

PRE-BUDGET BRIEFING PAPER

Ending the fossil fuel industry's age of entitlement:

An analysis of Australian Government tax measures that encourage fossil fuel use and more pollution

Summary

This briefing paper summarises government estimates of federal tax measures that encourage the production and use of fossil fuels. It shows how in each of the coming four years, the Australian Government plans to gift around \$10 billion of taxpayer's money to subsidise fossil fuel use, unless significant changes are made in the May Federal Budget.

The assessment concludes that the Australian Government is set to spend over \$40 billion (see Table on page 4) in the form of tax rebates and concessions, foregone revenue and expedited write downs of assets per year from 2013/14 to 2016/17. This assessment only includes tax measures, and does not include direct grants or State Government measures, which could add billions more to the annual totals.

On the basis of this assessment, Environment Victoria and Market Forces are recommending that the Federal Government prioritises action at the upcoming Budget to cut three key subsidies which would save taxpayers over \$12 billion over the next three years. For a government that has expressed its eagerness to end corporate welfare, removing fossil fuel subsidies represents a win for the climate and a win for the budget bottom line.

Key Measures for 2014/15 Federal Budget	Savings (\$ million)			Total
	2014/15	2015/16	2016/17	
Fuel tax credits scheme to the mining industry ^(a)	2274	2414	2449	7137
Statutory effective life caps (accelerated depreciation) to the oil and gas, and petroleum extraction industries, and to non-specified industries. ^(b)	240	490	490	1220
Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	1280	1340	1400	4020
TOTAL	3794	4244	4339	12377

(a) Estimates based on the proportion of Fuel Tax Credits in 2010-11 that were claimed by the mining industry (\$2 billion of \$5.2 billion).

(b) Values taken from Business Tax Working Group discussion paper deliberations, obtained through Freedom of Information.



Why Australia needs to end polluter handouts

The Federal Government is proposing to make Australia the first country in the world to remove an established price on carbon. The proposed replacement climate policy, the Emissions Reduction Fund, relies on paying companies as an incentive to reduce their emissions. A fundamental contradiction exists between such a policy and the continuation of a range of existing fossil fuel subsidies. Many subsidies significantly reduce the economic signal for companies to identify efficiency opportunities.

Polluter handouts are also highly inequitable. For instance, the mining industry receives a 32c per litre discount on fuels such as petrol and diesel for off-road use.¹ So while most Australians are paying full price for their fuel at the bowser, their taxes also cover the cost of a huge discount to the mining industry. In all, this handout costs Australian taxpayers \$2 billion each year.

Australia, along with all other G20 nations, committed in 2009 to phase out inefficient fossil fuel subsidies over the medium term. In his recent State of the Union address, US President Barack Obama reiterated the need to phase out tax-based fossil fuel subsidies.² Other organisations like the International Monetary Fund, the World Bank, the United Nations and the International Energy Agency are also calling for nations to end fossil fuel subsidies.

In 2009, the Commonwealth Treasury identified \$8 billion in annual savings that could be made if Australia fulfilled this commitment.³ This money could be used to fund a wide range of nation-building projects, yet to date we continue to use these funds to line the pockets of polluting, and in many cases highly profitable, industries.

Political and economic context

Prime Minister Abbott has said that there is to be an end to corporate welfare.⁴ Statements by Treasurer Joe Hockey have warned that “the age of entitlement is over,” and that “everyone in Australia must do the heavy lifting now.”⁵ It is critical that this rhetoric, if applied, is applied consistently.

In 2012, the Business Tax Working Group put forward options for removing the exploration and prospecting deduction and accelerated depreciation that could return billions of dollars over the coming few years to the public purse. Exploration and prospecting deductions were removed in 2013/14, and there is now an opportunity to remove accelerated depreciation subsidies in 2014/15.

Analysis in December 2013 by Macroeconomics concluded that the government should “cut early and cut hard because they will never have a better chance than now to fix the budget.” In this context, withdrawing \$10 billion of

¹ <http://www.ato.gov.au/Business/Fuel-schemes/In-detail/Fuel-tax-credits---for-GST-registered-businesses/Calculating-and-record-keeping/Fuel-tax-credit-rates-and-eligible-fuels/>

² NPR, Transcript: Obama’s State of the Union Address as prepared for delivery, 28 Jan 2014.

<http://www.npr.org/blogs/itsallpolitics/2014/01/28/267901424/transcript-obamas-state-of-the-union-address-as-prepared-for-delivery>

³ Australian Financial Review, 28 February 2011, “Swan under pressure over fossil fuels”.

http://www.afr.com/p/national/politics/swan_under_pressure_over_fossil_fuels

⁴ <http://www.theguardian.com/world/2013/dec/18/tony-abbott-declares-an-end-to-corporate-welfare>

⁵ <http://www.smh.com.au/federal-politics/political-news/hockey-calls-end-to-age-of-entitlement-20140203-31xgl.html>



subsidies could be used to plug the hole in the budget while simultaneously providing emissions reduction at zero cost to the government.

Fossil fuel subsidy reform will be highly contested by industries such as mining, even though it is a policy measure that benefits the budget and environment. A Treasury minute reveals that in November 2012 the Association of Mining and Exploration Companies met the Secretary of the Australian Treasury. The industry was concerned about losing their entitlements to Fuel Tax Credits,⁶ which reaped the industry \$2 billion in 2010-11,⁷ and launched an ad campaign calling on government to “keep mining strong”.

It is also worth noting that all of the measures described below fall within the definition of “subsidies” used by the World Trade Organisation and agreed to by all of its members (including Australia).⁸

In an era of significant budget constraints, cuts to fossil fuel subsidies can return billions of dollars to the budget bottom line and significantly reduce greenhouse emissions.

Building a campaign to end polluter handouts

Market Forces and Environment Victoria have joined with other environment groups across Australia to tell the federal government to **End Polluter Handouts**. The campaign (at paidtopollute.org.au) will be a focal point for community action calling on Treasurer Hockey and MPs across Australia to support the redirection of polluter handouts towards projects that benefit Australia.

In 2013 progress was made as the exploration and prospecting deduction was cut in the May Budget, saving the taxpayer \$1 billion over the coming four years. However, increases in other subsidies, such as the fuel tax credits scheme and excise concessions will counteract this gain, resulting in federal taxation-based fossil fuel subsidies increasing to almost \$11 billion per year by 2016/17.

⁶ <http://www.marketforces.org.au/wp-content/uploads/2013/10/Treasury-Doc-12.pdf>

⁷ <http://www.anao.gov.au/Publications/Audit-Reports/2010-2011/Fuel-Tax-Credits-Scheme>

⁸ <http://www.oecd.org/env/45575666.pdf>, paragraph 9, page 8.

Assessment of Federal taxation-based fossil fuel subsidies

Measure	2012/13	2013/14	2014/15	2015/16	2016/17
Fuel tax credits scheme (total)	5,519	5,871	5,906	6,270	6,360
Statutory effective life caps (accelerated depreciation)	1555	1720	1795	1780	1705
Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	970	1010	1280	1340	1400
Fringe Benefits Tax - Application of statutory formula to value car benefits	970	810	790	870	950
Energy Security Fund – payments and free permits to the most carbon intensive power stations	876	897	922	1026	1068
Exploration and prospecting deduction	550	-	-	-	-
Carbon Price Mechanism thresholds for obligations	100	120	-	-	-
FBT - Exemption for employee taxi travel to or from their place of work*	5	5	5	5	5
Exemption for employer-provided motor vehicle parking*	55	55	55	55	55
GST – Tourism; domestic air or sea travel*	55	55	55	55	55
PRRT - expenditure uplift rate*	55	55	55	55	55
PRRT - gas transfer price regulations*	55	55	55	55	55
PRRT – starting base and uplift rate for capital assets*	55	55	55	55	55
PRRT – Increased deduction for petroleum exploration expenditure in designated frontier areas*	5	5	5	5	5
Shipping - investment incentives	55	55	55	55	55
Carbon Price Mechanism uncovered sectors – Decommissioned mines	10	20	-	-	-
FBT - Discounted valuation for car parking fringe benefits	19	21	24	26	28
Alternatives to the logbook method of substantiating car expenses*	5	5	5	5	5
FBT - Exemption for minor private use of company motor vehicle*	5	5	5	5	5
FBT - Exemption for transport for oil rig and remote area employees in certain circumstances*	5	5	5	5	5
Capital expenditure deduction for mining, quarrying and petroleum operations	2	2	2	2	-
	Expenditure per year (\$ millions)				
	2012/13	2013/14	2014/15	2015/16	2016/17
	10926	10826	11074	11669	11866
Without Energy Security Fund payments	10050	9929	10152	10643	10798



* Values represent the middle value of a range estimated by Treasury. i.e. 5 is reflective of a Treasury estimate of \$0-10 million, 55 reflective of a Treasury estimate of \$10-100 million.

Sources:

All measures and their corresponding values except for the Energy Security Fund and Fuel Tax Credits Scheme taken directly from Treasury Tax Expenditures Statement 2013, released January 2014.

(<http://www.treasury.gov.au/Treasury%20Home/PublicationsAndMedia/Publications/2014/TES%202013>)

Fuel Tax Credits Scheme: figures taken directly from Australian Government Budget 2013-14, Budget Paper 1, Page 6-41. (<http://www.budget.gov.au/2013-14/content/bp1/html/index.htm>)

Energy Security Fund: values calculated by multiplying the value of free permit allocations to carbon pollution-intensive coal-fired power stations (41.705 million per annum – see <http://www.cleanenergyregulator.gov.au/Carbon-Pricing-Mechanism/Industry-Assistance/coal-fired-generators/Pages/default.aspx>) with the forecast carbon price (obtained from Chart 5.1: Australian carbon price, www.carbonpricingmodelling.treasury.gov.au/carbonpricingmodelling/content/chart_table_data/chapter5.asp) where the price taken reflected the second half of that financial year. The Australian Treasury does not include measures related to the Clean Energy Future beyond 2013-14 as Government policy is to repeal the legislation. However, as this outcome is not certain, we have retained the Energy Security Fund payments (which are linked to the carbon price) in this analysis, providing totals that both include and exclude this measure.

Descriptions of individual measures†

Fuel tax credits scheme

Under the scheme, eligible companies are able to claim a reduced rate of excise for fuels. The mining industry is able to use Fuel Tax Credits to lower the cost of fuels for mining trucks, digging and hauling equipment operating on a quarry site. The reduced rates as of 1 July 2013 are:

- Petrol: 32.347cents per litre
- Diesel and other liquid fuels: 31.622 cents per litre

Statutory effective life caps (accelerated depreciation)

'Statutory effective life caps' provide a shorter write-off period for assets subject to a statutory cap where the cap is below the effective life determined by the Commissioner. Statutory caps exist for a range of assets, including:

- aircraft and certain assets used in the oil and gas industries;
- trucks, truck trailers, buses and light commercial vehicles; and
- tractors and harvesters.

Concessional rate of excise levied on aviation gasoline and aviation turbine fuel

Aviation gasoline and aviation turbine fuel are subject to a lower rate of excise than the benchmark rate. From 1 July 2012 to 30 June 2014, the excise rate includes a 'carbon component rate', which is determined by the emission factor of each fuel and the carbon price. The inclusion of a carbon component of excise reduces the value of the concessional rate of excise. From 1 July 2014, the value of the concession will increase due to the revised carbon tax benchmark.

Fringe Benefits Tax - Application of statutory formula to value car benefits

A fringe benefit arises where an employee is provided with a car for private use. The statutory formula method is designed to provide employers with a low compliance cost alternative to the operating cost method, eliminating the



need to maintain a vehicle log book. The statutory formula method removes the need to explicitly distinguish between the business and private use of a vehicle. Under the statutory formula method, a person's car fringe benefit is determined by multiplying the relevant statutory rate by the cost of the car.

Energy security fund - payments and free permits to the most carbon intensive power stations

Under the carbon price mechanism, "transitional assistance" to Australia's most carbon intensive coal-fired power stations is being provided in the form of cash handouts and free carbon permits. This package is valued at \$5.5 billion over five years, and began with an early payment of \$1 billion in cash to eligible electricity generators prior to the 2012-13 financial year. This measure has been found to reap Victoria's brown coal generators a windfall gain of \$2.3-5.4 billion. See notes beneath table of subsidy measures to see how we have treated this program over the coming financial years.

Exploration and prospecting deduction

Expenditure on exploration or prospecting for the purpose of mining and quarrying is immediately deductible. In addition, the cost of a depreciating asset is immediately deductible if the taxpayer first uses the asset for exploration or prospecting for minerals or quarry materials obtainable by mining operations, the asset is not used for petroleum development drilling or for operations in the course of working a mining or quarrying operation, and when the taxpayer starts to use the asset, the taxpayer either carries on mining operations, or proposes to carry on such operations, or carries on a business that includes exploration and prospecting for which the cost of the asset was necessarily incurred.

Carbon Price Mechanism thresholds for obligations

In most covered sectors under the CPM, only entities producing above 25,000 tonnes of emissions per year are liable. This is largely for practical reasons — participation thresholds are designed to balance the benefits of increased CPM coverage against the costs of scheme compliance.

Fringe Benefits Tax - Exemption for employee taxi travel to or from their place of work

Any benefit arising from taxi travel by an employee is exempt from fringe benefits tax if the travel is a single trip beginning or ending at the employee's place of work.

Goods and services tax – Tourism; domestic air or sea travel

Domestic air or sea travel within Australia by residents or non-residents as part of a wider international arrangement is not subject to GST. Domestic air travel within Australia by non-residents is also GST-free if the ticket is purchased outside Australia. Transport insurance for the above supplies is also GST free.

Petroleum Resources Rent Tax - expenditure uplift rate

Under the PRRT regime, expenditure is uplifted at a number of different rates depending on when the expenditure took place and the nature of the expenditure. For example exploration expenditure is uplifted at the long term bond rate plus 15 per cent and general expenditure is uplifted at the long term bond rate plus 5 per cent. These uplift rates are beyond the appropriate benchmark rate of the long term bond rate.

Petroleum Resources Rent Tax - gas transfer price regulations

For PRRT purposes, the gas transfer price regulations stipulate rules for calculating the gas transfer price where there is no arm's length transaction. The regulations provide an allowance for capital expenditure which is based on the long term bond rate plus 7 percentage points rather than the applicable benchmark rate. The regulations also provide further concessions in the calculation of the gas transfer price by reducing the estimated upstream gas price by half the difference between the estimated 'upstream' price and the estimated 'downstream' price where the upstream price is the higher.



Petroleum Resources Rent Tax – starting base and uplift rate for capital assets

Under the PRRT regime, existing investments of projects brought under the PRRT on 1 July 2012 are recognised through the provision of a starting base allowance. The starting base allowance recognises assets relating to the upstream assets of the PRRT project on 2 May 2010. The starting base may be calculated using the market value method, the accounting book value method or the 'look back' value method. Unused starting base losses are uplifted at the long term bond rate plus 5 per cent. Unused exploration expenditure under the look back valuation option is uplifted at long term bond rate plus 15 per cent.

Shipping — Investment incentives

Since 1 July 2012, the following incentives are provided to encourage investment in Australian shipping:

- an income tax exemption on qualifying income for ship operators;
- a royalty withholding tax exemption;
- accelerated depreciation, under which Australian ship owners will be able to depreciate vessels over an effective life that is capped at 10 years; and
- balancing adjustment roll-over relief for Australian ship owners if they cease to hold a vessel and purchase another eligible vessel within two years.

Carbon Price Mechanism uncovered sectors – Decommissioned mines

Fugitive emissions from decommissioned coal mines will be excluded from the CPM. This is partly because of measurement difficulties caused by sealing a mine, but also because fugitive emissions from most decommissioned mines are expected to be below the 25,000 tonne emissions threshold. Decommissioned mines that may initially exceed the threshold are expected to fall below it within a few years.

Fringe Benefits Tax - Discounted valuation for car parking fringe benefits

A car parking fringe benefit arises if within a one kilometre radius of the premises on which the car is parked there is a commercial parking station that charges a fee for all day parking that is more than a specified car parking threshold calculated by reference to movements in the Consumer Price Index. The threshold for the fringe benefits tax year commencing 1 April 2013 is \$8.01. For fees under the threshold no parking fringe benefit arises.

Alternatives to the logbook method of substantiating car expenses

Three alternative methods to the logbook method (which is based on actual expenditure) are available to value car expense deductions:

- the one third of actual expenses method (only available if business use exceeds 5,000 kilometres);
- the 12 per cent of original value method (only available if business use exceeds 5,000 kilometres); and
- the cents per kilometre method (only available up to a maximum of 5,000 business kilometres).

Fringe Benefits Tax - Exemption for minor private use of company motor vehicle

Where an employee is provided with the use of a motor vehicle that is not a car, such use is exempt from fringe benefits tax if any private use is restricted to travel to and from work, use which is incidental to travel in the course of duties of employment, and non-work-related use that is minor, infrequent and irregular.

Fringe Benefits Tax - Exemption for transport for oil rig and remote area employees in certain circumstances

Transport provided to employees in remote areas in Australia or who work on oil rigs or other installations at sea may be exempt from fringe benefits tax. The exemption applies where the employees are provided with accommodation at or near the work site on working days and it would be unreasonable to expect the employees to travel to and from work on a daily basis.



Capital expenditure deduction for mining, quarrying and petroleum operations

Certain capital expenditure incurred in carrying on a mining, petroleum or quarrying operation can be deducted over the lesser of the life of the project or 10 years (20 years for quarrying). The deduction is available for expenditure incurred before 1 July 2001 or expenditure relating to a depreciating asset acquired before 1 July 2001 (excluding plant and equipment). Expenditure incurred on or after 1 July 2001 can be deducted over the life of the project.

[†] All descriptions except for those of the Fuel Tax Credits Scheme and Energy Security Fund are amended versions of descriptions provided in the 2013 Tax Expenditure Statement (<http://www.treasury.gov.au/Treasury%20Home/PublicationsAndMedia/Publications/2014/TES%202013>)