of these specific rules). A key assumption is that some variant of industry specific rules will continue to ensure that petroleum mining is not disincentivised by its tax treatment.

Officials have worked closely with the petroleum mining industry and other government departments to develop the proposals in this RIS. This consultation is commensurate with the nature of the issue and the parties concerned.

A key constraint on our analysis relates to determination of fiscal cost estimates for each option. Because petroleum decommissioning expenditure is already deductible and eligible to be spread-back the cost of decommissioning is already incorporated into the fiscal cost estimates. Unless otherwise noted, the proposals considered in this RIS are expected to have, at most, a timing effect on the total cost to the Crown of decommissioning. These forecasts, however, are influenced by a number of factors that are unable to be reliably determined at this time. These factors include:

- the regulatory standard for the level of decommissioning required, which is still being determined by the government;
- the timeframe for decommissioning of the various existing rigs which is currently estimated to occur between 2018 and 2046;
- any new exploration discoveries or changes in technology that extend field life;
- estimates of decommissioning costs including how this changes over time because of better information, changes in technology and environmental regulations; and
- changes in estimated oil and gas prices and the effect this has on economically recoverable reserves.



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STATUS QUO AND PROBLEM DEFINITION

Current tax treatment

1. The tax rules for petroleum mining split the life of a field into two distinct phases, namely exploration and development. “Exploration” is generally done under a prospecting or exploration permit¹ and involves looking for oil and gas reserves that can be extracted in commercially feasible quantities, whereas “development” is done under a mining permit and involves the extraction of oil or gas for commercial production.
2. “Exploration expenditure” is deductible when incurred whereas “development expenditure” is spread over either seven years or under the reserve depletion method which spreads the deduction over the remaining life of the field. Changing this tax treatment is not within the scope of the current project.
3. The petroleum mining tax rules apply equally to onshore and offshore installations². However, onshore installations can be decommissioned at a significantly lower cost. Furthermore petroleum miners with onshore installations typically have income from more than one source. Because of these factors onshore petroleum mining has never utilised the spread-back provisions. While onshore petroleum mining would continue to be able to access the same rules (including the proposals in this RIS) as offshore petroleum mining it is not considered further in the analysis in this regulatory impact statement (RIS).
4. A petroleum miner will incur significant decommissioning expenditure before relinquishing their mining permit. Decommissioning is what happens to wells, installations and surrounding infrastructure when a petroleum field reaches the end of its economic life. Offshore decommissioning usually involves:
 - the plugging and abandoning of wells;
 - removal of equipment; and
 - the complete or partial removal of installations and pipelines.

Policy

5. The policy underlying the current tax rules recognises that this expenditure is an unavoidable consequence of the production process and that industry specific timing rules should allow deductions for this expenditure to effectively be offset against income derived in earlier periods.
6. In the absence of industry specific tax rules a petroleum miner may pay tax in earlier periods then incur decommissioning expenditure which would be carried forward as a loss to

¹ It can also be done under a mining permit where a petroleum miner is seeking to expand production within a field that has already entered commercial production.

² The decommissioning tax rules have always applied to both onshore and offshore decommissioning. The tax treatment of development expenditure was aligned from 2008 to reflect modern drilling and oil and gas extraction techniques making the previous boundary unsustainable as offshore wells could be situated just on the onshore side of the boundary.

future periods. Unless the petroleum miner has income from other sources, such as a separate field, this loss would never be utilised. Officials recognise that this would be inappropriate and would discourage petroleum exploration and development or could encourage a petroleum miner to decommission a field that still contained economically recoverable reserves to ensure that any deductions could be offset against the higher income amounts that are derived in earlier years of a field's life³.

7. To address this issue, the petroleum mining tax rules allow a petroleum miner to request that the Commissioner reopen earlier tax years to claim a deduction for decommissioning expenditure incurred "because of the relinquishment of the permit". This process is referred to as a "spread-back". Expenditure is spread-back to the previous year to the extent taxable income was returned and if the expenditure exceeds the amount of profit the remainder is carried back another year and so on.

8. This can be illustrated by the following example:

Tax year	2012	2013	2014	2015
Without spread-back				
Operating profit	60	50	40	30
Decommissioning				100
Total profit	60	50	40	-70
Tax paid (28%)	16.8	14	11.2	0
Loss Carried Forward				-70
After spread-back				
Total profit	60	20	0	0
Tax payable	16.8	5.6	0	0
Less tax paid	-16.8	-14	-11.2	0
Refund	0	8.4	11.2	0

Problems with current tax treatment

Significant problems

9. The petroleum mining decommissioning tax rules have never been applied as no offshore installations have been decommissioned in New Zealand. The petroleum mining industry has started planning for future decommissioning in recent years and have been working with officials; a number of issues have been identified.

10. The primary concern of the petroleum mining industry is the effect of section RM 2 of the Income Tax Act 2007 (ITA 2007) which prevents the Commissioner from refunding an amount of tax if more than four years have passed from the end of the tax year in which an income tax return was filed. The spread-back does not have an equivalent limit, so the Commissioner could reassess a period from more than four years previous to create a credit balance. However, section RM 2 would then prevent the Commissioner refunding this credit balance to the petroleum miner.

11. There are two possible practical consequences of this restriction:

³ Generally output from a field peaks in early years of production and slowly declines. This results in higher profits and tax payments in earlier years than in later years as the field approaches the end of its life.

- i. The petroleum miner is unable to get a refund for the full amount of their decommissioning costs spread-back despite the existing policy that they should be able to.
- ii. The petroleum miner may decommission the field earlier than they otherwise would to ensure they have sufficient profits within the four previous years to fully cover the cost of decommissioning.

12. To the extent the second path is chosen, and the industry has advised this is what would occur, this four year restriction would have no impact on the amount of tax deductions⁴ offset against taxable income but would reduce the amount of oil and gas extracted. The Crown Minerals Act 1991 requires the Crown to assess and agree with a petroleum miner as to whether the maximum economic recovery of a field has been reached and cessation of production can occur. If tax deductions for decommissioning costs cannot be effectively utilised this would be factored into the Crown's assessment. Premature decommissioning would result in lost revenue to the Crown in the form of foregone royalties and corporate taxes.

13. A number of other issues and uncertainties also arise with the existing rules. These could be resolved within the existing policy and are explained further below.

Other problems

14. There are two qualifying criteria for triggering the spread-back of decommissioning expenditure under the current rules, depending on the type of expenditure or loss, these are "in a tax year in which a petroleum miner relinquishes a permit" and "because of the relinquishment of the petroleum permit". While the first is often clear on timing the second is less so and when combined they create uncertainty in a number of situations such as:

- A wide variety of expenditure will be incurred because of the relinquishment of the permit, including planning for decommissioning before drilling has commenced which may be 40 years before the permit is eventually relinquished. It is not clear whether expenditure has to be within a reasonable time period of the permit relinquishment.
- A petroleum miner may undertake activities that look like decommissioning but are not directly linked with the relinquishment of a permit. It is not clear whether this expenditure would ever qualify for the spread-back.
- A petroleum miner may decommission a well several years before relinquishing the permit. It is not clear whether this expenditure would qualify when incurred or whether it would have to wait until the permit was relinquished.
- A petroleum miner may decommission a well and surrender acreage within a permit area without relinquishing the entire permit. It is not clear whether this expenditure would qualify for the spread-back until the entire permit was relinquished.

⁴ For example, a petroleum miner that is subject to the four year limit is generating sufficient income to cover operating costs but with only a small profit. If this situation continued into future periods, each year the additional operating profit would be less than the effectively foregone deduction for decommissioning so it would make economic sense to decommission even if, in the absence of tax, production could continue for several more years. In this example the refund for decommissioning would be identical but tax on profits would be reduced.

15. As well as decommissioning development wells a petroleum miner will incur expenditure on abandoning exploration wells. These exploration wells may have been drilled before, during or after commercial production and may or may not have resulted in a discovery of petroleum reserves that are commercially extractable⁵. It is officials' view that expenditure on abandonment of exploration wells is not eligible to be spread-back but this is not clearly articulated in the legislation and some petroleum miners consider it is currently available.

16. When an exploration well is subsequently used for commercial production the cost that was previously deducted is added back and spread over a number of future years⁶ which puts it in the same position as if it was originally drilled as a development well. If the permit is relinquished any undeducted costs are intended to be able to be spread-back. However, an error in the rewrite from the Income Tax Act 2004 to the Income Tax Act 2007 introduced an incorrect cross reference so that only expenditure on an exploration well that is used for commercial production but not expenditure on a development well is eligible for the spread-back.

17. It is officials' view that the spread-back is a mechanism for generating a payment to the taxpayer rather than altering the amount of tax originally payable in that earlier period. Accordingly, when a petroleum miner spreads-back expenditure they should not be entitled to credit use of money interest (UOMI). However, unlike other equivalent sections⁷, there are no specific provisions confirming that UOMI is not payable when a petroleum miner spreads-back expenditure.

Opportunities in amendment

18. Historically, there were a number of spread-back provisions, for both income and expenditure, in the Income Tax Act. Officials view such spread-backs as an outdated approach that results in high compliance and administration costs. Many spread-back provisions have been removed as part of previous reforms and there are no remaining provisions that spread-back expenditure equivalent to the petroleum decommissioning rules.

19. Officials view the need to amend the petroleum mining rules as an opportunity to modernise the decommissioning rules in a manner that is broadly consistent with existing policy but reduces compliance and administration costs.

Scale of the problem

20. As noted above, the petroleum mining rules apply to both offshore and onshore installations. However, onshore installations can be decommissioned at a relatively low cost and are typically operated by petroleum miners who have income from other sources. Accordingly, the decommissioning rules, and any problems associated with them, typically only apply in practice to offshore installations.

21. Offshore installations in overseas jurisdictions normally cost between NZ\$100 million and NZ\$1 billion to decommission. The lower end of this range generally incorporates

⁵ The global industry average success rate for exploratory wells is around 1 in 6.

⁶ Either 7 years or under the reserve depletion method.

⁷ See for example section 120PA of the Tax Administration Act 1994 which states no UOMI is payable when a credit for a supplementary dividend is carried back to create a refund in an earlier period.

FPSO⁸ installations, through to smaller unmanned fixed platforms with larger manned fixed platforms at the higher end. New Zealand has examples of all types. The number of offshore decommissioning projects in other jurisdictions has increased over the last decade; however, large scale decommissioning is not yet commonplace. Over the coming decade, more decommissioning projects are expected to commence, which will lead to improvements in best industry practice and will help refine estimates of what decommissioning costs can be expected, with the possibility of reduced costs.

22. Under current settings the Crown may be liable to pay up to 42 percent of decommissioning costs as tax and royalty rebates to operators. The four year limitation does not arise for royalties which are handled through the Ministry of Business, Innovation and Employment. This RIS only considers the tax consequences of decommissioning, which are limited to the tax rate applying to the petroleum miner which for all current petroleum miners is the company tax rate of 28 percent. As the spread-back (and the refundable credit in option 3) are linked to the petroleum miners' tax rate any future increases or decreases in the corporate tax rate would result in the same change in the tax cost to the Crown of decommissioning.

23. In addition to the size of the installation, two other main factors influencing the cost of decommissioning are:

- New Zealand's distance from where decommissioning vehicles are typically located (often in Singapore or the North Sea) which means mobilisation costs are higher than for other jurisdictions; and
- the age of the rig being decommissioned as older rigs were typically built with less planning towards eventual decommissioning⁹.

24. There are currently four offshore producing petroleum operations in New Zealand's Exclusive Economic Zone and a fifth offshore operation in the territorial sea¹⁰. Decommissioning of these existing offshore installations has yet to occur, but the first offshore decommissioning project could commence as early as 2018.

25. Although there are only five operations these are typically operated by joint ventures of several different taxpayers¹¹, each of which would be affected by these proposals. In addition further taxpayers are in the exploration phase or may enter the exploration phase in the future. These petroleum miners may subsequently enter the production phase and eventually decommission.

⁸ Floating Production, Storage and Offloading units – dedicated vessels attached via anchor chains to the seabed and removable lines to the oil wells. Once a field is exhausted the FPSO can be moved to a new location.

⁹ Overseas jurisdictions tend to require modern installations or structures to be fully removed except in circumstances where the installation was constructed prior to 1998 or where safety or environmental risks require the infrastructure to remain. New Zealand has examples of rigs constructed before and after this date. New Zealand's decommissioning requirements and how they relate to specific installations are still being determined.

¹⁰ The territorial sea covers the area up to 12 nautical miles from land while the exclusive economic zone covers from 12 to 200 nautical miles.

¹¹ For example one particular field is a joint venture of five operators.

26. The most recent Ministry of Business, Innovation and Employment estimate of the cost of decommissioning the existing offshore installations is \$2,200 million between 2019 and 2046. At a 28% tax rate the tax cost would be \$616 million¹². These amounts are already refundable under the current law.

27. The options in this RIS would not affect the cost of decommissioning or the deductibility of those costs. The options could have a minor impact on timing of tax payments and refunds which could have some behavioural impacts on production and, therefore, tax payments. These impacts are difficult to quantify for the reasons provided below:

- the regulatory standard for the level of decommissioning required, which is still being determined by the government;
- the timeframe for decommissioning of the various existing rigs which is currently estimated to occur between 2018 and 2046;
- any new exploration discoveries or changes in technology that extend field life;
- estimates of decommissioning costs including how this changes over time because of better information, changes in technology and environmental regulations; and
- changes in estimated oil and gas prices and the effect this has on economically recoverable reserves.

OBJECTIVES

28. The **main objective** is to modernise the tax rules that apply to petroleum mining decommissioning.

29. All options are assessed against the status quo in relation to the main objective and the following criteria:

- (a) **Neutrality:** the tax rules should not influence a petroleum miner's decision about when to decommission
- (b) **Fairness and equity:** the tax rules should reflect the income and expenditure profile of the petroleum mining industry but should not otherwise provide a concession not available to other taxpayers
- (c) **Efficiency of compliance and administration:** the impacts on taxpayers of compliance with the rules and administrative impacts on the government should be minimised as far as possible

30. The neutrality and fairness and equity criteria are equally weighted as it is important that petroleum mining is not disincentivised by the tax system but it is equally important that the petroleum mining industry is not provided with tax concessions that create an advantage over other industries.

¹² This estimate does not factor in any tax refunds that may not be available due to the four year limit or insufficient tax being paid in previous periods. For the reasons set out elsewhere in this RIS officials do not expect either of these factors to provide a significant impediment to the amount of tax refunds available to petroleum miners from decommissioning.

31. While efficiency of compliance and administration is an important factor it is secondary to the other two criteria as the costs and any inefficiencies arising from them are smaller than inefficiencies arising from the first two criteria.

32. There are no relevant constraints to this analysis.

REGULATORY IMPACT ANALYSIS

33. Officials have identified five options to address the problem:

- Option 1 – The status quo
- Option 2 – Amendments to the spread-back provision
- Option 3 – Introduce a refundable credit
- Option 4 – Introduce an environmental restoration account
- Option 5 – Allow deductions for provisions

34. There are no social or cultural impacts associated with any of the identified options. There may be an environmental impact from any one of the options to the extent they create or remove incentives or disincentives for petroleum mining.

35. We consider that the options would have no material impact on fiscal costs or revenue. The options consider the timing of deductions and there would be no change in the ultimate treatment of decommissioning expenditure – it would continue to be deductible. Options 1 to 3 would allow a deduction at the end against income previously returned whereas options 4 and 5 would allow the same deductions (or at least a proxy for them via provisions) against income as it is returned. Therefore, options 4 and 5 would have a higher fiscal cost than options 1 to 3. However, it is difficult to estimate the extent that this would occur. To the extent the existing four year limit accelerates decommissioning, removing this would raise revenue; but this is not considered significant given the other uncertainties in the forecasts which are explained in paragraph 27.

Option 1

36. Option 1 is the status quo. The spread-back provision would be retained, including the four-year refund limitation.

Assessment against criteria – option 1

37. The status quo does not meet the main objective. Spread-backs are considered an outdated approach that has high compliance and administration costs. Previous reforms have not introduced any new spread-back provisions for a long time and many have been removed.

38. *Neutrality.* The current rules do not meet the neutrality criterion. They encourage a petroleum miner to decommission earlier than they otherwise might and to relinquish a permit earlier than they otherwise might.

39. *Fairness and equity.* The current rules do not meet the fairness and equity criterion. The four year refund limit disincentivises petroleum mining because of the industry specific

income and expenditure profile. It also provides a concession not available to other industries by potentially paying UOMI on spread-backs when no UOMI is paid in other spread-back situations. The petroleum mining industry considers abandonment costs of exploration wells can be spread-back which, if allowable, would be concessionary compared to other industries where current period losses from non-profitable ventures cannot be spread-back against profits from previously profitable ventures.

40. *Efficiency of compliance and administration.* The current rules do not meet the efficiency of compliance and administration criterion. The current rules require prior assessment periods to be reopened which requires manual intervention by Inland Revenue staff. This may also impose higher compliance costs on petroleum miners who will have to account for refunds from various periods that have previously been finalised.

Option 2

41. Option 2 is to amend the status quo. This would retain the spread-back but would remove the four year refund limitation and make other clarifying amendments to address the problems in paragraphs 14 to 17 consistent with the existing policy. These include clarifying when the spread-back is available, that the spread-back is not available when an exploration well is abandoned and that no UOMI is payable when the spread-back results in a refund in prior years.

Assessment against criteria – option 2

42. Option 2 does not meet the main objective. While the amendments would clarify the legislation so that its application is consistent with the policy intent the spread-back would be maintained which, as covered in option 1, is not a modern approach to tax compliance and administration.

43. *Neutrality.* Option 2 is an improvement over the status quo. The amendments would remove the incentives and disincentives present in the current rules.

44. *Fairness and equity.* Option 2 is an improvement over the status quo. The amendments clarify a number of issues that could be concessionary towards petroleum miners.

45. *Efficiency of compliance and administration.* Option 2 is worse than the status quo. It would have all the problems of the status quo plus removing UOMI from refunds from prior periods would require manual intervention¹³ to override the standard treatment.

Option 3

46. A refundable credit has a very similar effect to a spread-back under option 1 and 2. The difference is that qualifying decommissioning expenditure would generate a refundable tax credit in the petroleum miner's current income tax return instead of requiring the Commissioner to reopen prior periods to reassess and reduce previous tax liabilities already paid. The refund would be limited to the amount of income tax paid in prior years.

¹³ Manual intervention would be required under Inland Revenue's FIRST computer system. The replacement system – START – will be operational by the time these changes would be enacted. It is not confirmed what the process would be for this; however, it would still be a variation from the standard treatment.

47. Unlike the spread-back mechanism, there are a number of refundable credits already in the ITA 2007¹⁴. Most relevant is a refundable credit for mineral mining which relates to rehabilitation expenditure at the end of mining operations. Officials see many similarities between rehabilitation by mineral miners and decommissioning by petroleum miners and there would also be many similarities between how refundable credits would work for the two industries¹⁵. This option would also incorporate the same clarifying amendments covered in option 2 above.

Assessment against criteria – option 3

48. Option 3 meets the main objective. The refundable credit mechanism would broadly align with other credits already available and would be consistent with the policy intent of the petroleum mining rules.

49. *Neutrality*. Option 3 is an improvement over the status quo. The rules would remove the incentives and disincentives present in the current tax rules.

50. *Fairness and equity*. Option 3 is an improvement over the status quo. The rules would include clarification of a number of issues that could be concessionary towards petroleum miners. Providing a refundable credit recognises the different income profile of petroleum mining but does not otherwise provide a concession not available to other industries.

51. *Efficiency of compliance and administration*. Option 3 is a significant improvement over the status quo. It would remove the need for any interaction between Inland Revenue and petroleum miners regarding reopening prior assessment periods. In comparison with options 4 and 5, it would also reduce the focus on verifying provisions for decommissioning with Inland Revenue at any point prior to claiming the refundable credit.

Option 4

52. An environmental restoration account would allow a petroleum miner to make a payment into an account operated by the Commissioner based on provisions for decommissioning. Provisions are an accounting deduction for expenditure or loss expected to be incurred by the person in a future period and allow a more conservative accounting profit to be recorded to reflect deductions that would have otherwise arisen in a later period. Generally accounting provisions are not deductible for tax purposes. Amounts deposited into this account would be deductible when paid and the petroleum miner could withdraw them from this account at a later date to satisfy decommissioning expenditure when it was incurred. Modest interest on the account balance would be paid in the meantime.

53. This option would be closely based on existing provisions for environmental restoration accounts in subpart EK of the ITA 2007. Existing environmental restoration accounts are not industry specific and can be available whenever the necessary criteria are met. An example of a current use of an environmental restoration account would be a taxpayer operating a landfill.

¹⁴ A list of refundable credits is in section LA 6(1) of the ITA 2007

¹⁵ Further detail on how refundable credits for mineral miners operate can be found in Tax Information Bulletin Volume 26, No 4, May 2014. <http://www.ird.govt.nz/resources/a/e/aee2f96e-f5c6-4b1f-ae75-e951c8bae62e/tib-vol26-no4.pdf>

54. Environmental restoration accounts were also proposed for rehabilitation expenditure for mineral mining in the October 2012 *Taxation of specified mineral mining officials' issues paper*¹⁶. However, upon considering feedback from submitters, which was strongly opposed particularly because of the negative cash flow impact of making deposits into the account, this was replaced by the refundable credit mechanism covered by option 3.

Assessment against criteria – option 4

55. Option 4 meets the main objective. The proposal is consistent with rules that already apply to similar restoration processes.

56. *Neutrality*. Option 4 is an improvement over the status quo. The rules would remove the incentives and disincentives present in the current rules.

57. *Fairness and equity*. Option 4 is an improvement over the status quo. The amendments clarify a number of issues that could be concessionary towards petroleum miners.

58. *Efficiency of compliance and administration*. Option 4 is worse than the status quo. Petroleum miners are likely to strongly oppose this option because it would have a significant negative cashflow impact on them. It would also incur administration costs as the Commissioner would have to operate the appropriate accounts.

Option 5

59. As with other industries, petroleum miners create accounting provisions for expenditure or loss they expect to incur in a future period. This option would allow a petroleum miner to claim a deduction based on accounting provisions for decommissioning expenditure that is expected to be incurred in a future period. Although a petroleum miner would commit themselves to decommissioning expenditure once they started the development phase the cost of decommissioning would be spread over the expected life of the field so that the timing would align with the income derived.

60. When this option is discussed it is usually referenced back to the Privy Council decision in *C of IR v Mitsubishi Motors*¹⁷ which was a case regarding the deductibility for tax purposes of provisions created upon the sale of new cars based on prior history of warranty claims.

Assessment against criteria – option 5

61. Option 5 meets the main objective. Prior returns would not need to be reopened.

62. *Neutrality*. Option 5 is an improvement over the status quo. The option would remove the incentives and disincentives present in the current rules.

63. *Fairness and equity*. Option 5 is worse than the status quo. Petroleum miners would be eligible for deductions for expenditure based on provisions which is a treatment not available to other industries. With the international focus on removing concessions for the fossil fuel industry this would be likely to be very controversial.

¹⁶ <http://taxpolicy.ird.govt.nz/publications/2012-ip-mineral-mining/overview>

¹⁷ *Commissioner of Inland Revenue v Mitsubishi Motors New Zealand Limited* (1995) 17 NZTC 12,351

64. *Efficiency of compliance and administration.* Option 5 is an improvement over the status quo. It would remove the need to reopen prior periods. However, basing deductions on provisions would likely increase the focus on ensuring these were correct, which would be more difficult than verifying expenditure incurred.

CONSULTATION

65. Because decommissioning consideration is being undertaken concurrently by various government departments an interagency petroleum decommissioning working group was formed including Inland Revenue, the Treasury, the Ministry of Business, Innovation and Employment, the Ministry for the Environment and other departments. Officials have discussed details of the current rules and proposed changes with this group and its members, who have not raised any concerns.

66. Officials also undertook targeted consultation with the petroleum mining industry and their advisors during August and September 2016. This consultation proposed that the current spread-back be replaced by a refundable credit.

67. Submitters were all in favour of replacing the current spread-back (which is subject to the 4 year refund limitation period) with a refundable credit. The two common themes in submissions were around not limiting the refund to tax previously paid by an entity – this limit already exists in the status quo, and allowing a refundable credit for abandonment costs – where the industry disagrees with officials and considers that a spread-back is already available. A number of other more minor changes have also been incorporated as a result of the consultation. Officials have extended their recommendations to include tax paid by a petroleum miner before joining a consolidated group and to allow a refundable credit for certain abandonment provided that is done as part of decommissioning a production well.

CONCLUSIONS AND RECOMMENDATIONS

68. The following table summarises our consideration of the options from the regulatory analysis section above. Within the overview table the following symbols are used:

- ✓✓ Significantly better than the status quo
- ✓ Better than the status quo
- × No better than the status quo
- ×× Worse than the status quo

Options	Analysis against the objective and criteria
Option 1 – Status quo	Does not meet the main objective
Option 2 – Amendments to the spread-back	Does not meet the main objective Neutrality ✓ Fairness and equity ✓ Efficiency of compliance and administration ××
Option 3 – Introduce a refundable credit	Meets the main objective Neutrality ✓ Fairness and equity ✓ Efficiency of compliance and administration ✓✓

Option 4 – Introduce an environmental restoration account	Meets the main objective Neutrality ✓ Fairness and equity ✓ Efficiency of compliance and administration ××
Option 5 – Allow deductions for provisions	Meets the main objective Neutrality ✓ Fairness and equity ×× Efficiency of compliance and administration ✓

69. Options 3, 4 and 5 satisfy the main objective of ensuring that the petroleum mining decommissioning rules are appropriate.

70. Officials recommend option 3 as it is the only option that provides an overall improvement on the status quo (option 1). This is for the following reasons:

- Option 1 is not sustainable as it has a number of uncertainties and inappropriate outcomes that both disincentivise petroleum mining and provide concessions not available to other industries. Option 3 is preferable over option 2 as it would result in lower compliance and administration costs from not having to reopen prior periods to include all or part of the decommissioning costs that could not be included in the original return and would not require manual intervention of UOMI calculations.
- While option 3 provides a treatment not available to most other industries this reflects their unique income profile and is not an unjustified concession.
- Option 3 is preferable over option 4 as it would result in lower compliance costs from the petroleum miner not having to make upfront payments into an account operated by the Commissioner before the expenditure is incurred. It would also result in lower administration costs from the Commissioner not having to operate this account.
- Option 3 is preferable over option 5 as it corrects the issue arising from significant expenditure at or near the end of the production process without providing a concession that is not available to other industries (being able to claim a current period deduction for expenditure that will be incurred in a future period).

IMPLEMENTATION

71. Changes to introduce a refundable credit for petroleum decommissioning expenditure would require amendments to the Income Tax Act 2007. These amendments would be included in the next available omnibus tax bill, scheduled for introduction in early 2017.

72. These amendments would apply equally to all petroleum miners, including those that are already in production as well as those still in the exploration phase who need to plan for future decommissioning. The bill containing these amendments would be expected to be enacted before the first offshore installation begins decommissioning which may occur in 2018. As no petroleum miners have decommissioned an offshore installation in New Zealand this timeline would ensure that the new rules apply equally to all petroleum miners.

73. These changes would not impose significant compliance costs on petroleum miners as the primary change would be to include decommissioning expenditure in the relevant period's income tax return rather than calculating this amount and requesting it be included in previous

years' assessments. Depending on how the petroleum miner accounts for refunds from prior periods the change may also reduce compliance costs of recording these refunds.

74. The bill commentary and a *Tax Information Bulletin* publication upon enactment to explain the changes would be required. Minor systems changes would also be required to START to allow petroleum miners to obtain a refund in a current income year that exceeded tax paid in that year. However, these changes have previously been implemented in FIRST and would be incorporated into START for the mineral mining industry, so replicating these for petroleum mining is not expected to be a significant cost and would be met within existing baselines.

MONITORING, EVALUATION AND REVIEW

75. Inland Revenue would closely monitor the effectiveness of the proposed changes once income tax returns including decommissioning start being prepared – with the first possibly to be in the 2018-19 income year.

76. In general, any changes identified as necessary following enactment would be added to the tax policy work programme, and proposals would go through the Generic Tax Policy Process (GTPP). The GTPP is a multi-stage process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995. Opportunities for external consultation are built into various stages of the process. In practice, any changes identified as necessary following enactment would be considered for inclusion in the tax policy work programme, and proposals would go through the GTPP.