

INCENTIVES FOR PETROLEUM OPERATIONS

Implementation of the amendments to the Income Tax, Dividend (Withholding) Tax and Interest (Withholding) Tax Rates Act (Chapter 111) and the Income Tax Act for introduction of incentives for petroleum exploration and development as provided for in the 2003 Budget Provisions.

The 2003 budget provisions have included a special package of incentives for the petroleum industry.

Due to concerns about the lack of exploration activity in Papua New Guinea, particularly in the drilling of exploration wells, and the projected steep decline in oil production from the existing Kutubu, Gobe and Moran oil fields over the period 2003-2010, the Government has introduced special fiscal terms that are to provide an incentive to the industry to explore.

Those special terms are styled as “incentive rate petroleum operations”.

Fundamentally, incentive rate petroleum operations will be subject to a revised income tax of just 30% of taxable income. This is a significant decrease from normal petroleum operations, the income of which is currently assessed at 50% of taxable income for petroleum projects established prior to January 1st 2001 and 45% for projects thereafter.

The new 30% rate of taxation will be available for petroleum operations pursuant to a Petroleum Development Licences granted on or before 31st December 2017. To qualify for this incentive rate, companies need to be granted a petroleum prospecting licence within the designated period of 1st January 2003 to 31st December 2007.

It is hoped that during this five-year period, petroleum companies will apply for and be granted new licences undertaking aggressive exploration programmes that would lead to new discoveries. As our standard licence provisions are for an initial six-year term followed by a five-year extension (in respect of half the area), the incentive programme will cater for discoveries throughout the life of such new Petroleum Prospecting Licences.

We hope that these provisions will reward new and renewed investment by the petroleum companies in exploration. Their reward will be a significantly reduced tax on eventual petroleum production emanating from these new licences.

Additionally, the incentives provide for the removal of the first tier of Additional Profits Tax (APT) in respect of all petroleum operations with effect from 1st January 2003. The APT is an incremental tax on the accumulated value of net project receipts that is: petroleum income less deductions uplifted at a set accumulation rate each year. The normal provisions for APT are for a 1st tier 20% tax on any positive balance of net projects receipts after applying a 15% accumulation rate, and a 2nd tier 25% tax on any positive balance after applying a 20% accumulation rate. For all petroleum operations other than gas operations, we are removing the first tier of APT.

The incentive rate petroleum operations designation will be available for all petroleum operations arising from newly granted licences throughout all of the petroleum basins of Papua New Guinea. We are thus providing the incentives to all our basins including existing productive basins, under-explored basins and unexplored basins. We intend to encourage exploration activity not only in our productive and recognised petroliferous areas, but also in lesser explored or frontier areas.

We recognise that outside of the Papuan Basin, our basins are relatively unexplored and we clearly see the need to spur the exploration of such frontier areas through the application of these incentives.

Equally, we recognise that drilling has already tested many of the large prospects of the Papuan Basin and that exploration in the Papuan Fold and Thrust Belt and the Papuan Foreland has been very expensive. With the incentive provisions, we therefore intend to stimulate the petroleum industry to explore smaller prospects and find oil and gas fields, which would otherwise have been left unexplored for and unidentified. Previously sub-economic prospects and marginal fields prospects should benefit from these new terms.

The incentive tax rate as defined provides a clear stimulus to the industry to apply for new licences and discover new oil and gas fields in both the petroliferous areas and the under-explored areas. However, we also need to provide a stimulus for those companies that have persisted in exploring to date and provide them with a reward for their steadfastness and belief in eventual discovery in PNG.

We have just sixteen active Petroleum Prospecting Licences at present - down from a peak of forty in 1990. Many of those licensees are finding it difficult to commit to high exploration expenditures and gain management approval to spend scarce exploration budgets in PNG. We also recognise that competition is plentiful around the world for investments in petroleum exploration. We wish to encourage the exploration managers of our current operators to renew their interest in PNG.

Whilst the incentive rate terms have been defined for new Petroleum Prospecting Licences, I am equally concerned about encouraging existing licensees to accelerate their existing exploration

programmes. I am therefore prepared to grant new licences to those who hold existing tenements provided the incumbents voluntarily surrender their current licences simultaneous with submitting applications for new licences. The new licence applications must, however, have stronger exploration work commitments than the obligations of the current licences.

By this device, I will be able to extend the new incentive terms to existing licence areas on a discretionary basis, but based on enhanced investment and work commitments. This will be particularly useful for Petroleum Prospecting Licences away from the main oil and gas fairways in the lesser-explored parts of the Papuan Basin.

Those current licensees who wish to avail of the new incentive terms will nevertheless have to recognise that with the grant of new licences comes new tenure, and that moreover all prior exploration expenditure also becomes eligible as a tax deduction under the incentive terms. I will therefore only consider re-grants of licences over previously licensed areas where the licensees seriously heed my conditions and listen to my call for enhanced investment in exploration programmes.

There are some marginal oil fields that lie inside some existing Petroleum Development Licence areas. It may be possible in certain circumstances to offer the incumbent licensees a similar trade-in of a block or blocks of their current licence area for a re-grant as a new Petroleum Prospecting Licence. Such re-grants should not, however, compromise the arrangements and licensing for the original development for which the Petroleum Development Licence was granted in the first place. In this manner, we may be able to selectively offer the new incentive terms for certain undeveloped marginal fields.

The Government has thus defined a package of fiscal stimulus, which deserves the industry's consideration. It is now up to the petroleum industry to respond in an appropriate and speedy manner, and to work with the Government in rejuvenating the country's oil exploration and development industry.

In application of the new incentive rate tax, we have left open a large window for the application for new Petroleum Development Licences derived from new Petroleum Prospecting Licences. The incentive period lasts till the end of 2017, but I do not wish to see explorers sit on discoveries without bringing them into development.

There are sound provisions in the Oil and Gas Act commencing with *licensees' notification of discovery; directions on discovery; declaration of a petroleum location; investigation of locations for the recovery of petroleum; and revocation of locations* - to combat such acreage and reserve sitters. In being flexible in the consideration of the application of the new incentive terms to existing tenement

holders, I also provide notice of my determination to apply the full force of the Oil and Gas Act to bring about early and prompt development of discovered oil and gas fields.

Some companies may be concerned, that the application of the incentive rate petroleum operations terms may be the subject of too much Ministerial discretion. In respect of new licences, the powers of discretion will remain as they have always been; that is, for the Minister acting on the advice of the Petroleum Advisory Board (PAB) to grant, or not to grant a petroleum prospecting licence to an applicant. The advice of the PAB is based on an examination of the technical, financial and corporate strengths of the applicant and an assessment of the appropriateness of the applicant's detailed proposals for exploration work and expenditure.

In the application of the new terms to existing tenements, where incumbents surrender their licences and then apply for a new licence over the same area, I will be pleased to follow the established protocol of receiving the written report of the PAB and its advice in the same manner as for any new application.

Our overall concern will be to obtain the maximum investment in exploration activities so that we may enhance the incidence of discovery and thereby ultimately maintain our national oil production at respectable levels. I now look forward to the industry taking up the challenge and finding all the oil that we have dreamed about.

Moi Avei, K.B.E, M.P.

Minister for Petroleum and Energy

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Port Moresby