

23 October 2009

Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attention: General Manager

Dear Sir/ Madam,

Re: Research and Development ("R & D") Tax Incentive

Apache Energy Limited ("Apache") is the second largest operated volume producer of both oil and gas in the Canarvon Basin in Western Australia. Apache operates 16 oil and gas production facilities, providing between 35-40% of Western Australia's domestic natural gas supply.

Current Australian production operations includes the Varanus Island facilities (14 oilfields and 6 gas fields), and the Legendre and Stag Oil Fields. Apache's net daily production is approximately 360 TJ of gas and 30,000 barrels of oil and condensate. New projects currently under development in Western Australia include the Van Gogh oil field and the Devil Creek gas plant.

Over the years, Apache has conducted significant research and development activities as part of its operations in the oil and gas industry. Some of these activities have led to the development of technologies that have been given international recognition as successful innovative technologies. Accordingly, we believe that we are well placed to provide a practical perspective on R&D and are pleased to provide comments in response to the various issues and principles raised in the consultation paper, titled "The New Research and Development Tax Incentive".

To date, the current R&D rules have significantly influenced Apache to undertake R&D in Australia. We would therefore urge government to carefully consider any changes that further tighten the R&D eligibility criteria and the impact this may have on the overall R&D activity in Australia.

Specific Comments

1. Principle 6: Eligible R&D activity will be defined as systematic, investigative and experimental activity that:

- a) Involves both innovation and high levels of technical risk; and***
- b) Is for the purpose of producing new knowledge and improvements.***

The paper proposes that the R&D definition will be changed to require activities to exhibit both innovation **and** high levels of technical risk. Apache's R&D activities include activities that may contain one or both of these criteria however not all of our activities meet both of these criteria. Our concern is that this restriction will severely limit the amount of activities eligible under the current arrangement to the extent that any incremental gains made by the 40% tax credit will be mitigated. We are of the view that an activity that leads to the incremental improvement in process, although not ground breaking R&D (but contains high levels of technical risk), play a vital role to the collective knowledge and advancements in the oil and gas industry.

2. Principle 7: Supporting R&D will continue to be recognised under the new R&D tax incentive but claim will be subject to new limitations.

The consultation paper states that the underlying basis for the government proposing this change is that currently a large proportion of R&D claims relate to supporting, rather than core activities which are out of proportion to the broader public benefit they provide.

As a matter of course, under this principle, companies will be required to distinguish between core and supporting R&D. It is our view that requiring companies to distinguish between core and supporting activities would add a level of unnecessary administrative and interpretive complexity and may lead to activities being incorrectly classified.

We believe that any concerns that the government may have in relation to funding supporting activity, would best be addressed by reducing the overall level of credit available under the new R&D scheme.

3. Standard tax credit

The consultation paper states that a refundable credit of 45% will be provided to companies with a revenue turnover less than \$20m (small to medium sized companies) and a 40% non-refundable tax credit (standard tax credit) to entities with a revenue turnover greater than \$20m (large companies). It is the government's view that small to medium sized companies should be treated more favourably as they "are more responsive to fiscal incentives".

We note that underpinning the design of the proposed R&D tax incentive is that a public subsidy for R&D should generate additional R&D activity with benefits that spill over to other firms and the community. We are of the view that any decision to direct funding should be consistent with this overarching principle. Accordingly, our view is that the level of credit provided to a company should not be based on an arbitrary factor such as company size (or revenue turnover). Apache is in an industry that has high up front capital costs and the response to incentives that will assist in project economics should not be underestimated.

4. Date of implementation

The proposed commencement date of the proposed R&D amendments is 1 July 2010. We note however that no mention is made in government's consultation paper on how this implementation date will apply to companies with a year end other than 30 June. Apache, therefore seeks confirmation that the commencement date of the new legislation will commence from the start of income year following 1 July 2010. This would mean that for a company such as Apache with a 31 December year end, the new legislation will apply from 1 January 2011.

We would welcome any opportunity to further discuss any of the issues raised above.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "H Kraus", with a horizontal line underneath.

Helen Kraus
Director of Tax - Australia
APACHE ENERGY LIMITED