JUBILEE AUSTRALIA RESEARCH CENTRE
PO Box 20885 World Square NSW 2000
Ph: 02 6130 0530
inquiry@jubileeaustralia.org
www.jubileeaustralia.org

Jubilee Australia Research Centre

Submission to the Corporate Tax Inquiry

For enquiries please contact:

Luke Fletcher, Executive Director

[redacted]

About Jubilee Australia

Jubilee Australia (formal name: the Jubilee Australia Research Centre) engages in research and advocacy to prevent human rights abuses, environmental destruction and economic injustice for impoverished individuals and groups adversely affected by the actions of Australian corporations, financial institutions and government agencies.

In 2015, Jubilee formally merged to become part of The Australia Institute, the influential Canberra-based think tank.

Summary

This submission looks at the problems of corporate tax avoidance in PNG, Australia's nearest neighbour and largest aid recipient, and the connections to corporate and government policies in Australia.

This submission looks in detail at PNG's largest enterprise, the PNG LNG project, and the behaviour of companies ExxonMobil and Oil Search, the largest entities in the PNG LNG joint venture.

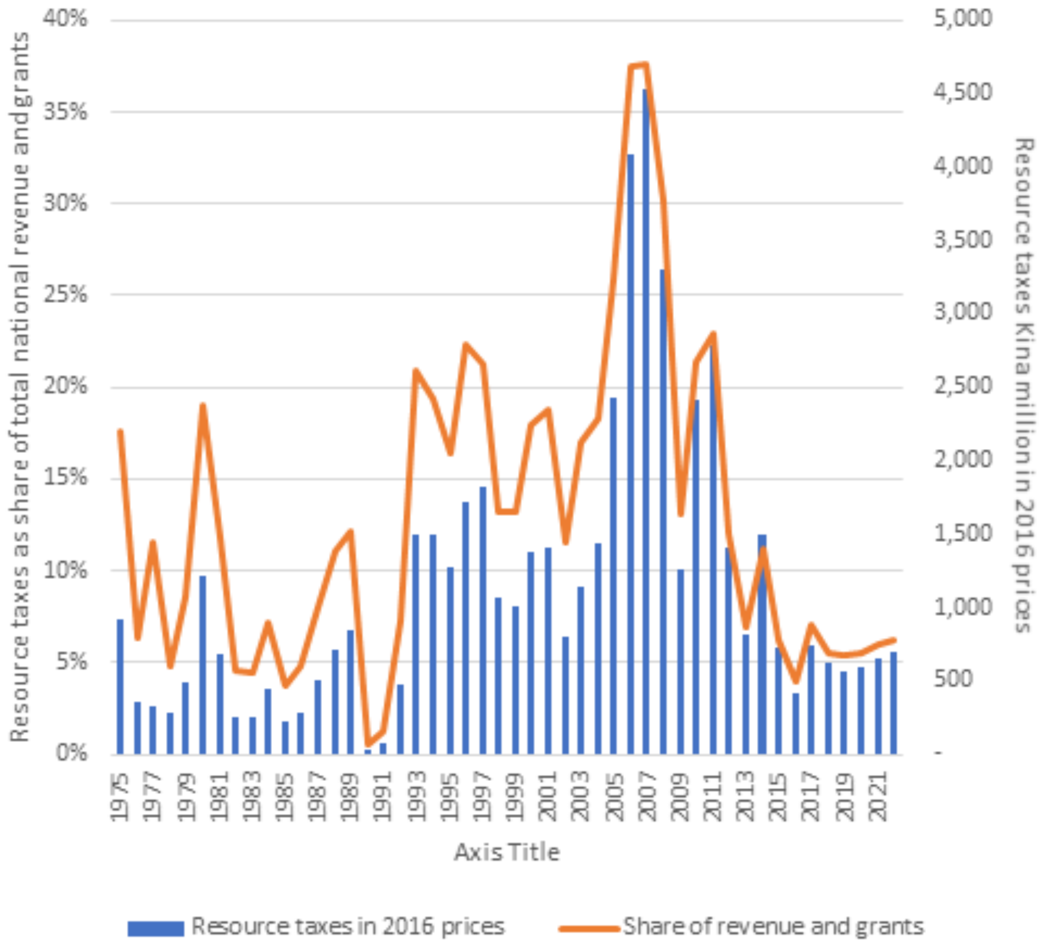
The submission finds that despite huge revenues from the project, ExxonMobil and Oil Search are paying very low revenues to the PNG Government, especially corporate tax payments. The submission concludes that this low payment of revenues is due to a combination of generous tax concessions given to the company as well as the use of subsidiary companies in known tax havens.

This submission is made on the basis of research towards a larger report that Jubilee is currently undertaking into the PNG LNG project. A more complete version of this paper can be presented when public hearings are held by this inquiry.

1. Papua New Guinea's Declining Resource Revenues

Papua New Guinea is in a budget crisis. The crisis is connected to the decline in the country's resource revenues in recent years. The country suffered a boom during the high commodity prices in the mid 2000s. As Figure 1 (below) shows, this period saw resource taxes reach 2.5 billion Kina, or 35% of GDP. However, since the commencement of the exports from the PNG LNG project, resource revenues have dropped to under 0.7 billion Kina estimated in 2018. In constant 2016 prices, despite the start-up of the PNG LNG project, the move into full production of the Ramu Nickel mine, and continued production from Ok Tedi and Lihir and Kutubu oil exports, the resource sector is currently contributing just over half the long-term average.

Figure 1: Resource Taxes as Share of Total PNG Government Revenues and Grants [1]

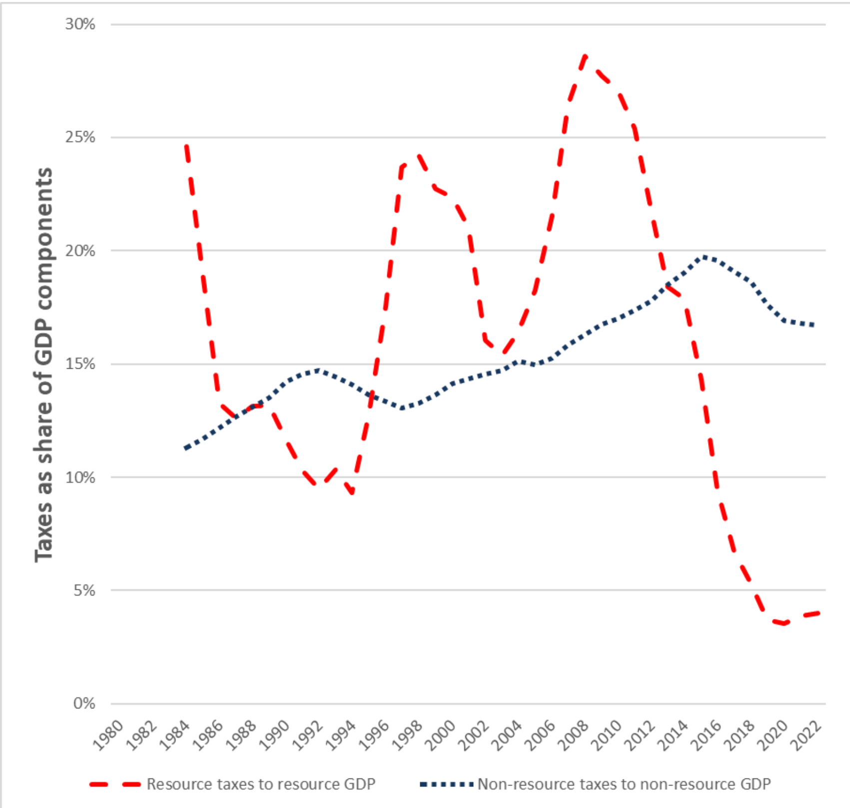


When looking at the level of resource taxes paid relative to the size of the resource sector, the story is even more worrying. PNG Treasury's recent 2018-2022 Medium-Term Revenue Strategy acknowledges the collapse in revenues in PNG. This has

[1] Sources: PNG Budget Papers, Asian Development Bank Data, Bank of PNG.

contributed to a fiscal crisis, with the largest deficits in PNG's history matched with falls in government services. The key aim of this new revenue strategy is to lift the share of overall revenues of PNG's economy, measured by GDP, back to 15%. This seems a modest aim. However, when examining the cause for the long-term decline in PNG's revenue base, it is clear that the major cause has been the fall in the level of resource taxes paid relative to resource earnings or resource GDP. This is very starkly illustrated in Figure 2 (below) which shows the level of taxes as a share of the relevant part of GDP (under a five year moving average to smooth out some yearly volatility). For the non-resource sector, which includes the key areas such as agriculture, retail and wholesale trade, construction, transport and public services, the ratio of taxes has been generally increasing, moving from around 12% in the early 1980s to around 17% currently. This ratio exceeds the 15% target set by the new government. On the other hand, there has been a significant decline in the ratio of resource taxes to resource GDP. Indeed, it has moved in recent years to being under 5%. This is less than half the ratio of taxes paid in the worst previous times in PNG's history. What is the reason for this shift to such extraordinarily low levels, both relative to PNG's own history and in comparison to other parts of PNG's economy?

Figure 2: How Much Tax is the Resources Sector Paying?[2]



While the fall in commodity prices since 2014 has had an impact, this is too simple an answer as PNG has regularly suffered falls in its major commodity prices in the past. This was the case in the early 1980s when copper and gold prices reduced earnings from the Bougainville Copper Mine, and in the early 1990s with the collapse in oil

[2] Sources: PNG Budget Papers, Asian Development Bank Data, Bank of PNG, National Statistics Office.

prices just as Kutubu oil production was gearing up. In both those cases, the average resource tax ratio stayed at 9 to 13%, essentially double current levels. Clearly, there is something strange going on here. Why are PNG resource companies paying so little tax?

According to our analysis, this fall in resource taxes has a number of different causes.

First, some of it is due to poor management of specific resources projects. The case of the Ok Tedi mine in Western Province is illustrative. Many believe that poor management of this resource since its effective nationalisation in 2014 has led to problems with the project that has seen its profits decline. (Declining ore grades at Ok Tedi and the 2015 drought have also been a factors but Ok Tedi was able to continue producing during the even more severe 1997 drought and some major ore walls have collapsed which probably should not have.)

A second cause of the decline in PNG resource revenues has been specific government policies and decisions to grant tax concessions to particular companies and sectors. A third cause is the actual underpayment of taxes in the sector through the use of tax havens and other vehicles that allows the underreporting of profits in the PNG jurisdiction.

This second cause is a sovereign matter for the Government of PNG, and therefore not strictly the concern of Australian policymakers. Nevertheless, Australian government decisions at the highest level helped make the PNG LNG possible and have fostered and supported PNG's push towards natural resource exploitation.

These latter two aspect of the problem can be said to be interrelated. A lack of oversight of government officials and favourable tax regimes are connected by a common thread: the undue influence of the oil and gas sector over the political economy of resource rich nations such as PNG. These two aspects will be explored in Section 2, through an examination of the case of the PNG LNG project.

2. Case Study: ExxonMobil and OilSearch

The PNG LNG Project: Bold Predictions

The project consisted of new gas wellheads in the newly created Hela Province in the Southern Highlands of PNG, a gas pipeline running from the highlands to just north of Port Moresby and an LNG liquefaction plant. This was also at the time the largest development project (in monetary terms: US$16 billion, further blowing out to US$19 billion) in the history of the Pacific region. Australia actively supported this project, most specifically through Australia's Export Finance and Investment Corporation (EFIC) making its largest loan ever of $US350 million.

The lead operator is the U.S. oil and gas giant ExxonMobil, which owns 33% of the shares. There is also significant involvement from the ASX-listed Oil Search (29%) which owns some of the oilfields from which the gas is being extracted. Australian company Santos and the government of PNG are also passive shareholders. For more details about the project, see chapter 2 of Jubilee Australia's 2012 Report Pipe Dreams.[3]

Economic modelling published by the Exxon and its joint venturers predicted significant revenue boosts for the PNG economy, both in the short-lived construction phase, but more importantly, in the multi-decade production phase. Predictions for the construction phase proved more or less accurate. Construction on the project was started in 2010 and completed in 2014.

Predictions for the production phase however, have proved so far to have been wildly optimistic. In 2014, the gas started to flow and May 2017 saw the 300th shipment of LNG in this project leave PNG's shores. Until recently, there have been minimal interruptions as to the delivery of the gas to its buyers.

The project proponents modelled three different scenarios for revenues in predicting annual net cash flow coming to the government and landowners (from taxes, royalties, levies, etc). The low case assumption from 2014-2023 was approximately 1 billion Kina per year. The study case assumption predicted cash flows of 3 billion Kina/year and the high case 4 billion Kina/year.[4]

And yet PNG LNG revenues to government have been far below even the low case assumption, and in recent years, shockingly so.

What the Data Shows

PNG is a signatory to the Extractives Industry Transparency Initiative (EITI) which is a voluntary scheme through which companies and governments publicly report payments in the resources sector in order to prevent underpayment and corruption. The data for Exxon and Oil Search are presented in table 1 below.

An analysis of this data from the last three years (2014, 2015 and 2016) shows that the revenues collected from PNG LNG fall well short even of the most pessimistic predictions for the project. The data are laid out in Table 1 on the next page.

The striking story that the data tell is the low level of total revenues collected from the combination of company tax, group tax (which is formally a tax on workers on the project rather than the project itself and do not reflect a tax on the resource rents being extracted), royalties and development levies. In total these numbers are well below K1 billion for each year, which it will be remembered was the low case assumption for the collection of revenues. However, this low case assumption was based on gas prices significantly below what it has been for these past few years.

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[3] Jubilee Australia, Pipe Dreams: PNG LNG and the Hopes of a Nation, Chapter 2.
[4] ACIL Tasman Report, PNG LNG Economic Impact Study—Final Report, February 2008, vii.

To look at this from another angle, the Oil Search Annual Report for 2016 was US$710 million??, and projecting this should mean total earnings for the project for all four of the major Joint Venturers would be around US$1.5 billion, or K4.5 billion.[5]

Given that the company tax rate is supposed to be 30%, then company tax payments alone from PNG LNG for ExxonMobil and Oil Search should tally at well over K1 billion (especially as the company tax rate on oil companies up until 1 January 2017 was 45 to 50 per cent with LNG companies paying 30 per cent). The 2014 company tax figures for the two companies were closing in on K500 million, which although disappointingly low are at least in the same ball park. But company tax payments for 2015 and 2016 are, as the table shows, an order of magnitude below what would be expected. This is truly shocking. These very low outcomes relative to expectations are causing increasing concerns within PNG Government circles. In his 13 February 2018 address to the PNG Parliament, PNG Treasurer Charles Abel stated when presenting the Final Budget Outcome for 2017 that "Of particular note again is the mining and petroleum income tax collections of K114m, K41m below budget and representing only one and three quarter of the total tax take."

Generous tax concessions received by the PNG LNG Joint Venturers probably have played a role here – both when it came to corporate tax collection and other revenues streams such as royalties and development levies. For example, the IMF has reported that although royalties are supposed to be 2% of the wellhead value of the gas, which would have led to royalties of around K290 million, various concessions allowed the company to reduce royalty payments to just over K50 million.

The EITI data also show that even within these lower-than expected payments, there are still some serious discrepancies between the amounts reported as paid by the companies and the amounts reported as received by the PNG government. These discrepancies are present not just in the company tax figures but also in the royalties and development levies. The meaning and significance of these discrepancies will be discussed in more detail in Jubilee Australia's upcoming report on the PNG LNG project For now it suffices to say that the discrepancies paint a concerning picture as to what is happening with regards to the management of resource revenues in PNG.

[5] Make Exxon Pay & Tax Justice Network Australia, Joint Submission to the Senate Economics Commottee for the Inquiry into Corporate Tax Avoidance, 7.

Table 1: ExxonMobil and Oilsearch Payments to PNG Government, 2014-16 (Millions Kina)

		2014		2015		2016	
		Paid	**Received**	**Paid**	**Received**	**Paid**	**Received**
Company Tax	*Exxon*	159.4	156.6	49.9	51.5	3.2	17.4
	OilSearch	322.4	314.7	3.8	3.9	37	37.4
Dividends	*Exxon*						
	OilSearch						
Input Tax Credits Expenditure	*Exxon*	-	-	-	-	-	
	OilSearch	-	-	224	80.1	100.9	82.1
Input Tax Credits Claimed	*Exxon*	-	-	18.2	18.4	1.3	1.3
	OilSearch	-	-	3.1	34.1	3.2	139.5
Group Tax	*Exxon*	223.2	-	170.5	170.5	139.5	139.5
	OilSearch	97.9	-	92.6	97.2	85.2	88
Other Taxes	*Exxon*	-	-	-	44.8	-	17.8
	OilSearch	-	-	-	27	-	17.8
Oil and Gas Payments	*OilSearch*	-	-				
	PNG LNG	-	-	n/a	1003.6	n/a	293.4
Development Levy	*Exxon*	0	0	74.6	0	62.2	0
	OilSearch	16.8	16.4	16.1	16.1	7.4	7.4
Royalties	*Exxon*	46.3	47.4	78	0	10.8	0
	OilSearch	53.5	52	30.6	30.4	26.3	26.3

The Use of Tax Havens

A skilful (and therefore legal) exploitation of tax loopholes and concessions given to the Joint Venturers may go a long way to explaining the disappointingly low revenues collected from the PNG LNG project. Nevertheless, given what has recently been uncovered about the byzantine nature and location (in known tax havens) of ExxonMobil and PNG LNG's corporate structures, we content that there is more to the story.

In their submission to this committee, Tax Justice Network Australian and the Make Exxon Pay Coalition have found that both Exxon and Oil Search have both set up companies in the Bahamas which receive the companu revenues from the PNG LNG project. There is also a Delaware connection for Exxon: an Australian-based company Mobil PNG Gas Pty Ltd is owned by an Exxon corporation registered in Delaware. The Bahamas and Delaware are known tax havens.[6]

With respect to the Bahamas connection, the submission says: 'This use of the Bahamas-based entity is very likely to reduce taxable profit in PNG and Australia and book profit in the Bahamas where the corporate income tax rate is zero.'[7]

It therefore seems very possible that the disappointing revenues flowing to PNG from the PNG LNG project may not just be due to generous tax concessions, but also to the use of these subsidiary companies based in tax havens.

3. Relevance for Australian Policymakers

There are three reasons why the information presented in this submission should be of great concern to Australian policymakers. First, PNG is our closest neighbour and largest aid recipient. Its stability and prosperity are of most importance to Australia. It is therefore in Australia's interest to ensure that it benefits from the revenues due to it from its natural resources to the greatest extent possible.

Second, the Australian Government has spent significant funds towards the Extractives Industries Transparency Initiative (EITI). The purpose of this project is to allow the public to become aware when revenues may be being stolen or somehow lost. And yet tax evasion through the use of tax havens and the granting of generous tax concessions has the same impact as does the theft or mishandling of revenues. The result: supposed benefits of natural resources wealth are alienated from the populations of the countries from which the resources are extracted.

Finally, the sorts of vehicles and techniques that Exxon appears to be using to pay less tax to PNG are also being used in its operations in Australia.[8] In other words, what is

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[6] Make Exxon Pay & Tax Justice Network Australia, Joint Submission to the Senate Economics Commottee for the Inquiry into Corporate Tax Avoidance, 5-7.
[7] Ibid,. 6-7.
[8] Ibid.

happening in PNG is also happening here—it is part of the same problem. How can we expect Exxon to pay proper tax in PNG if it is not doing so here either?

4. Recommendations

Although Jubilee Australia endorses all seven recommendations in the Tax Justice Australia/Make Exxon Pay submission, we would like to emphasise the importance of recommendations 1 and 3 as being particularly important to the PNG LNG case. We therefore strongly recommend:

First, the introduction of mandatory reporting regimes for disclosure of payments made too and from all governments on a project-by-project basis.

Second, the Australian Government through the ATO and other agencies investigate all claims raised concerning Exxon in its operations in Australia and PNG.