PCG 2016/12 - Petroleum Resource Rent Tax - deductibility of general project expenditure relating to the overhead component of time written costs

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PCG 2016/12

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Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this Guideline is about

1. This Guideline explains our compliance approach to applying section 38 of the *Petroleum Resource Rent Tax Assessment Act* 1987 (the Act) to the overhead component of time written costs charged to a joint venture billing statement or sole risk operation account.

Date of effect

2. This compliance approach will apply to general project expenditure that is actually incurred (or taken by Division 5 of Part v. of the Act to be incurred) on or from 1 July 2015 by an entity in relation to a petroleum project.

What entities are covered by this Guideline?

3. This Guideline is intended to cover an entity that is entitled to derive assessable petroleum receipts in relation to a petroleum project in a financial year.

Background

- 4. Generally a payment is deductible under section 38 of the Act as general project expenditure where it is not excluded, exploration or closing-down expenditure, and:
 - (a) it has a close, or quite direct, connection with the physical activities of the petroleum project, and
 - (b) it can either be traced, or reasonably allocated, to the operations, facilities or other things set out in subsection 19(4) of the Act.
- 5. Payments that cannot be reasonably allocated to operations, facilities and other things in subsection 19(4) are considered 'indirect' for the purposes of paragraph 44(1)(j) of the Act.

Joint venture arrangements

- 6. A joint venture operating agreement is the standard commercial agreement that governs the relationship between joint venture participants in oil and gas exploration and developments.
- 7. The accounting procedure in a joint venture operating agreement sets out equitable methods for the parties to the agreement to determine the charges applicable to operations covered by the agreement. The procedure includes rights of non-operators to audit the accounts and records of the operator.
- 8. The accounting procedure governs charges to the joint account and joint venture billing statements.
- 9. Sole risk costs are incurred when a party or parties conduct an operation (also known as a sole risk operation) that is permitted under the terms of the joint venture operating agreement, and that fewer than all the participants to the agreement undertake at their sole risk, benefit, cost and liability.
- 10. Sole risk costs in a sole risk operation are calculated using the principles in the accounting procedure set out in the joint venture operating agreement. Despite this, the costs of a sole risk operation are accounted for separately.
- 11. The Commissioner recognises that in these circumstances a commercial tension exists amongst unrelated joint venture participants.

Our compliance approach

- 12. In view of this commercial tension, the Commissioner will not generally devote compliance resources to examining whether payments incurred and charged to a joint venture billing statement, or a sole risk operation account, within the terms of the joint venture operating agreement between unrelated participants, are deductible under section 38 of the Act.
- 13. The entity must satisfy all of the following conditions for the Commissioner to apply this compliance approach.
 - (a) The payment constitutes an undisputed and direct charge to the joint venture billing statement or sole risk operation account. That is, it represents an actual cost or expenditure incurred within the limits of the approved work program and budgets specified in the joint venture operating agreement.

- (b) The payment is an overhead cost described in paragraph 17 of this Guideline that is actually incurred and allocated to the resource cost pool via time writing or another allocation method accepted by the joint venture operating agreement.
- (c) The payment, or any portion thereof, does not relate to a social infrastructure cost arising from either a statutory requirement or an entity's social licence to operate. This includes sponsorship costs and costs to build hospitals, roads, transport, water and sewerage assets and other facilities for the general community.
- (d) The entity maintains appropriate records to support their expenditure claims and furnishes these records if required by the Commissioner.
- 14. This compliance approach also applies to payments made to procure the carrying on or providing of operations, facilities or other things of a kind described in section 38 of the Act by another entity, where paragraph 41(1)(d) of the Act applies.

The overhead component of time written costs

- 15. Time writing is a method of allocating an individual's labour charges to the cost objects or the endpoint, based on their timesheet entries. Each time entry is translated to a cost (hours x time writing rate).
- 16. Overhead costs can be embedded within the time writing hourly rate by which the time written cost is determined.
- 17. For the purposes of this compliance approach, the Commissioner considers overhead costs to comprise the costs relating to:
 - (a) office rent and associated utilities
 - (b) information technology
 - (c) executive management
 - (d) human resources
 - (e) health, safety, security and environment, and
 - (f) public and government affairs (excluding investor, corporate/shareholder public relations).
- 18. However, the Commissioner does not consider that overhead costs include:
 - (a) expenses charged to the joint venture participants on a generalised basis for operator support services without reference to a specific underlying service, activity or cost (for example, overhead charged as a percentage of capital expenditure)
 - (b) costs relating to downstream assets and activities, or
 - (c) excluded costs under paragraphs 44(1)(a) to (i) of the Act, and costs related to these.

Are there situations where this approach is not appropriate?

- 19. The compliance approach does not apply:
 - to expenditure claims that attract the anti-avoidance provisions in Division 6 of Part V of the Act
 - (b) to expenditure claims that are not fair and reasonable in the Commissioner's opinion, or
 - (c) where, or to the extent that, it conflicts with the terms of a dispute settlement concerning expenditure claims that are outside the scope, or date of effect, of this approach.

Will we be monitoring the application of the approach?

20. We will be monitoring expenditure claims (including conducting post-lodgment reviews) in order to ensure that eligibility for the compliance approach has been established.

Commissioner of Taxation

12 September 2016

References

ATOlaw topic(s)	Petroleum resource rent tax ~~ Deductible expenditure ~~ General expenditure Petroleum resource rent tax ~~ Other
Legislative references	PRRTAA 1987 PRRTAA 1987 19(4) PRRTAA 1987 38 PRRTAA 1987 41(1)(d) PRRTAA 1987 44(1)(a) PRRTAA 1987 44(1)(i) PRRTAA 1987 44(1)(j)
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