8 April 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

Dear Dr Preston

BP Amoco's Submission on the Review of Business Taxation

BP Amoco is pleased to respond to the request from the Review of Business Taxation Committee for comments on the proposals and options as canvassed in the "*A Platform for Consultation*" Discussion Paper of 22 February 1999.

In this submission, we have not undertaken a detailed review of all the issues discussed in the Consultative document, as these will no doubt be fully canvassed by other industry and professional body submissions. We have focused on four substantive pillars of the reform agenda and outline how they affect BP Amoco's current and future operations in Australia.

Reduction in the income tax rate to 30% and possible loss of accelerated depreciation

BP Amoco is fully supportive of the proposals to reduce the corporate tax ("CT") rate to 30% albeit at the expense of a reduction in the rate of accelerated depreciation on new capital expenditures. We believe that the reduced CT rate will have several advantages for the Australian economy. It will:

- be less economically distortive. A new project or activity which is economically desirable, or not, pre-tax will be more likely to remain similarly desirable, or not, post-tax,
- generate a higher level of taxable income, albeit at a lower rate, and so minimise the problems associated with the distribution of tax preferred income, and
- reduce the incentive for multi-nationals to finance by debt as it aligns the Australian CT rate with effective tax rates similar to that applying in other jurisdictions.

However three important caveats must be made:

1. Existing investments have been committed on the basis of accelerated depreciation regimes in existence at the time of the investment decision. It would be inequitable if such investments were disadvantaged by a retrospective loss of the depreciation treatment on which the investment had been justified. We urge therefore that existing investments and projects committed at or before 22 February 1999 can utilise existing accelerated depreciation provisions if such plant is installed ready for use say, within a three year period. It might be argued that the 30% tax rate is a "trade off" for the immediate removal of accelerated depreciation. We do not consider this a strong argument. In our view, if we are to have transitional rules for accelerated depreciation, it is not appropriate to have transitional rules for the reduction in the CT rate. Such transitional rules for the CT rate will lead to practical problems of trying to ring-fence expenditures and delineating income streams which are taxed at 36% from those which are subject to a lower CT rate. The potential for abuse is obvious.

2. The loss of accelerated depreciation will make it harder to justify investment and will lead to potential loss of new Australian investment, particularly in industries such as Liquified Natural Gas ("LNG") which are highly capital intensive, have long effective lives and compete for global investment dollars in a extremely competitive global marketplace. BP Amoco strongly urges that any trade-off of accelerated depreciation necessary to reach the 30% CT rate be kept to as low as possible, to mitigate the potential loss, or deferral of, Australian international projects such as LNG. If it is felt by Government that the wider economic spin-off from a project such the expansion of the Australian LNG industry is sufficiently beneficial to the Australian economy to warrant some form of economic assistance, our preference is for such assistance to be the form of a taxable Government grant, so as to maximise creditable taxes and so minimise the likelihood of double taxation overseas. (Our interest in the North West Shelf LNG project is held through our BP America group).

This type of assistance has the added advantage, if properly structured, of enabling the Government to control and direct the level of assistance given to certain projects over the "30% CT rate / effective life depreciation" norm in accordance with the Government's public policy on industry assistance.

3. We understand that the Consultative document confirms the retention of 100% write off for exploration expenditure on an incurred basis. We fully support the retention of this vital component for maximising Australian exploration undertakings, particularly in the current environment of low world oil and gas prices and ever-reducing level of known liquid reserves.

Thin Capitalisation

We are aware of two options for amending the thin capitalisation rules. The first disallows interest in excess of the group's world-wide gearing ratio unless the "excess" debt can be justified on an arm's length basis. The second restricts interest in excess of a fixed gearing ratio unless consistent with the world-wide gearing level of that group.

We have no major problem with safe-harbour rules expressed either as an accounting gearing ratio or as a ratio of world-wide gearing.

We also accept that any thin capitalisation test should take into account the overall level of debt irrespective as to whether it is from a third party or a related person.

However to remain consistent with standard transfer pricing principles, we believe that the ultimate test as to the maximum level of debt and rate of interest should remain an arm's length one - that is what a third party would lend and charge taking into account the particular circumstances of the group's business and balance sheet. We submit any thin capitalisation rules should be based around this fundamental design principle.

We would also recommend transitional rules to allow for the reduction in debt levels for corporations that may have debt to equity ratios that are in accordance with Australia's current 2:1 thin capitalisation rules. (We assume here that 2:1 debt to equity levels are not arm's length, which of course, they may well be). It will no doubt take Corporates time to determine and monitor current group debt levels and third party comparables to determine a revised level of arm's length debt. We believe transitional rules similar to those introduced when the thin capitalisation ratio was phased down from 3:1 to 2:1 should equally apply to any proposed changes to inbound debt levels.

Consolidation

BP Amoco holds its interest in Australia through two corporate streams. Our "upstream" oil and gas exploration and production interests in the North West Shelf LNG project are owned by an Australian resident company, which is held via the United States ("US"). Our "downstream" oil refinery and marketing interests are held in a number of companies, with the Australian resident parent held directly under the United Kingdom ("UK"). All companies are ultimately 100% owned by BP Amoco plc.

At present both the upstream and downstream sectors of the Australian group are ultimately owned by BP Amoco plc and thus we can transfer trading and capital losses amongst the upstream and downstream parts of the group. If we have to consolidate under a local Australian parent, as has been proposed (and we are not sure why this has been mooted), it will cause us significant difficulties and unnecessary tax cost.

We are unable to transfer our upstream operations out of the US without enormous US income tax cost. Accordingly we will have to transfer our downstream operations under the US, at the earliest opportunity, so as to be able to continue to be able to group relieve - our downstream trading activities are currently generating tax losses. Such a forced reconstruction due to the removal of the existing grouping rules could trigger sizeable Stamp duty costs (many of our companies are 'land rich') and could be subject to many tens of millions of dollars in Stamp duty, as well as potentially additional US taxes in the future from lack of sufficient foreign tax credits - the reduction in the Australian CT rate to 30% results in less creditable tax in the US (as the US tax rate is 35%) and thus effectively wipes out the benefit of the reduction in the Australian CT rate.

To avoid such unintended and unnecessary tax cost, we strongly recommend that:

- The existing group relief provisions remain in place for groups where there is an ultimate publicly listed foreign owner. We believe that if there are certain tax avoidance schemes that exist which negatively impact the Australian Revenue, that specific anti-avoidance measures are introduced to curb such schemes.

- Failing this, if consolidation is deemed necessary and grouping rules are abolished, then consolidation should be allowed to occur where the companies concerned are wholly owned by the same publicly listed foreign parent. We believe that the rigour of being a publicly listed company will provide sufficient assurance to the Australian Revenue that there is 100% ultimate common ownership.

- If resident Australian parent consolidation is deemed necessary and the retention of grouping rules are considered inappropriate, then we believe transitional rules should be introduced to allow existing company groups to benefit from the existing grouping rules, until such time as the State governments abolish Stamp duty for reconstructions necessitated by the proposed consolidation rules.

- We recognise that Stamp duty is not a Federal tax, but would urge the Committee to consider discussing with the State Governments the option of Stamp duty reconstruction relief necessitated by the proposed consolidation rules.

Entity Taxation

As a matter of principle, we believe that tax should, wherever possible, be on realised taxable income not the movement of capital or unrealised profit. BP Amoco, like most corporates evaluate projects on the after tax cash flow they generate for our shareholders. As our parent company is based in the UK we require all cash to be ultimately repatriated back to the UK. Withholding tax ("WHT") on dividends out of Australia will for the most part be an absolute cost for us, in whatever its form, and thus negatively impact on the economics of our investments in Australia. In this regard the existing WHT/dividend rebate regime has considerable merit, and we would be highly supportive of its retention. However, if there is to be a WHT on unfranked inter-corporate dividends, we prefer either the "resident dividend withholding tax" or "tax on unfranked inter entity distribution" options rather than the "deferred company tax" option.

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BP Amoco is eager to discuss any aspect of this submission with you and to meet with members of the various focus groups to further discuss our submission.

In the meantime, any questions you may have on the above should be directed, in the first instance, to Dr Peter Dow, Regional Tax Manager, BP Australia, 33rd floor, 360 Elizabeth Street, Melbourne, Victoria 3000. Tel: (03) 9268 3219, Fax: (03)9268 4090 or email: DowPD@az1.bp.com.

Yours sincerely

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