Hon Dr Megan Woods, Minister of Energy and Resources

Hon Stuart Nash, Minister of Revenue

Information Release

Non-resident oil rig and seismic vessel operators: extension of tax exemption

Cabinet paper, regulatory impact assessment, and minute

July 2019

Availability

This information release is available on Inland Revenue's Tax Policy website at http://taxpolicy.ird.govt.nz/publications/2019-cab-dev-19-sub-0151/overview.

Documents in this information release

1. DEV-19-SUB-0151 – Cabinet paper: Extending tax exemption for non-resident offshore oil rig and seismic vessel operators (12 June 2019)
2. DEV-19-SUB-0151 – Regulatory impact assessment: Extending tax exemption for non-resident oil rig and seismic vessel operators (17 July 2018)
3. DEV-19-MIN-0151 – Minute: Non-resident oil rig and seismic vessel operators: extension of tax exemption (12 June 2019)

Additional information

The Cabinet paper was considered by the Cabinet Economic Development Committee on 12 June 2019 and confirmed by Cabinet on 17 June 2019.

Information withheld

No information was withheld for this information release.

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Office of the Minister of Energy and Resources
Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

Extending tax exemption for non-resident offshore oil rig and seismic vessel operators

Proposal

1 At present, there is a temporary five-year exemption from income tax on the income of non-resident offshore oil rig and seismic vessel operators which is due to expire on 31 December 2019. We propose that the exemption be extended for a further five years from 1 January 2020 until 31 December 2024.

Executive Summary

2 At present, there is a temporary five-year exemption from income tax on the income of non-resident offshore oil rig and seismic vessel operators which is due to expire on 31 December 2019. The exemption removes the incentive for rigs and seismic vessels to "churn", that is, move in and out of New Zealand waters within 183-days to ensure income is exempt from income tax under many of our double tax agreements (DTAs).

3 In the absence of the tax exemption no company tax would be paid by the oil rig and seismic vessel operators, while the increased costs from churning would be deductible to the New Zealand petroleum company and the reduced exploration and production may result in lower company taxes, petroleum royalties, and other taxes being paid over time.

4 A decision to extend the income tax exemption would be in keeping with the announcement that there will be no new offshore petroleum exploration permits granted, which included maintaining the existing and subsequent rights of existing operators. Where further offshore petroleum exploration is undertaken under existing permits, it is in New Zealand's interest for this to be done as efficiently as possible, without having policies that encourage churn.

Background

5 The tax exemption was introduced in 2004 to address an issue created by our DTAs, under which operators are only taxable in New Zealand if they are present here for at least 183 days. The exemption was subsequently renewed in 2009 and again in 2014 on the basis that this provides a more sensible result from a tax policy perspective. As the exemption is due to expire again on 31 December 2019, a decision is required on whether the exemption should continue to apply.

6 New Zealand generally taxes non-residents on income that has a source in New Zealand and if the non-resident has a “permanent establishment” in New Zealand. Many of our DTAs (such as the New Zealand/United States DTA) have a specific rule providing that a non-resident enterprise involved in exploring for natural resources only has a permanent establishment in New Zealand if they are present for a particular period of time, often 183 days in a year. Once a non-resident has a permanent establishment in New Zealand, it is taxed on all its New Zealand business profits starting from its first day in New Zealand.

7 Before the exemption was introduced rigs and seismic vessels used in petroleum exploration and production were leaving New Zealand waters before the 183 day threshold was reached to avoid being subject to New Zealand tax. This meant that, in most cases, a rig or vessel would leave before 183 days and a different rig or vessel was mobilised to complete the exploration/production programme, if required. This increased the cost for companies engaged in exploration and production and delayed exploration drilling and any subsequent discovery/development of oil or gas. It also meant that there was no company tax revenue collected from rigs and seismic vessels. Due to the limited supply of offshore drilling rigs, and the significant mobilisation costs, it could also result in exploration activity not taking place when it otherwise would.

Comment

8 Rigs and seismic vessels are used to drill for oil and gas and gather data on potential oil and gas finds. These rigs and vessels do not generally work offshore in winter weather for safety reasons. No New Zealand companies own these assets, and offshore rigs and seismic vessels owned by non-residents are covered by the current income tax exemption.

9 Between 2009 and 2017, there have been nine non-resident offshore drilling rigs operating in New Zealand. The average length of stay of these rigs has been 315 days. By contrast, between 2000 and 2005 (before the exemption was introduced), no rigs stayed in New Zealand waters beyond six months. At this stage it is anticipated at least one rig will operate within New Zealand waters in 2019-20.

10 Twelve seismic vessels have operated in New Zealand since 2009 with an average duration of 108 days with one high-value survey extending through to 200 days. Before 2005, the average length of stay was around four months. Maintaining the exemption removes a barrier for lengthier stays (which have been fewer but are typically more lucrative).

11 A consistent application of New Zealand’s tax policy framework would normally minimise any distortions caused by tax rules. However, with rigs and seismic vessels used for exploration or production work the normal tax rules do not provide the right outcome. This is because the normal tax rules create an incentive for rigs and seismic vessels to “churn”, that is, move in and out of New Zealand waters within a 183 day period where income is exempt under many of our DTAs. If rigs and seismic vessels churn in and out of New Zealand waters within the non-taxable period of 183 days it will reduce the revenue base, and increase unnecessary costs and greenhouse gas emissions.

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12 Under the exemption, royalties, income tax and other indirect taxes would still be payable in relation to any petroleum discoveries (in addition to the direct and indirect economic benefits from the activity), as the exemption only applies to the non-resident rig and seismic vessel operators rather than the petroleum miner.

13 The 2015 APEC fossil fuel subsidy reform peer review of New Zealand noted that this exemption appears to prevent 'churning' or cycling of equipment which avoids unnecessary costs, including additional fuel consumption (i.e. wasteful consumption by drilling operators), and associated greenhouse gas emissions. The OECD lists this measure as a "support measure" but has attributed a zero fiscal cost to New Zealand for each year since 2006.

Environmental impact, health and safety and security of supply

14 Offshore drilling for petroleum in New Zealand began in the 1960s. To date, over 200 offshore wells have been drilled in New Zealand, 10 of which have been in deep water, without any significant incidents. New Zealand also has high health and safety standards with respect to oil and gas exploration and production. This is evidenced in our tight regulation and monitoring of operators and our absence of oil and gas environmental disasters. However, we note that rig mobilisations, demobilisations, and other movements (that occur as a result of churn) increase health and safety risks due to the activities and large infrastructure assets involved. If the exemption is allowed to lapse we would expect increased churn, and therefore increased, but still a low probability of, health and safety risks.

15 New Zealand's gas reserves are only sufficient to cover a decade of annual gas demand at current demand levels. To prevent the situation of gas reserve depletion interrupting our energy supply, new sources of gas may need to be found within the next few years. This may be by way of new gas finds, or extension of existing fields, but either of which will involve some lead-time to production.

Consistency with recent Government announcement on no new offshore petroleum exploration permits

16 On 12 April 2018 the Government announced there will be no new offshore petroleum exploration permits granted. The Cabinet Minute [CAB-18-MIN-0162 refers] confirms this policy is not intended to affect the rights of current permit holders to continue production or exploration activities under existing permits.

17 A decision to extend the income tax exemption would be in keeping with the policy to maintain the rights of existing operators. Where further offshore petroleum exploration is undertaken under existing permits, it is in New Zealand's interest for this to be done as efficiently as possible, without encouraging churn.

18 Instead of a further five-year extension we also considered making the exemption permanent. We consider a five year extension is more prudent as this will provide sufficient certainty for near-term investment decisions while allowing time to consider and develop the Tax Working Group's recommendations, related to improving environmental and ecological outcomes.

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Consultation

19 Targeted consultation has been undertaken with the oil and gas industry representative body, the Petroleum Exploration and Production Association of New Zealand (PEPANZ), which supports extending the exemption. PEPANZ has also submitted in support of this exemption to the Finance and Expenditure Committee in their consideration of the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill.

20 Inland Revenue, the Ministry of Business, Innovation and Employment, the Treasury and the Ministry for the Environment have been consulted and support the proposed 5-year extension.

Financial Implications

21 This proposal would give rise to $16 million in tax revenue over the current forecast period. Based on the information available on rig activity, extending the exemption could reduce costs to the New Zealand purchasers of rig services of approximately $14 million per year with flow-on effects for the tax base. The flow on effects of reduced tax revenue from expiry of the exemption have already been included in the baseline tax forecasts. The table below shows the forecast revenue gains of instead extending the exemption. The final year of revenue impact is 2023/24, when the extended exemption expires.

	$m - increase/(decrease)				
Vote Revenue Minister of Revenue	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23 & Outyears**
Crown Revenue and Receipts: Tax Revenue	-	4.000	4.000	4.000	4.000

22 The revenue gain from this proposal can be accounted for on the tax policy scorecard. The implementation of this policy would increase the cumulate scorecard balance to $52 million

23 Officials' best judgement is that if the exemption is not extended, rig and seismic vessel operators are likely to resume churning. In this case, no extra revenue would be collected from oil rig and seismic vessel operators while firms purchasing their services are expected to pay less tax. This is because the cost of these services (deductible to the New Zealand purchaser) could increase as a result of rigs and seismic vessels being churned. This expectation is already included in the baseline forecasts.

Human Rights

24 The proposal is consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative Implications

25 Extending the exemption before the expiry of the current exemption on 31 December 2019 will require an amendment to the Income Tax Act 2007. The only suitable bill is the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill which has recently been reported back by the Finance and Expenditure Committee (FEC).

26 The FEC has accepted the PEPANZ submission to include an extension of the exemption in the Bill. Removing the oil rig exemption from the Bill after the second reading would require Cabinet and Parliamentary support for a Supplementary Order Paper (SOP) at the Committee of the whole House stage. This would have the effect of delaying the progress of the Bill.

Regulatory Impact Analysis

27 A Regulatory Impact Analysis (RIA) is attached.

28 The Quality Assurance reviewer at Inland Revenue has reviewed the Extending tax exemption for non-resident oil rig and seismic vessel operators RIA and considers that the information and analysis summarised in it meets the quality assurance criteria of the Regulatory Impact Analysis framework.

Publicity

29 The Minister of Revenue has issued a press release announcing that an extension has been included in the reported back version of the Bill, in response to submissions to the FEC. Inland Revenue will publish details of the new legislation in a Tax Information Bulletin once the tax bill containing the amendments is enacted.

Proactive Release

30 We propose to proactively release this Cabinet paper, together with the associated RIA.

Recommendations

The Minister of Energy and Resources and the Minster of Revenue recommend that the Committee:

1 **Note** that there is an existing temporary income tax exemption for the income of non-resident offshore rig and seismic vessel operators that is due to expire on 31 December 2019.

2 **Note** early signalling of intentions is important for industry certainty and investment decisions.

3 **Note** that maintaining the exemption would be consistent with the approach to maintaining existing settings taken in the offshore oil and gas exploration announcement made on 12 April 2018.

4 **Note** that the Finance and Expenditure Committee has accepted that an exemption be included in the revision tracked version of the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill.

5 **Agree** to the exemption for the income of non-resident offshore rig and seismic vessel operators being extended until 31 December 2024.

6 **Note** that agreeing to recommendation 5 above will have an estimated revenue gain of $16 million over the forecast period, which can be accounted for on the tax policy scorecard:

	$m - increase/(decrease)				
Vote Revenue Minister of Revenue	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23 & Outyears**
Crown Revenue and Receipts: Tax Revenue	-	4.000	4.000	4.000	4.000

7 **Note** the last year of revenue impact is 2023/24, when the exemption expires.

8 **Note** that this Cabinet paper, the associated Cabinet minute, and Regulatory Impact Assessment will be proactively released on Inland Revenue's website.

Authorised for lodgement

Hon Dr Megan Woods

Minister of Energy and Resources

Authorised for lodgement

Hon Stuart Nash

Minister of Revenue

Coversheet: Extending tax exemption for non-resident oil rig and seismic vessel operators

Advising agencies	*Inland Revenue and the Ministry of Business, Innovation and Employment (MBIE)*
Decision sought	*Whether to extend the current income tax exemption for non-resident oil rigs and seismic vessels which is scheduled to expire on 31 December 2019*
Proposing Ministers	*Hon Dr Megan Woods (Energy and Resources), Hon Stuart Nash (Revenue)*

Summary: Problem and Proposed Approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
There is currently an exemption from New Zealand income tax for non-resident-owned oil rigs and seismic vessel operators. The aim of this exemption is to remove a tax distortion that incentivises operators to churn[1] rigs and vessels, thereby slowing resource development, increasing operators' costs, and reducing tax and royalty revenue. This exemption was first introduced in 2004 for five years and was subsequently extended in 2009 and again in 2014. The most recent extension is due to expire on 31 December 2019. This RIA considers whether the exemption should be further extended.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
This exemption was introduced to discourage oil rigs and seismic vessels from leaving New Zealand before 183 days to avoid being treated as a New Zealand tax resident under a double tax agreement. Extending this exemption would prevent this churning reoccurring.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
The main beneficiaries are petroleum prospectors, explorers and miners with New Zealand petroleum permits, and the Crown. These miners would incur lower costs and undertake greater exploration which would have flow on benefits to the New Zealand economy and tax and royalty revenue.

[1] Having one rig leave the country and another enter to complete the work.

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Where do the costs fall?
Although the exemption will theoretically make the non-resident rig and seismic vessel operators exempt from tax, in practice they were not paying New Zealand income tax anyway as they were leaving New Zealand before 183 days. Extending the exemption has no fiscal cost. If the exemption is left to expire, a reduction in tax revenue forecasts would arise as a result of increased tax deductions from churning. Forecast baselines include an assumption that the exemption would be renewed. Absent that renewal, we anticipate a behavioural change toward churn of rigs and consequential reduction in tax revenue forecasts arising from the expense of that churn. Officials do not anticipate that the rigs would start paying tax if the exemption is not extended. There are also small one-off costs for regulators of extending the exemption.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
The proposal risks leading to increased domestic carbon emissions; however, the impact is expected to be minor, as carbon emissions from New Zealand's oil and gas production are very small. Given New Zealand's high environmental standards, the environmental footprint from developing oil, gas and mineral resources in New Zealand is likely to be less than many other countries we would otherwise source them from. As nearly all New Zealand oil is exported, increased New Zealand production will have no effect on the Government's international commitments. The proposal carries some other environmental risks, but these are low due to New Zealand's tight regulation and standards.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
The proposal is not incompatible with the Government's 'Expectations for the design of regulatory systems'.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
There is a degree of uncertainty on the future level of petroleum exploration as this is determined by a number of factors, including the future oil price and other discoveries. However, historical comparison before and after the introduction of the exemption in 2004 provides a high degree of certainty that the policy achieves its desired goal of eliminating tax-driven rig and seismic vessel churning.

Quality Assurance Reviewing Agency:
Inland Revenue
Quality Assurance Assessment:
The Quality Assurance reviewer at Inland Revenue has reviewed the *Extending tax exemption for non-resident oil rig and seismic vessel operators* RIA prepared by Inland Revenue and MBIE and considers that the information and analysis summarised in it **meets** the quality assurance criteria.

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Reviewer Comments and Recommendations:
The reviewer's comments on earlier versions of the Regulatory Impact Assessment have been incorporated into the final version.

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Impact Statement: Extending tax exemption for non-resident offshore oil rig and seismic vessel operators

Section 1: General information

Purpose
Inland Revenue and MBIE are solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

Key Limitations or Constraints on Analysis
A constraint affecting the consideration of the options is that of time – the existing tax exemption expires at the end of 2019. Accordingly, any extension of the exemption should be enacted before the end of 2019. A limitation concerning the analysis is that there is some degree of uncertainty regarding the behaviour of rig operators if the exemption were to be removed. This affects our ability to reliably estimate the fiscal impacts of removing the exemption. However, MBIE's best judgement (based on the rig operators' behaviour before the introduction of the exemption) is that if the exemption was removed, rig operators are likely to modify their behaviour and begin churning again.
Responsible Manager (signature and date):
Emma Grigg Policy Director Policy and Strategy Inland Revenue 17 July 2018

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Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?
Seismic vessels are used to gather data on potential oil and gas finds, and rigs are used to drill for oil and gas, in the exploration and development stages of petroleum mining. These are very specialist and expensive pieces of equipment that are owned by businesses that specialise in providing these services to petroleum miners who have permits for a specific area. These rigs and vessels do not generally work offshore in winter weather for health and safety reasons. While there is a worldwide industry in rigs and seismic vessels, no New Zealand companies own these assets, so any company seeking to explore natural resources in New Zealand waters needs to use a rig or seismic vessel provided by a non-resident owner. Offshore rigs and seismic vessels owned by non-residents are covered by an income tax exemption that is due to expire on 31 December 2019. Wells generally take between 30 and 90 days to drill and there is significant cost in bringing a rig or vessel to and from New Zealand. Because of this, operators often align their plans in order to conduct their work using the same rig or vessel in the same summer period. There is usually a programme of work that forms the core activities of the rig or vessel, and then there may be opportunistic wells or surveys added because the rig or vessel is already coming. These opportunistic wells or surveys are at particular risk from the expiry of the existing exemption as completing these could result in the rig or vessel being in New Zealand long enough to become a New Zealand tax resident and therefore taxable on income derived from exploration and development activities in New Zealand waters, including from already completed contracts for core activities. In the absence of an exemption these operators leave New Zealand before this time to prevent a New Zealand income tax liability arising. Between 2009 and 2017, there have been nine non-resident offshore drilling rigs operating in New Zealand. The average length of stay of these rigs has been 315 days. By contrast, between 2000 and 2005 (before the exemption was introduced), no rigs stayed in New Zealand waters beyond six months. At this early stage, we anticipate at least one rig to be operating within New Zealand waters in 2019/20. Twelve seismic vessels have operated in New Zealand since 2009, with an average duration of 108 days, and with one high-value survey extending through to 200 days. Before 2005, the average length of stay was around four months. Maintaining the exemption removes a barrier for lengthier stays (which have been fewer but are typically more lucrative). There have been 73 offshore wells drilled since 1 January 2009. Twenty of these wells have been exploratory in nature, with some hosting sub-commercial discoveries. All of these efforts, successful or not, improve our knowledge of the Crown mineral estate, which is critical to making economic discoveries. A substantial discovery has the potential to significantly benefit the economy and the Government's fiscal position by way of direct economic benefits, royalties, increased tax revenue, and other indirect benefits (e.g. supporting goods and services and consumption). It is likely that a number of wells would not have been drilled without the tax exemption, as

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the application of income tax would likely have created too large a barrier (due to the high cost of mobilisation and demobilisation and the associated delays caused) for discretionary wells. Mobilisation and demobilisation costs can exceed $750,000 per day and, depending on where the rig comes from, the transition time and associated cost can be significant and in the order of $14 million.

Extending the exemption is likely to ensure oil and gas prospecting, exploration and production is not impeded compared with letting the exemption expire. This increases the chance of successful discoveries and consequentially oil and gas production, which increases economic development activity, and tax and royalty revenue. Increased oil and gas production could result in an increase in carbon emissions. However, given New Zealand's high environmental standards, the environmental footprint from developing oil, gas and mineral resources in New Zealand is likely to be less than many other countries we would otherwise source them from. Therefore, from a global emissions perspective, developing some of these resources in New Zealand could provide better environmental outcomes.

In the context of climate change, gas is internationally recognised as a transition fuel. In particular, natural gas emits 50 to 60 percent less carbon dioxide than coal when used to generate electricity. Thus, gas could play a role in New Zealand meeting its climate commitments in the short-term.

Furthermore, New Zealand's gas reserves are only sufficient to cover a decade of annual gas demand at current demand levels. To prevent the situation of gas reserve depletion interrupting our energy supply, new sources of gas would need to be found within the next few years. This could be by way of new gas finds, or extension of existing fields, but either of these would involve some lead-time to production.

2.2 What regulatory system, or systems, are already in place?

New Zealand generally taxes non-residents on income that has a source in New Zealand. However, our double tax agreements (DTAs) provide that non-residents are only taxable on their New Zealand-sourced business profits if they have a "permanent establishment" in New Zealand. Many of our DTAs (such as the New Zealand/United States DTA) have a specific rule providing that a non-resident enterprise involved in exploring for natural resources only has a permanent establishment in New Zealand if they are present for a particular period of time, often 183 days in a year. Once a non-resident has a permanent establishment in New Zealand, they are taxed on all their New Zealand business profits starting from their first day in New Zealand. While this 183 day rule does not apply outside of DTAs, in practice, no rigs or seismic vessels come from non-DTA countries.

Ordinarily, a broad-base, low-rate framework applies to the tax system. A consistent application of this framework will normally minimise any distortions caused by tax rules. However, with seismic vessels and rigs used for exploration and development work, the normal tax rules do not provide the right outcome.

The exemption was introduced to address an issue caused by this DTA provision – rigs and seismic vessels used in petroleum exploration and development were leaving New Zealand waters before the 183 day threshold was reached to avoid being subject to New Zealand tax.

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This meant that rigs and vessels would leave before 183 days and a different rig or vessel was mobilised to complete the exploration programme, if it was completed. This increased the cost for companies engaged in exploration and delayed exploration drilling and any subsequent discovery of oil or gas. It also meant that there was no income tax collected from owners of rigs and seismic vessels. Because of the limited supply of offshore drilling rigs, it could also result in exploration activity not taking place when it otherwise would.

2.3 What is the policy problem or opportunity?

If the status quo is maintained (i.e. the temporary exemption is left to lapse at the end of 2019), it is likely that rigs and seismic vessels would resume leaving New Zealand waters before 183 days, so that the operators are not subject to tax. This would mean that the cost of offshore exploration and development activity would increase for New Zealand companies that engage offshore rig and seismic vessel services, as a new rig would have to be engaged to continue exploration and development work. Mobilising and demobilising such rigs has a cost of around $14 million per rig. This would have flow-on effects for tax revenue, as the cost would be deductible to the New Zealand company. The churn would also cause a delay in any potential revenue from successful exploration and development activity, which would have an impact on the present value of royalties received. However, this would be partially offset by the delay in the deductions associated with that additional exploration and development activity.

The underlying cause of the problem is that the normal tax rules increase costs for business by creating an incentive for seismic vessels and rigs to "churn", that is, move in and out of New Zealand waters within a 183-day period where income is exempt under many of our DTAs.

2.4 Are there any constraints on the scope for decision making?

It is not possible to efficiently resolve this issue by renegotiating New Zealand's DTAs. These DTAs are part of an international framework and it is not feasible to alter this particular article, particularly given this would require renegotiation of each of the DTAs which New Zealand is currently party to and would be dependent on our treaty partners being agreeable to such a change.

New Zealand is a global advocate for fossil fuel subsidy reform. While there are a range of definitions of what constitutes a subsidy, the most widely internationally accepted definition is that adopted by the World Trade Organisation (WTO) under the WTO Agreement on Subsidies and Countervailing Measures. New Zealand has no fossil fuel subsidies as this term is defined by the WTO. The non-resident rig and seismic vessel income tax exemption has been in place since 2004 and is **not** considered a subsidy. This position was also confirmed in a 2015 peer review of fossil fuel subsidies by the Asia-Pacific Economic Cooperation (APEC).

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2.5 What do stakeholders think?

Targeted consultation has been undertaken with the oil and gas industry representative body, the Petroleum Exploration and Production Association of New Zealand (PEPANZ), which supports making the exemption permanent.

The Treasury and the Ministry for the Environment support extending the exemption for a further five years to balance the need for business certainty while leaving scope for future changes at a time when tax and environmental policy is evolving.

Section 3: Options identification

3.1 What options are available to address the problem?

Three options have been considered:

- **Option 1 – Status quo:** Do not extend the exemption. The current exemption will expire on 31 December 2019. After this date non-resident oil rig and seismic vessel operators will be subject to New Zealand income tax from the day they arrive if they are present in New Zealand for at least 183 days.
- **Option 2 – Temporary exemption:** Extend the current exemption for a further five years.
- **Option 3 – Permanent exemption:** Remove the expiry date from the current exemption so it applies permanently.

Both options 2 and 3 address the problem by effectively removing the 183 day test so that non-resident operators do not face an incentive to churn rigs and vessels by leaving New Zealand prior to 183 days.

These options are mutually exclusive and are the same options considered when the exemption has previously been due to expire in 2009 and 2014. No non-regulatory options are possible as the liability for income tax is determined through legislation.

Option 2 and option 3 are both unique to New Zealand. Officials are not aware of any other country having a similar exemption due to a combination of factors, such as: not having an offshore petroleum industry; having a sufficiently large market to have domestic owned rig and seismic vessel operators; being closer to other countries, so that mobilisation costs are much lower; and having different wording in their applicable DTAs, so that the 183 day threshold does not apply.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The options have been assessed against the following criteria:

1. **Economic efficiency and neutrality** – The tax rules should generate funding for Government expenditure rather than influence whether a rig or seismic vessel remains in New Zealand. The use of tax instruments to implement non-tax outcomes should be approached with caution. The level of oil and gas exploration and development activity should be determined by what is economically efficient in conjunction with wider Government policies, and not by unintended consequences of tax rules.

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2. **Certainty of tax treatment –** The tax rules should provide certainty of tax treatment.
3. **Administration costs** – Administration costs should be minimised as far as possible. In addition to costs arising to government agencies under the option, this includes policy and law-making costs.
4. **Compliance costs –** Compliance costs should be minimised as far as possible.

Criterion one is the most important as tax should not be influencing petroleum miners' decisions to act in ways that are economically inefficient, and care should be taken before using tax rules to implement non-tax policies, where other more direct, and transparent measures may be available.

3.3 What other options have been ruled out of scope, or not considered, and why?

Renegotiating New Zealand's DTAs to increase or reduce the number of days an operator can be in New Zealand without becoming a tax resident was not within scope. This would require individual renegotiation with each of New Zealand's treaty partners and would be inconsistent with international norms. This could not be achieved before expiry of the current exemption if it could be achieved at all, therefore this option is considered impractical.

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Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

	Status Quo – Letting exemption expire	Option 2 – Temporary exemption	Option 3 – Permanent exemption
Efficiency/neutrality	**0**	++ An exemption will prevent tax rules incentivising operators to leave New Zealand prior to 183 days. The level of exploration and development will be determined by the market and specific Government policies rather than an unintended consequence of tax rules. Petroleum miners able to coordinate rigs and seismic vessels and incur lower planning costs, thus improving efficiency.	++ As with the temporary exemption.
Certainty	**0**	+ Petroleum miners and operators will have certainty of tax treatment for a 5-year planning horizon.	++ As with the temporary exemption, with the benefit of additional certainty for petroleum miners and operators planning beyond the expiry of a temporary exemption.
Compliance costs	**0**	+ No impact on tax compliance costs (as no tax obligation on operators with or without exemption) but reduction in costs of complying with other Government regulation for operators and petroleum miners.	++ As with the temporary exemption, with the benefit of less compliance costs for exploration and development near to expiry of a temporary exemption.
Administration costs	**0**	+ Consistent with current (pre-December 2019) treatment, so less update needed to internal and external knowledge bases and other guides.	++ As with the temporary exemption, as well as removing need for further update when the temporary exemption expired, and only one-off policy and law-making costs.
Overall assessment	**0**	++ This option is significantly better than the status quo, as tax will not be an impediment to operators acting in an efficient manner. This option will not impose any additional costs on government or taxpayers. However, it is not the preferred option as it creates less certainty for taxpayers and imposes costs on officials, Parliament and stakeholders in reconsidering the exemption each time it expires.	++ This is the preferred option. It has all the benefits of option 2 with the additional benefits of providing greater certainty for stakeholders and fewer administration costs as a result of not needing to periodically renew the exemption.

Key:

++	Much better than doing nothing/the status quo	-	Worse than doing nothing/the status quo
+	Better than doing nothing/the status quo	- -	Much worse than doing nothing/the status quo
0	About the same as doing nothing/the status quo		

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Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

Having an exemption beyond 31 December 2019 is significantly better than letting the exemption lapse and both Inland Revenue and MBIE recommend that this exemption is permanent rather than for a further five year period. As these rigs are planned well in advance, the additional certainty of a permanent exemption is supported by the petroleum industry.

An exemption removes a tax distortion that results in economically inefficient outcomes, and imposes no ongoing revenue cost to the Government, while negative environmental impacts are expected to be low. Removing the churn of oil rigs and seismic vessels has a number of benefits, including:

- opportunistic exploration not being hindered by the lack of availability of rigs and vessels;
- additional exploration increasing petroleum miners' and the Government's knowledge of the mineral estate;
- reduced costs of petroleum exploration and development resulting in higher revenue from taxes and royalties;
- increased domestic emissions from more production (but noting some reduction in carbon emissions as a result of fewer rigs and vessels travelling to and from New Zealand); and
- rigs and vessels may stay in New Zealand beyond 183 days for repairs and maintenance which would increase output of supporting industries.

There is a high degree of confidence in the assumptions and evidence used in this RIA as this exemption is already in place and data before and after its introduction can be compared.

Making the exemption permanent will significantly reduce the policy and parliamentary resources required to be dedicated to this issue.

As the exemption has been in place since 2004, fiscal forecasts include the ongoing impact of this exemption. If the exemption is not extended increased churn costs would result in forecast tax revenue needing to be reduced by approximately $4m per year.

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5.2 Summary table of costs and benefits of the preferred approach

Affected parties	Comment:	Impact	Evidence certainty
Additional costs of proposed approach, compared to taking no action			
Regulators	One-off cost of officials' and parliamentary resources required to extend the exemption	Low	High
Wider government	Assumed that operators would churn rigs and vessels to avoid a New Zealand tax liability, in the absence of an exemption, so no expected revenue cost	$0	High
Other parties	Environmental impacts of increased petroleum exploration and production	Low (refer to explanation in section 2.1)	Medium
Total Monetised Cost		$0	High
Non-monetised costs		Low	Medium
Expected benefits of proposed approach, compared to taking no action			
Regulated parties	Ongoing reduction in costs to petroleum miners of rigs and seismic vessels being churned Reduced health and safety risks from reduced churn	$230m[2] Low	Medium Medium
Regulators	Reduced costs to update tax guidance	Low	High
Wider government	Increased tax revenue from petroleum miners due to reduced deductions for exploration costs	$67m[3]	Medium
Other parties	Increased economic activity due to increased presence of rigs and seismic vessels	Medium	Medium
Total Monetised Benefit		$297m	Medium

[2] $14 million cost / 0.06 (discount rate applied in RIA) = $233.33m rounded to $233 million.

[3] $4 million tax cost / 0.06 (discount rate applied in RIA) = $66.67 million rounded to $67 million.

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Non-monetised benefits		Medium	Medium

5.3 What other impacts is this approach likely to have?
The preferred approach is likely to increase oil and gas exploration and development (or not decrease it) compared with the status quo. This increases the chance of successful discoveries and consequentially increased oil and gas production, which increases economic development activity, tax revenue and royalties. Increased oil and gas production risks increasing carbon emissions. However, nearly all of New Zealand oil production is exported, so this increased production would have no effect on the Government's international commitments. Officials consider the impact of increased carbon emissions would be minor as the production in New Zealand of oil and gas has very little impact on consumption of oil and gas and, relative to international output, New Zealand production is so small that increases in production will not affect the world price. Other environmental risks are also low due to New Zealand's tight regulation and standards which have seen over 200 offshore wells drilled since the 1960s without a significant incident. As New Zealand is a net importer of oil, any increase in domestic production is likely to reduce the balance of payments deficit.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?
The preferred option is not incompatible with the Government's 'Expectations for the design of regulatory systems'.

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Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?
The preferred option would involve amendments to the Income Tax Act 2007 to remove the 31 December 2009 expiry date. This would continue the operation of the exemption, broadly as it has applied since 2004. As with other legislative changes this would be signalled in a *Tax Information Bulletin* shortly after the enactment of the bill containing the proposals as well as other documents published throughout the parliamentary process. Owing to the high mobilisation costs, the schedules for rigs and seismic vessels are frequently planned well in advance of the rig or vessel arriving in New Zealand. Thus, the industry would welcome timely advice of a Cabinet decision on the exemption. Cabinet approval of the preferred option would allow the necessary legislative changes to be included in the upcoming tax omnibus bill which is expected to be enacted in 2019. A press release is intended to be released after the Cabinet decision.

6.2 What are the implementation risks?
There are no risks with implementing a temporary or permanent exemption as this would be effectively continuing the law as it has applied since 2004. If there are delays in announcing an extension of the exemption and inclusion in a bill, or if the Government decides not to extend the exemption, this risks creating uncertainty in the market which could result in reduced operation of non-resident rigs and seismic vessels in New Zealand. If the preferred option is supported by Cabinet but not included in the upcoming bill there may not be a suitable tax bill enacted before the end of 2019 that could include this amendment. This would require the amendment to either be included as a Supplementary Order Paper to another bill – which would not allow the same ability for public consultation – or for the amendment to be enacted retrospectively after the end of 2019 – which provides less certainty for the petroleum industry and is less desirable than prospective legislation.

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Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
MBIE monitors the number and duration of rigs and seismic vessels operating in New Zealand. Comparison of behaviour prior to and after the 2004 introduction of the exemption suggests that the exemption is successful in removing the incentive to leave New Zealand prior to 183 days. As the exemption is in place now, if extended we do not expect any change in behaviour.

7.2 When and how will the new arrangements be reviewed?
MBIE will continue to monitor the petroleum mining sector more generally. As the exemption has been working as intended since 2004, if the exemption is permanently extended it is not anticipated that further review will be necessary which will reduce administration costs compared with a temporary exemption, and reduce compliance costs compared with letting the exemption expire. Inland Revenue and MBIE have ongoing interaction with the petroleum mining sector which will provide that sector with the ability to raise concerns in the unlikely event they arise.

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Cabinet Economic Development Committee

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Non-Resident Oil Rig and Seismic Vessel Operators: Extension of Tax Exemption

Portfolios **Energy and Resources / Revenue**

On 12 June 2019, the Cabinet Economic Development Committee:

1 **noted** that there is an existing temporary income tax exemption for the income of non-resident offshore rig and seismic vessel operators that is due to expire on 31 December 2019

[CAB Min (13) 37/9];

2 **noted** that early signalling of intentions is important for industry certainty and investment decisions;

3 **noted** that:

3.1 on 9 April 2018, Cabinet noted that, in addition to excluding offshore blocks from Block Offer 2018, there will be no offshore blocks offered in future Block Offers or through an alternative process, and that it was the Minister of Energy and Resources' intention that this policy will not affect the rights of current permit holders to continue production or exploration activities under existing permits [CAB-18-MIN-0162];

3.2 maintaining the exemption referred to in paragraph 1 would be consistent with the above approach;

4 **noted** that the Finance and Expenditure Committee has accepted that an exemption be included in the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Bill;

5 **agreed** to the exemption for the income of non-resident offshore rig and seismic vessel operators being extended until 31 December 2024;

6 **noted** that the effect of paragraph 5 above will be an estimated revenue gain of $16 million over the forecast period, which can be accounted for on the tax policy scorecard:

	$m - increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23 & Outyears**
Crown Revenue and Receipts: Tax Revenue	-	4.000	4.000	4.000	4.000

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7 **noted** that the last year of revenue impact is 2023/24, when the proposed exemption will expire.

Janine Harvey
Committee Secretary

Present:
Hon Kelvin Davis
Hon Grant Robertson (Chair)
Hon Phil Twyford
Hon Dr Megan Woods
Hon Iain Lees-Galloway
Hon Jenny Salesa
Hon Shane Jones
Hon Kris Faafoi
Hon Willie Jackson
Hon James Shaw
Hon Eugenie Sage

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

Hard-copy distribution:
Minister of Energy and Resources
Minister of Revenue