Papua New Guinea’s 2017 budget takes big steps in resource tax reform. Following suggestions that I made together with former Labor minister Craig Emerson, starting next year resources companies operating in Papua New Guinea will pay a revamped resource rent tax, as well as the existing royalties and company taxes.

With Australia’s budget deficit worsening, following Papua New Guinea’s lead may help us bring in more revenue from natural gas, sooner.

The different ways of taxing resources

Companies in Australia operating large gas-to-liquefied natural gas (LNG) projects pay a resource rent tax (a tax levied on above-normal profits), as well as the regular company tax. Above-normal profits from these new projects are perhaps a decade away, which is why there has been a recent drop in resource tax revenue.

This resource rent tax has replaced royalties for most of these LNG projects. While the resource rent tax is paid on profits, royalties are paid directly on the value of a resource as it is extracted, long before profit or loss is a factor.

A re-introduction of some level of royalties would not increase the tax burden for industry, but would more immediately provide much-needed revenue for government.

Our tax system wasn’t designed for current gas production

Australia’s petroleum resource rent tax (PRRT) applies to oil and gas projects but it was not originally fine-tuned for gas.

My recently published PRRT working paper provides an overview of newly available archival documents that give insight into the political and consultative processes of the Hawke-Keating government (1983-1991), which passed the PRRT.

Back in 1984, gas production was for domestic consumption and the technology for LNG exports was underdeveloped. The archival papers show that gas design considerations were excluded because projected PRRT revenues could not match gas royalties. So instead the Hawke-Keating government focused on generating PRRT revenues from oil.

The gas industry is important

There are now more gas than oil reserves in Australia. The image below shows the large integrated gas-to-LNG projects in Australia: offshore natural gas in the west, and onshore coal seam gas in the east. The focus of resource tax reform should be on gas projects in Commonwealth waters off Western Australia. They include Woodside's Pluto, Chevron's Wheatstone and Gorgon, and Inpex's Ichthys.

The table below shows the current taxation of selected LNG projects. Company tax and the PRRT apply to all these projects. But only coal seam gas and the North West Shelf projects need pay royalties.

Industry has not complained about the payment of these royalties.

The way we tax our gas needs reform

All countries with petroleum resources levy additional resource taxes, which result in industry paying high taxes. For example, look at Norway and the United Kingdom. In both those countries, the accepted justification for additional resource taxes on petroleum is due to the finiteness of mineral resources: extraction can only occur once.

As the Turnbull government scrambles to fix the budget deficit, the media has focused on the low revenue forecasts from the PRRT on gas for LNG export. No wonder, given Australia's export gas industry has invested $200 billion in new infrastructure.

Pressure is building for a parliamentary inquiry into the PRRT. At a recent Senate Economics Legislation Committee hearing, Finance Minister Mathias Cormann and Tax Commissioner Chris Jordan found it difficult to answer questions posed to them on the PRRT.

How should the natural gas for LNG be taxed?

The PRRT has its place in the tax mix. However, given the different infrastructure needs and lower pricing characteristics of natural gas, the PRRT for gas needs to be modified. This has been highlighted before, most notably the 2009 Henry Review of Australia's tax system, criticised the design of the PRRT for gas.

The Turnbull government should assess whether the sole PRRT in relation to LNG projects in Commonwealth waters is sufficient to meet the objective of sharing the benefits from resource projects. Australia's 2016 federal budget figures show a projected decrease in PRRT revenues to $800 million per annum in 2020, which suggests that the community could wait decades for benefits from PRRT on gas.

A more equitable arrangement would require more prompt payment to the government for gas extraction, such as production-based royalties paid on the coal seam gas and North West Shelf projects, as well as a modified PRRT design.

Paul Keating famously described the 1990s recession as “the recession we had to have”. Likewise, taxation reform of the PRRT applicable to natural gas processed for LNG export is an absolute necessity. It's a reform we "have to have".

Diane Kraal does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.

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