What is Petroleum Resource Rent Tax?

What is the Petroleum Resource Rent Tax (PRRT)? Why and when was it introduced? How important is it for revenue? How could it be improved? This Tax Fact focuses on the economic role the PRRT plays in Australia's tax system.

What is the PRRT?

The PRRT is a tax on profits derived from the sale of Australian petroleum products, designated as "marketable petroleum commodities" (MPC). This includes: stabilised crude oil, sales gas, condensate, liquefied petroleum gas (LPG), ethane, shale oil, and any other product declared by regulation to be an MPC.

The PRRT is one of Australia's most efficient taxes. An efficient tax is one that can raise revenue, without substantially changing company or individual behaviour [see our Tax Fact #2 – Economic Fundamentals: Deadweight loss]. By contrast, inefficient taxes change behaviour to a significant degree and thus have a detrimental impact on the efficient allocation of resources and economic growth. Efficient taxes can be used to raise additional revenue at minimal economic cost.

The PRRT is an economic rent tax. Economic rents, also known as "super profits", are profits that exceed a normal, risk-adjusted return to investment [see our Tax Fact #8 – "Good tax policy: Taxing economic rents"]. Economic rent taxes are efficient because they do not distort investment or production decisions. A business could earn economic rents in any industry, but they are especially associated with natural resources, which are immobile and in fixed supply.

For more detail on how the PRRT works, especially regarding its complicated gas transfer pricing rules, see our Tax Fact #28 – "How does the Petroleum Resource Rent Tax work and how does it apply to gas?".

Why and when was the PRRT introduced? How has it changed over time?

The PRRT was introduced in 1988 for new offshore petroleum projects, to largely replace the pre-existing federal system of royalties and excise on petroleum production for these projects [1]. Royalties, which are taxes applied to resource values rather than to super profits, are inefficient because they distort investment and production decisions.

In 2012, onshore petroleum became subject to PRRT, but this was subsequently revoked in 2019. The 2019 removal of onshore projects from the PRRT was an integrity measure designed to prevent companies from transferring potentially high onshore exploration costs to offshore projects owned by the same company group for PRRT purposes [2]. Such a tactic would allow them to offset onshore costs against offshore profits, thus reducing their tax liability.

As of 2023, the PRRT only applies to offshore petroleum. Onshore petroleum production is not subject to PRRT, with some limited exceptions. State and territory royalties are applicable to onshore petroleum.

Do companies subject to PRRT also pay corporate income tax?

Companies subject to PRRT are also subject to corporate income tax. PRRT payable is deductible as an expense from corporate income tax.

Why does it make sense to apply an additional tax to resources? Community resources, such as petroleum and minerals, belong to all Australians. Resource rent and royalty taxes are mechanisms to charge companies for the right to exploit those community resources on an ongoing basis.

Pricing negative externalities [see our Tax Fact #4 – Good tax policy: Taxing negative externalities] into activities associated with climate change and other environmental damage, such as petroleum mining, is achieved through other mechanisms, such as carbon pricing schemes or excise taxes.

How important is the PRRT for Commonwealth tax revenue? Why does it raise so little tax revenue?

The PRRT is estimated to raise $2.79b of revenue in 2022-23, equivalent to 0.45% of total Australian government revenue [3], or 0.11% of GDP [4]. This represents a modest increase in recent years – in 2017-18, the PRRT raised $1.1b in revenue [5], which was equivalent to 0.06% of GDP or 0.25% of total revenue. Throughout the 1990s and early 2000s, PRRT revenue was higher, averaging around 0.2% of GDP [6].

PRRT revenue has declined since the early 2000s due to a combination of lower petroleum prices, declining production in mature fields, changes in industry structure and large amounts of deductible expenditure (a consequence of the PRRT's design).

Over time, natural gas resources have become more important relative to oil, which was not predicted at the time of the PRRT's design. Gas is more difficult to extract and export than oil, so it requires very large capital investment. Higher costs correspond to high deductible expenditure. A particular feature of the PRRT design is that losses are carried forward with interest [see our Tax Fact #28 – "How does the Petroleum Resource Rent Tax work and how does it apply to gas?"]. Very generous uplift rates, applied to large losses, compound over time, causing many companies to pay little to no PRRT.

The Callaghan Review of the PRRT in 2017 estimated that PRRT revenue will total around $12b over the 10 years to 2027 and will total around $106b in the period to 2050 [6]. However, in 2019, uplift rates for exploration expenditure were significantly reduced. This, along with the removal of onshore projects from the regime, should have a positive ongoing effect on revenue.

Future policy considerations

Despite not raising much revenue, the PRRT is an important tax. It ensures that all Australians share in the profits from the exploitation of their natural resources and it does so in an efficient way. The ongoing effects of the 2019 PRRT reforms (removing onshore projects from the regime and reducing uplift rates) remain to be seen.

Further reforms that should be considered include: taxing the full rent from integrated projects that produce liquefied natural gas (LNG) for export (currently, only half the rent is taxed for these projects) [see our Tax Fact #28 – "How does the Petroleum Resource Rent Tax work and how does it apply to gas?"] and increasing the PRRT rate.

Even more significantly, a resource rent tax (RRT), applied to all mining, which would operate in a similar way to the PRRT, should be introduced. A federal RRT could raise substantial revenue with minimal loss of overall welfare, especially important given Australia's COVID-19 debt [7].

The negative externalities [see our Tax Fact #4 – "Good tax policy: Taxing negative externalities"] associated with mining natural resources which contribute to global warming, should also be priced into economic activity – for example, through a carbon pricing scheme.

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[6] Australian Government (2017). Petroleum Resource Rent Tax Review, Final Report. Commonwealth of Australia, Canberra, ACT.
[7] Rose, T. and Breunig, R. (2022). Paying back Australia's COVID-19 debt, TTPI Working Paper 10/2022. Retrieved from https://taxpolicy.crawford.anu.edu.au/sites/default/files/publication/taxstudies_crawford_anu_edu_au/2022-08/complete_rose_breunig_wp_july_2022.pdf.

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